Time and Time Again the Board Is Paramount: The Evolution of the Unocal Standard and the Revlon Trigger through Paramount v. Time

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I. INTRODUCTION

The landmark Unocal case provided the standard under Delaware law by which to judge the defensive efforts of a corporation's management and board of directors when control of the company is threatened. Though only promulgated in 1985, the test has received a great deal of attention due to the surge in takeover activity in the 1980s.

At first, the test appeared to be a significant bulwark against the erosion of share value in the face of management entrenchment. However, in Paramount Communications, Inc. v. Time, Inc., the Delaware Supreme Court effectively narrowed the scope of judicial review of the board of directors' actions in response to a threatened takeover. After Time, a director's duty of care and loyalty to the shareholder does not include share value maximization (at least not over any definitive period), except in very limited instances. Directors may now fulfill their duty through the application of long-term business plans, regardless of their effect as anti-takeover devices.

For better or worse, after Time, directors have greater protection from being ousted from their posts and shareholders have reduced ability to realize maximum share value.

Part II of this Note traces the Unocal standard to its origin in the duties of care and loyalty and discusses the conflicts between the accompanying judicial standards of review. It then introduces the solution proffered by the Delaware Supreme Court. Part III analyzes the development of the standard through the major cases. As the standard is fact specific, this Note discusses the cases in some detail. Part IV distills the holdings and dicta from the cases to determine the essential parameters of the standard through Time. Part V discusses the propriety of the direction taken by the

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2 571 A.2d 1140 (Del. 1989).
3 See infra notes 227-37 and accompanying text.
4 See infra note 204 and accompanying text.
5 See infra text accompanying notes 239-44.
6 Assuming that such plans do not absolutely preclude a tender offer. See infra notes 96-106 and accompanying text.
7 Shareholders' rights have been reduced by limiting the legal avenues to protest share value reduction. Time effectively limited legal recourse to egregious circumstances. The Delaware Supreme Court stated that the investment horizon of the company was exclusively the domain of the board of directors. See infra note 208 and accompanying text.
Delaware court with regard to the Unocal standard and concludes that Unocal is properly applied as a threshold test.

II. THE ORIGIN OF THE UNOCAL TEST

The duties of care and loyalty owed to the corporation by the board of directors can be severely tested by the myriad defensive and hostile maneuvers routinely made in the context of modern mergers and acquisitions. Before beginning the analysis of the development in Delaware cases of the complex interplay between these duties, a discussion of the standards themselves is in order.

A. The Duty of Care and the Duty of Loyalty

The board of directors is ultimately responsible for the management of the corporation and accordingly owes a duty of due care in carrying out its function. The standard of care owed to the corporation by the board of directors is that of a reasonable director. However, in a claim of misfeasance by the board, the court will initially defer to the business judgment of the directors of the corporation before applying the reasonable director standard. This initial deference is known as the business judgment rule. The business judgment rule is a presumption that in making a business decision, the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company. Traditionally, the Delaware courts have held that unless the plaintiff can establish a failure of this standard, the court will not substitute its judgment for that of the board.

In Smith v. Van Gorkom, the Delaware Supreme Court re-

8 In Graham v. Allis-Chalmers Mfg. Co., 41 Del. Ch. 78, 188 A.2d 125 (Del. 1963), the court enunciated the reasonable director standard when it said, "[d]irectors of a corporation in managing the corporate affairs are bound to use that amount of care which ordinarily careful and prudent men would use in similar circumstances." Id. at 130. In Unocal, the Delaware Supreme Court cited DEL. CODE ANN. tit. 8, § 141(a) (1974) for the general delegation of corporate responsibility from which the fiduciary duties of the board arise. Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985).


10 "We will not substitute our views for those of the board if the latter’s decision can be attributed to any rational business purpose." 493 A.2d at 949 (quoting Sinclair Oil Corp. v. Levien, 280 A.2d 717, 720 (Del. 1971)).

11 488 A.2d 858 (Del. 1985).
fined this standard when it stated, "the concept of gross negligence is the proper standard for determining whether a business judgment reached by a board of directors was an informed one." In effect, this collapsed the review of directors' actions down to one standard—gross negligence. Grossly negligent conduct of a director makes the next step in the duty of care analysis, the reasonable director standard, a *fait accompli*. Directors also owe a duty to act solely in the best interests of the corporation. This director's duty of loyalty is codified in section 144 of title 8 of the Delaware Code. The section states that a transaction is not "void or voidable solely for [a director's conflict of interest]" if (i) the transaction was approved by a majority of disinterested directors, or (ii) the transaction was specifically approved by the shareholders, or (iii) the transaction is fair as to the corporation. Though the test is disjunctive as written, in practice, the fairness prong is applied in judicial review regardless of the disposition of the first two prongs.

In the context of mergers and acquisitions, the director's duty of loyalty necessarily intersects the duty of care. In *Bennett v. Propp*, the Delaware Supreme Court recognized a special spe
cies of conflict of interest in these situations:

We must bear in mind the inherent danger in the purchase of shares with corporate funds to remove a threat to corporate policy when a threat to control is involved. The directors are of necessity confronted with a conflict of interest, and an objective decision is difficult .... Hence, in our opinion, the burden should be on the directors to justify such a purchase as one primarily in the corporate interest.\(^\text{18}\)

The court later, in *Cheff v. Mathes*,\(^\text{19}\) revisited this situation and said that though the directors in this context do have a conflict of interest, it is qualitatively different from the usual conflict of interest situation and "[a]ccORDingly ... will not be held to the same standard of proof."\(^\text{20}\) In this context directors have a duty to not only act without self-interested motives, but must take reasonable care in making these decisions.

*Cheff* represented the Delaware Supreme Court's initial response to this tension between director conflict of interest and the business judgment rule. The case involved the propriety of a stock repurchase made to thwart a hostile acquirer. The *Cheff* court held that the issue was "whether or not defendants satisfied the burden of proof of showing reasonable grounds to believe a danger to corporate policy and effectiveness existed."\(^\text{21}\) The court found there were numerous threats to which the board could have reasonably reacted, such as the unrest of the workforce and the reputation of the acquirer for "bust-up" takeovers. But, the court placed the greatest emphasis on the threatened change in the target's sales policy which the board viewed as vital to the company's success. In the face of these "threats," the court found that defensive action did not constitute the "improper desire to maintain control."\(^\text{22}\)

Professors Gilson and Kraakman\(^\text{23}\) have described the court's

succumb to influences which convert an otherwise valid business decision into a faithless act. On the other hand, the duty of care requires a director, when making a business decision, to proceed with a "critical eye" by acting in an informed and deliberate manner respecting the corporate merits of an issue before the board.

*Id.* at 1345 (citations omitted).

18 187 A.2d at 409.


20 199 A.2d at 554-5.

21 *Id.* at 555.

22 *Id.* at 556.

23 Gilson & Kraakman, *Delaware's Intermediate Standard for Defensive Tactics: Is There*
handling of the tangential relationship between the business judgment rule and director conflict of interest in Cheff by noting:

If a target's directors could demonstrate disagreement over corporate policy with a would-be acquirer, they were presumed to act from business consideration rather than self-interest. With the specter of a breach of duty of loyalty thus conveniently set aside, the appropriate standard of review became the business judgment rule . . . .

With the advent of the corporate raider in the 1980s, the protection provided the shareholder under the Cheff rule was rendered ineffectual. The court felt restraint in this area was necessary, at least to a certain extent, as "by the very nature of corporate life a director has a certain amount of self-interest in everything he does." The result was cautious regulation, when it was applied at all:

Certainly, application of the fairness test was not justified, at least initially, for this "qualitatively different" conflict of interest. The solution would require some threshold test to determine if the judgment of the court should be substituted for that of the directors, as in the case of the fairness test, or if the business judgment rule should be applied. The Unocal case provided this test.

B. Unocal: A Second Step Is Added to Cheff

In Unocal Corp. v. Mesa Petroleum Co. the Delaware Supreme Court adopted a new, intermediate level of review of target directors' actions in response to a hostile tender offer.

On April 8, 1985, Mesa, which owned 13% of Unocal's outstanding stock, announced a "front loaded" tender offer. The front end was cash for sixty-four million shares (about 37%)
of Unocal's outstanding stock at $54 per share. The back end of Mesa's plan offered highly subordinated debt securities (in this case, junk bonds) purportedly worth $54 per share, for the remaining shares. On April 13, Unocal's board of directors, after receiving detailed presentations from their attorneys and investment bankers, unanimously rejected the Mesa offer as inadequate. On April 15, the board met again and adopted a resolution stating that if Mesa acquired a total of 51% of Unocal's stock, then Unocal would offer to exchange the remaining outstanding shares (49%) for senior debt securities having an aggregate par value of $72 per share. The board purportedly did this to adequately compensate the shareholders that otherwise would be frozen out on the back end of the merger proposal. It thereby had the effect of limiting the coercive aspect of Mesa's offer. Mesa was excluded from the exchange offer. On April 17, Unocal commenced their exchange offer. Mesa, as a stockholder, challenged the board's power to exclude it from the exchange offer.

The Delaware Supreme Court first dealt with the board of directors' power to adopt a defensive measure that excluded a minority shareholder. The court concluded that a board has the power to deal selectively with its stockholders. The court stated, "the board's power to act derives from its fundamental duty and obligation to protect the corporate enterprise, which includes stockholders, from harm reasonably perceived, irrespective of its source." Unocal's board protected the other shareholders from the coercive effects of Mesa's bid to acquire the company. The court found this action acceptable.

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29 493 A.2d at 949.
30 Unocal's board consisted of eight outside directors and six inside directors. Id. at 950.
31 At the April 13, 1985 meeting, Unocal's investment advisors, Goldman, Sachs & Co. and Dillon, Read & Co. were of the opinion that the minimum cash liquidation value of Unocal's stock was in excess of $60. Id.
32 Id. at 951.
33 The court relied primarily on two sections of the Delaware Code in reaching this conclusion: the inherent powers conferred on a board respecting management of a corporation's business and affairs given by DEL. CODE ANN. tit. 8, § 141(a) (1974) and a corporation's extensive authority to deal in its own stock conferred by DEL. CODE ANN. tit. 8, § 160(a) (1974). 493 A.2d at 954.
34 493 A.2d at 954.
35 The court noted a board "may deal selectively with its stockholders, provided the directors have not acted out of a sole or primary purpose to entrench themselves in office." Id. See also Cheff v. Mathes, 41 Del. Ch. 14, 187 A.2d 405 (Del. 1962).
The more significant issue (in retrospect) was whether Unocal’s action would receive the protection of the business judgment rule. The Delaware Supreme Court noted, in oft quoted language, that when a board of directors addresses a takeover bid there is an inherent conflict of interest:

Because of the omnipresent specter that a board may be acting primarily in its own interests, rather than those of the corporation and its shareholders, there is an enhanced duty which calls for judicial examination at the threshold before the protection of the business judgment rule may be conferred. The enhanced duty requires a board of directors that takes defensive action in response to a tender offer to show (i) good faith and reasonable investigation in concluding there was a danger to corporate policy and effectiveness (the Cheff analysis), and (ii) that the actions taken to oppose the takeover were “reasonable in relation to the threat posed.” The second prong requires an analysis of both the threat and the response to determine if the board’s action was proportionate to the danger. This is the “Unocal test.”

Under the first prong of the test, the court held that Unocal’s board had demonstrated their good faith and reasonable investigation in determining that the $54 per share offer was inadequate and a threat to shareholder interests. The two-tier nature of the offer was coercive and therefore a threat, because shareholders, fearing that they would receive very little at the back-end of the transaction, would be forced to tender into the front-end. The first prong satisfied.

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36 493 A.2d at 954.
37 The court noted that “such proof is materially enhanced, as here, by the approval of a board comprised of a majority of outside directors who have acted in accordance with the foregoing standards.” Id. at 955.
38 Id.
39 The court gave examples of factors that a board may weigh in responding to a bid:

[I]nadequacy of the price offered, nature and timing of the offer, questions of illegality, the impact on ‘constituencies’ other than shareholders (i.e., creditors, customers, employees, and perhaps even the community generally), the risk of nonconsummation, and the quality of the securities being offered in the exchange . . . it also seems to us that a board may reasonably consider the basic stockholder interests at stake, including those of the short term speculators.

Id. at 955-56. The court made clear that this list was not all-inclusive.
40 Id. at 955.
41 The “junk bonds” at the back-end would, in all likelihood, be worth less than $54 cash. Id. at 956.
The second prong of the analysis, that the actions taken to oppose the takeover were "reasonable in relation to the threat posed,"\(^42\) focused on the exchange offer—the Unocal board's response to the two-tier offer. The court found that the offer would either compensate those shareholders that otherwise would be inadequately compensated on the back-end, or it would defeat the coercive tender offer. Both purposes were found reasonable and fair.\(^43\)

The valid pursuit of these purposes would have been nullified by Mesa's participation in the exchange offer. If Mesa had been allowed to tender its shares, Unocal would have, in effect, subsidized Mesa's inadequate offer and the resulting displacement of the minority shareholders that Unocal's offer was designed to protect.\(^44\) Since the court found the defensive actions reasonable in relation to the threat, the business judgment rule protected Unocal's self-tender.

### C. The Standard Defined

*Unocal* established a threshold review of director action in response to tender offers. It was an intermediate standard that bridged the gap between the business judgment rule and the intrinsic fairness test. Under the *Unocal* test, a board's decision to deal selectively in its own stock for the purpose of protecting shareholder value was reasonable in relation to the threat of an inadequate, two-tier, coercive tender offer. However, it was not evident from the opinion whether that response would be reasonable in the context of a different type of threat. The narrow facts of *Unocal* left unmapped expanses under the new standard as to what constitutes a "threat" and what defensive actions by a board of directors would be reasonable in relation to different kinds of threats.\(^45\)

\(^{42}\) *Id.* at 955.

\(^{43}\) The court noted that Unocal's partial offer was "consistent with the principle that the minority stockholder shall receive the substantial equivalent of what he had before." *Id.* at 956.

\(^{44}\) The purpose of the exchange offer was to protect a class of shareholders that otherwise would have been injured by Mesa's tender offer. Mesa, by definition, would not fall within that class of shareholders.

\(^{45}\) The general terms of the *Unocal* test, although creating some uncertainty in the practice of law, allow courts to apply the test somewhat tailored to each case. "The usefulness of *Unocal* as an analytical tool is precisely its flexibility in the face of a variety of fact scenarios." Paramount Communications, Inc. v. Time, Inc., 571 A.2d 1140, 1153 (Del. 1989).
The Delaware Supreme Court, in two subsequent cases, explored some of the logical consequences of the new standard. These cases represented polar applications and served to delineate, in broad strokes, the expanse of Unocal.

1. **Moran: Confirmation of the Intermediate Approach**

   *Moran v. Household International, Inc.*[^46^] was the first case after Unocal to use the new standard. What distinguishes Moran from the rest of Unocal's progeny is that the board's defensive actions were not taken in reaction to a specific threat by a hostile acquirer. Yet, the court found that a sufficient threat existed to satisfy the new Unocal test.[^47^]

   The Household directors became concerned about the company's vulnerability to a hostile tender offer in February 1984. By the summer of 1985, the board had formulated and adopted a poison pill in the form of a "flip-over" rights plan.[^48^] The plan, most significantly, enabled shareholders, in the event of a merger or consolidation, to purchase $200 of the acquirer's common stock for $100.[^49^]

   Moran was a director of Household and through his company, the largest single stockholder. Moran initiated merger talks during this time, but negotiations did not progress beyond the discussion stage. Moran protested the adoption of the poison pill and filed suit.

   The Delaware Supreme Court noted that in the context of "a pre-planned defensive maneuver it seems even more appropriate to apply the business judgment rule."[^50^] Nevertheless, the court found that the rights plan was not irrevocable—the board could not arbitrarily reject a request to redeem the rights plan. Any such action would be governed by the Unocal standard.

[^46^]: 500 A.2d 1346 (Del. 1985).
[^48^]: The "poison pill" is typically in the form of a shareholder right to purchase shares of common stock at a discounted price. The rights become effective and transferable when an outside purchaser reaches a pre-set ownership level of the issuer's common stock. The flip-over provision entitles the holder of a right to acquire shares of an acquiring corporation at a drastically reduced price. The flip-in provision permits the holder of the right to buy shares of the target corporation at a drastically reduced price, thus diluting the acquirer's ownership interest.
[^49^]: 500 A.2d at 1349.
[^50^]: 500 A.2d at 1350.
The court then described the newly created Unocal standard and its relation to the business judgment rule. "[I]n Unocal we held that when the business judgment rule applies to adoption of a defensive mechanism, the initial burden will lie with the directors." This initial burden is satisfied by the now familiar showing of a threat to corporate policy (satisfied by good faith and reasonable investigation) and showing that the defensive mechanism was reasonable in relation to the threat posed. "Then, the burden shifts back to the plaintiffs who have the ultimate burden of persuasion to show a breach of the director's fiduciary duties."

The court then proceeded to reverse the order of analysis by first holding that the directors were not grossly negligent in taking the defensive action. After which, the court declared that "the Directors reasonably believed Household was vulnerable to coercive acquisition techniques [the threat] and adopted a reasonable defensive mechanism to protect itself [the reasonable relationship test]." The court concluded its opinion by reminding the directors that though the board passed the Unocal test and was thereby protected at this juncture by the business judgment rule, when confronted by a hostile offeror the directors' actions must again be reviewed under the Unocal standard.

The significance of Moran lies in the Delaware Supreme Court's confirmation of the Unocal approach to tender offer litigation. The court was somewhat tentative in its application of the Unocal standard and appeared to water down the threat requirement as Household was not faced with a cognizable threat from a

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51 Id. at 1356.
52 Id.
53 Id. at 1357.
54 For cases where the question is one of whether the Unocal standard should apply, see Gilbert v. El Paso Co., 575 A.2d 1131, 1141 (Del. 1990) (where the target board reached a settlement with an offeror, the settlement was viewed as a defensive response and was subject to review under Unocal); Doskocil Cos. v. Griggy, Civ. A. No. 10,095 (Del. Ch. Aug. 18, 1988) (1988 WL 85491) (The board of Wilson Foods Corp. tabled a planned defensive strategy for reconsideration in the face of a tender offer. The court held that once the board makes a decision on the tabled plan such action will be reviewable under Unocal. However, the court will not anticipate such decisions and render what amounts to an advisory opinion as to the validity of the proposed action.); Henley Group, Inc. v. Santa Fe S. Pac. Corp., Civ. A. No. 9569 (Del. Ch. April 12, 1988) (1988 WL 23945) (Defendant, Santa Fe, claimed that the issuance of dividends were protected under the business judgment rule and therefore Unocal was inapposite. However, the court found that the dividend, issued after the announcement of a proxy contest, that included a debenture subject to certain restrictions that could deter an acquirer, was defensive in nature and therefore subject to Unocal upon review).
hostile acquirer. In addition, the court let stand, what was at minimum a potentially preclusive action, the poison pill. Nevertheless, the court's warning that the pill would have to withstand judicial scrutiny if and when the company was actually faced with a tender offer by a hostile acquirer, signaled that the poison pill's efficacy remained in limbo.

2. Revlon: A Sub-set of the Unocal Test

In Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., the Delaware Supreme Court applied the Unocal standard of review to a bidding contest between a hostile acquirer and a white knight. The court objected to the Revlon board's halting of the auction process prematurely after entering into a "lock-up agreement" (among other things) with the white knight, Forstmann, Little & Co. (Forstmann). In the process, the court formulated a new subset of the Unocal standard of review.

Following the breakdown of discussions between Pantry Pride and Revlon, the Revlon board employed several defensive measures designed to thwart an anticipated takeover attempt by Pantry Pride. Thereafter, Pantry Pride made a hostile offer for Revlon's shares at $47.50. Revlon, in turn, announced an exchange of notes for stock valued at $47.50. These notes contained covenants which limited Revlon's ability to take on additional

55 506 A.2d 173 (Del. 1986).
56 "White knight" is Wall Street parlance for a favored acquirer, who rides in to save the company from an "evil" hostile bidder. The nature of mergers and acquisitions has inspired this feudal theme which Martín Lipton and Erica Steinberger have dramatically taken up in the prologue to their treatise. M. LIPTON & E. STEINBERGER, 1 TAKEOVERS & FREEZEOUTS (1988).
57 A "lock-up" is an agreement to sell assets (usually a division of the company) to the favored acquirer on the occurrence of another party obtaining a certain number of shares in the company. In Revlon, the lock-up price was "some $100-$175 million below the value ascribed to them by Lazard Freres, [conditional on] another acquirer [obtaining] 40% of Revlon's shares." 506 A.2d at 178.
58 The chancellor also enjoined a "no-shop" and cancellation agreement. See infra notes 66-68 and accompanying text.
59 "The nominal plaintiff, MacAndrews & Forbes Holdings, Inc., is the controlling stockholder of Pantry Pride." 506 A.2d at 175.
60 Special counsel, Martin Lipton, of Wachtell, Lipton, Rosen & Katz, recommended Revlon repurchase up to five million of its almost 30 million outstanding shares of stock and adopt a "poison pill" based on a "Note Purchase Rights Plan." Id. at 177. The plan was triggered upon anyone acquiring beneficial ownership of 20% of the company's stock and enabled shareholders to exchange shares for one year notes at a principal value of $65. In essence, this would bar hostile offers below $65. Pantry Pride filed for a restraining order on the plan and its subsequent bids were conditioned on the redemption, rescission, or voiding of the plan.
debt.\textsuperscript{61} The shareholders reacted positively to this offer, and Revlon obtained 10 million of its own shares.\textsuperscript{62} In response, Pantry Pride raised their bid to $50, and then again to $53.\textsuperscript{63}

In the meantime, the Revlon board had been discussing a leveraged buy-out (LBO)\textsuperscript{64} merger with Forstmann. The conditions of the merger included Revlon's agreement to waive the covenants of the notes, for which Forstmann, in return, would offer the shareholders $56 per share and assume the $475 million debt on the notes. In order to finance the LBO by Forstmann, Revlon would sell one division prior to the merger and Forstmann would sell several Revlon divisions afterward.\textsuperscript{65}

After the merger was announced, note prices declined dramatically. The holders became disgruntled and threatened to sue on the basis of Revlon's agreement with Forstmann to waive the covenants. Pantry Pride raised its bid to $56.25 and declared its intention to top any bid. Forstmann then offered $57.25 and agreed to support the price of the sagging notes (a major concern of the Revlon directors) on condition that Revlon give a lock-up option on two of Revlon's divisions at a price well below valuation. In addition, Revlon was to sign a "no-shop" and cancellation agreement.\textsuperscript{66}

The Revlon board approved Forstmann's offer. They justified their acceptance on three grounds. First, the price exceeded Pantry Pride's offer (though they were well aware of Pantry Pride's declaration to top any bid). Second, Forstmann would protect the interests of the noteholders by supporting the price of the notes. Third, Forstmann had its financing in place.\textsuperscript{67} Pantry Pride responded by seeking an injunction in the Court of Chancery and raising its bid to $58, conditioned upon the nullification of the rights plan, waiver of the note covenants, and an injunction

\textsuperscript{61} The covenants also limited the ability to sell assets or pay dividends unless approved by the independent directors as well. \textit{Id.}
\textsuperscript{62} Though 87% of Revlon's almost 30 million outstanding shares were tendered, the offer was for only 10 million shares. \textit{Id.}
\textsuperscript{63} \textit{Id.}
\textsuperscript{64} The leverage in an LBO is provided by the target company itself; financing is secured by the assets of the target. \textit{Id.} 506 A.2d at 178.
\textsuperscript{65} A no-shop agreement requires that the target not solicit additional offers. The cancellation agreement provided for a payment of $25 million to Forstmann in the event of termination of the agreement or another acquirer obtaining more than 19.9% of the stock. 506 A.2d at 178.
\textsuperscript{66} Actually, the state of both Forstmann and Pantry Pride's financing was virtually identical. \textit{Id.} at 179.
against the lock-up agreement. The Court of Chancery enjoined
the lock-up and no-shop agreements, as well as the cancellation
fee. The Supreme Court of Delaware affirmed.

The Delaware Supreme Court began its analysis by stating
that Unocal provided the applicable standard for review of the
board’s actions. The court applied this analysis to the poison
pill (rights plan) as well as to the exchange offer and found that the
board acted with due care and that the response was reasonable
in relation to the threat Pantry Pride posed.

However, when Pantry Pride increased its offer to $50 per
share, and then to $53, it became apparent to all that the
break-up of the company was inevitable. The Revlon board’s
authorization permitting management to negotiate a merger or
buyout with a third party was a recognition that the company
was for sale.

These actions by Revlon’s board triggered what has become
known as “Revlon mode.” When a corporation is in Revlon
mode, the Court no longer considers a hostile offer a threat. As
in the event of a sale of corporate control, there is no continuing
corporate policy or entity to threaten. Therefore, defensive tactics
are impermissible as they can bear no relation to a non-existent
threat. In Revlon, “[t]he whole question of defensive measures
became moot. The directors’ role changed from defenders of the
corporate bastion to auctioneers charged with getting the best
price for the stockholders at a sale of the company.”

Through this analysis, the Delaware Supreme Court found the
merger agreement did not fulfill this duty to maximize sharehold-
er value. The provisions, and in particular the lock-up, had the

69 506 A.2d at 176.
70 Id. at 182.
71 “On the level of legal doctrine, it is clear that under Delaware law, directors are
under no obligation to act so as to maximize the immediate value of the corporation or
its shares, except in the special case in which the corporation is in a ‘Revlon mode.’”
(CCH) ¶ 94,514 at 93,277 (Del. Ch.), aff’d, 571 A.2d 1140 (Del. 1989). Theodore N.
Mirvis of Wachtell, Lipton, Rosen & Katz, a premier M & A defense firm, described the
result as “scary Revlon-land, in which directors set foot only at the peril of being
consumed by goblins lurking around every doctrinal corner.” Mirvis, Efficient Market
Theory Doomed in Delaware, Nat’l LJ., Nov. 6, 1989, at S4, col. 1.
72 “Thus, nothing remained for Revlon to legitimately protect, and no rationally
related benefit thereby accrued to the stockholders.” 506 A.2d at 183.
73 Id.
effect of prematurely ending the auction prior to obtaining the highest price for the company, to the detriment of the shareholders. The court did not rule out the use of lock-ups, cancellation fees, and no-shop provisions per se, but stated that the effect of these in response to a hostile takeover must be to benefit shareholders. In essence, they must spur further bidding rather than preclude it.

The court applied the Unocal test to determine whether a legitimate threat existed. Upon the determination that there was no threat to corporate existence (sale of the corporation was "inevitable") the only threat that remained was to the shareholders' interests. Whereupon the only legitimate interest the directors had to protect was shareholder value. The court found that the directors did not fulfill this duty and the transaction was unfair to shareholder interests.

Revlon mode is essentially a subset of the Unocal test. Membership in this subset is triggered by the sale of the corporation or its component parts. At this point, the Unocal test devolves into purely a test of maximization of shareholder value. The failure of this test, as in the failure of the standard generally, shifts the standard of review to its most strict level, the intrinsic fairness test.

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74 Id.
75 "Where director action is not protected by the business judgment rule . . . the transaction can only be sustained if it is objectively or intrinsically fair; an honest belief that the transaction was entirely fair will not alone be sufficient." AC Acquisitions Corp. v. Anderson, Clayton & Co., 519 A.2d 103, 115 (Del. 1986).
76 See Reder, The Obligation of a Director of a Delaware Corporation to Act as an Auctioneer, 44 BUS. LAW. 275 (1989). Reder contends that the language of Revlon specifically refers to "bust-up" situations (where a company's divisions are sold off to finance the LBO) and that therefore, Revlon mode is only entered in the face of such a threat. Until Time, this article appeared misguided, as the Delaware courts appeared to apply the standard on a much broader basis. Specifically, change in control of the corporation was considered the Revlon trigger. See infra note 191 and accompanying text. However, the court in Time narrowed the scope of Revlon with specific reference to "bust-up" scenarios, yet the court implied a broader range of possible Revlon applications. See infra text accompanying note 239.
77 Gilson and Kraakman have noted that Revlon could be read to minimize the proportionality test. In essence, it does this by providing the automatic assumption of shareholder value maximization due to the lack of a threat to the corporation. "Unocal, Moran, and Revlon can be read to suggest that proportionality review is primarily a formal, rhetorical instruction rather than a substantive standard of review . . . . Revlon . . . may be consistent with this minimalist construction insofar as it pointedly invokes the directors' duty of loyalty in lieu of a proportionality argument when it enjoins management's defensive lock-up option." Gilson & Kraakman, supra note 23, at 252. However accurate the argument for lack of substance in the proportionality test
III. THE DEVELOPMENT OF THE UNOCAL STANDARD

After this trilogy of cases it was clear that the Unocal standard was a force to be reckoned with in the Delaware corporate world. The range of Unocal's application, at least at the extremes, had been defined and the mode of application by the courts clarified. Nonetheless, there remained (and to an extent will remain indefinitely) two principal areas of uncertainty. First, what were the cognizable threats under the standard, and the range of responses reasonable in relation to those threats. Second, when were Revlon duties triggered. The cases do not discretely address either one or the other of these issues, but rather the issues are necessarily interwoven. However, for the purposes of this Note the cases may be organized along these lines.

A. Unocal's Threats and Reasonable Responses

1. Interco: A Portend of Proportionality

In City Capital Associates Ltd. Partnership v. Interco, Inc., Chancellor Allen reviewed the response of directors to a non-coercive tender offer. On July 11, 1988, Interco's board, concerned about the increased trading activity of its stock, adopted a poison pill consisting of a shareholder rights plan with both flip-in and flip-over provisions. On July 15, the chairman of Interco's board issued a press release announcing that he intended to recommend a major restructuring of the company. On July 27, the Rales brothers offered to acquire Interco through their acquisition vehicle City Capital Associates (CCA), for $64 per share, all cash. Later they increased the offer to $70 per share.

Subsequently, Interco's investment bank, Wasserstein Perella, informed the board that in their opinion $70 per share was inadequate. The board rejected the CCA proposal and elected to
explore a restructuring alternative. One week later, CCA announced a public tender offer for all shares at $72 per share. On September 19, Interco’s board met, rejected the $72 offer as inadequate and adopted a restructuring plan.\(^{83}\)

The restructuring called for Interco to sell its most valuable asset (Ethan Allen Furniture), which generated approximately one-half of Interco’s gross income, and to borrow $2.025 billion. Shareholders were to receive two cash dividends totalling $38.15 per share, various subordinated debentures, convertible preferred stock and a stub equity interest. Wasserstein Perella opined that this combined restructuring would be worth $76 per share.\(^{84}\)

On October 18, 1988 CCA raised its bid to $74 per share, all cash. Interco’s board rejected the offer as inadequate and implemented the defensive strategies. CCA sued to redeem the poison pill and restrain the restructuring, most notably the sale of Ethan Allen. The chancellor granted the first request but refused to enjoin the sale of Ethan Allen.\(^{85}\)

Under the first prong of the Unocal test, the chancellor reasoned that as this was a non-coercive cash offer for all shares, the threat was to shareholder economic interest in the form of adequacy of price.\(^{86}\) A shareholder could prefer “a $74 cash payment now to the complex future consideration offered through the restructuring.”\(^{87}\) The chancellor also noted that the pill gave the board leverage against an offeror and could give the board “such time as it required in good faith to arrange an alternative value-maximizing transaction, then . . . the legitimate role of the poison pill in the context of a noncoercive offer will have been fully satisfied.”\(^{88}\)

Though the chancellor seemed to find the threat somewhat tenuous, he nevertheless decided the pill was not proportional to

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83 Id. at 793-94.
84 Regarding the valuation, the chancellor noted that Wasserstein Perella was to receive a substantial contingency fee if the restructuring was successfully completed. Therefore they had “a rather straightforward and conventional conflict of interest when [they] opine[d] that the inherently disputable value of its restructuring is greater than the all cash alternative offered by the plaintiffs.” Id. at 793. See also infra note 144.
85 Id. at 801.
86 The chancellor delineated two types of threats created by a tender offer. “Broadly speaking, threats to shareholders in that context may be of two types: threats to the voluntariness of the choice offered by the offer, and threats to the substantive economic interest represented by the stockholding.” Id. at 797.
87 Id. at 799.
88 Id. at 798.
the threat of CCA's offer and ordered its redemption. CCA's victory on the issue of the poison pill was a pyrrhic one due to the chancellor's refusal to enjoin the sale of Ethan Allen. The sale of Ethan Allen was termed a public sale, "not a 'crown jewel' sale to a favored bidder." Although a sale of assets by a target may complicate an offeror's transaction, an offeror "has no right to demand that its chosen target remain in status quo." As indicated in Unocal, when faced with a hostile tender offer "a board of directors is not a passive instrumentality." This holding by the chancellor recognizes a board of directors' considerable ability to implement alternative corporate transactions in good faith that make the target less attractive for a possible LBO.

The chancellor, by weighing the level of the threat and then the proportionality of the response thereto, gave substance to the "in relation" portion of the Unocal test. Moreover, by finding that the threat was to shareholder interests the chancellor opened the door for the court to determine which of the competing offers was better for the shareholders.

2. AC Acquisitions: Is Substantive Proportionality for Real?

Chancellor Allen reviewed another type of corporate restructuring in the context of a hostile takeover attempt in AC Acquisitions v. Anderson, Clayton & Co. As a result of a confluence of factors, the board of directors of Anderson, Clayton chose to

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89 Id. at 798-99.
90 551 A.2d at 801.
91 Id. The realistic effect of Interco's defensive restructuring was the withdrawal of the tender offer by CCA.
93 The court wrote that if a board "has arrived at a good faith informed determination that a recapitalization or other form of transaction is more beneficial to shareholders," Revlon does not command the board to hold an auction of the corporation merely because part of the restructuring included a sale of a corporate asset. 551 A.2d at 803.
94 See supra note 84 and accompanying text.
95 As the court indicated in Time, this interpretation was too "narrow and rigid a construction of Unocal." Paramount Communications, Inc. v. Time, Inc., 571 A.2d 1140, 1153 (Del. 1989). A corporation may be sufficiently threatened, as in Time, by a variety of factors including potential shareholder ignorance or mistaken belief as to the value of an offer. See infra notes 197-204 and accompanying text. In addition, the proportionality of the board's response is for all practical purposes irrelevant, as the court may not evaluate which offer is better for shareholders. See infra notes 195-96 and accompanying text.
96 519 A.2d 103 (Del. Ch. 1986).
97 Thirty percent of Anderson, Clayton stock was held in trust for the daughters of the founder of the company. The trusts were due to terminate in early 1986, and the beneficiaries were planning to liquidate their holdings. As a result, several options were
make a self-tender offer for 65% of its outstanding shares at a price of $60 per share. Prior to the effectuation of this plan a group of shareholders, AC Acquisitions, responded by making a hostile offer of $56 for all shares and filed suit to enjoin the company's self-tender due to its "coercive" nature.

The coercion claim arose from the nature and timing of management's offer. The company transaction required acceptance before completion of the offer. Thus, those stockholders tendering to AC Acquisitions would be left out of the recapitalization transaction if the hostile offer failed. As Anderson, Clayton's expected trading range after completion of the company transaction was estimated from $22 to $52, such a shareholder could lose substantial value.

The chancellor found the first prong of the Unocal test satisfied because:

There is no evidence that the [AC Acquisitions] offer—which is non-coercive and at a concededly fair price—threatens injury to shareholders or to the enterprise. However, I take this aspect of the test to be simply a particularization of the more general requirement that a corporate purpose... must be served by the stock repurchase.

In the second part of the Unocal test, that the defensive response be "reasonable in relation to the threat posed," the

considered to ensure the stability of the company during this significant shift in share ownership. The board considered a management led buyout, and also employed First Boston & Co. to search for a possible buyer for the entire company. Neither alternative proved fruitful and the board instead decided on the partial self-tender. Id. at 105-06.

In addition, the company was to then sell 25% of the outstanding shares to an ESOP (Employment Stock Ownership Plan). This dovetailed with the self-tender by securing, so Anderson, Clayton claimed, favorable tax treatment for the distribution of proceeds from the recapitalization. Id. at 108.

Bear, Stearns & Co., Inc., Gruss Petroleum Corp. and Gruss Partners were shareholders of Anderson, Clayton who formed AC Acquisitions for the purpose of the tender offer. Id. at 104.

Actually, it was announced as a two-step offer with the first step for a minimum of 51% of the shares at $56 each, and the second step a freeze-out merger at the same price. Id.

101 519 A.2d at 112-13. The hostile offer was made even less attractive by the conditions AC Acquisitions demanded which were by no means easy to accommodate within the time constraints and accentuated the tenuousness of the offer. These conditions included the abandonment of the self-tender and ESOP plan, as well as the amendment of "Article Eleventh" of the corporation's charter which limited a prospective acquirer's ability to control the company. Id. at 109.

102 Id. at 112.

Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 955 (Del. 1985). This leg of the test has remained unchanged and has been quoted verbatim in the opinions apply-
chancellor found the threat to be slight and the response practically preclusive. The board's actions were, therefore, unreasonable. The chancellor held that the company transaction was "deliberately structured so that no rational shareholder can risk tendering in to the [AC Acquisitions] offer." Rather than the company's self-tender transaction being merely an alternative to the hostile offer (as it was couched by the Anderson, Clayton board), it was an all too effective defense to the attempted takeover. Hence, the intrinsic fairness standard was applied to the board's actions. The chancellor had clearly characterized the actions as unfair throughout the opinion and application of the test was academic.

AC Acquisitions represents the chancellor's continued application of a proportionality evaluation between threat and response. The chancellor finding that the management transaction was practically preclusive and coercive to the corporation's own shareholders represented the high point of the Unocal test's substantive application. Nonetheless, at least two things may be garnered from AC Acquisitions: the board may offer an alternative transaction, but the transaction must not act to preclude shareholders from choosing the hostile offer to qualify for the protection of the business judgment ruling the test. Though the first prong of the test may have required some development by the courts to galvanize it for subsequent use, the second prong has been found semantically unambiguous. The difficulty with this prong lies in the vagaries of its application.

Gilson and Kraakman, supra note 23, explore whether this "proportionality test" will be able to evolve a comprehensive body of law that illuminates the parameters of action for a particular level of threat to corporate control. Without a clear indication of what is "reasonable" in a particular situation directors are acting very much in the dark. See infra note 245-46 and accompanying text.

104 519 A.2d at 113. "The offer poses a 'threat' . . . in only a special sense . . . [I]t is reasonable to create an option that would permit shareholders to keep an equity interest in the firm, but, in my opinion, it is not reasonable in relation to such a 'threat' to structure such an option so as to preclude as a practical matter shareholders from accepting the . . . offer." Id.

105 Id.

106 Gilson and Kraakman described the opinion as seeming "to foreclose preclusive tactics that force shareholders to accept the independence option (or prevent shareholders from choosing at all)." See Gilson & Kraakman, supra note 23, at 257. After Time, the language in parentheses may not be entirely correct, as the standard does not prevent a board from making the target unattractive or virtually unobtainable; thus causing the bidder to withdraw the offer. Although this may in fact prevent shareholder choice, it remains theoretically non-preclusive. See infra note 208 and accompanying text.
3. Polaroid: The Hazards of Instant Case Law

Polaroid I\(^{107}\) and Polaroid II\(^{108}\) both arise from the same hostile tender offer to purchase the Polaroid Corporation.\(^{109}\) On June 16, 1988, Shamrock acquired slightly less than 5% of Polaroid’s outstanding common stock and sent a letter requesting a meeting with Polaroid’s chief executive officer (CEO). Over the course of the next several days, Polaroid’s management, legal and investment advisors held strategy sessions to decide on a course of action. A special board meeting was scheduled for the earliest date possible.\(^{110}\)

At the board meeting, management discussed Shamrock’s overtures and management’s comprehensive plan to increase Polaroid’s profitability. An ESOP was an integral part of the plan and was the subject of Polaroid I. A unanimous board adopted resolutions authorizing the ESOP.\(^{111}\)


\(^{109}\) However, Polaroid’s most valuable asset is the “Kodak Litigation.” The litigation commenced in 1976 when Polaroid filed a patent infringement action against Kodak upon the introduction of Kodak’s instant cameras and film. Polaroid succeeded, and obtained a judgment in its favor in 1985. The damages portion of the trial was set to begin in 1989 (several months after these cases were decided). Polaroid was seeking $5.7 billion in damages. The after tax proceeds of a $5.6 billion recovery paid in 1991 would be worth over $44 per share. Polaroid II, 559 A.2d at 284.

\(^{110}\) Polaroid I, 559 A.2d at 267.

\(^{111}\) Id. at 268. The facts of Polaroid I developed as follows. For several years Polaroid’s management had seriously been considering the adoption of an ESOP. On March 29, 1988 the idea of the ESOP, its funding (the funds under consideration to pay for the ESOP were to come from reductions in several of the employee benefit plans and the elimination of a one-time seniority 5% pay increase), its effect on shareholder interests, and the expected positive results of giving the employees a stake in the company, were all presented to Polaroid’s board of directors. The board approved in principle a 5% ESOP and authorized management to develop a more detailed plan. On June 14, at its regularly scheduled meeting, the board approved and adopted an ESOP plan document. The size of the ESOP was not discussed. Id. at 264.

Several days later Shamrock informed Polaroid that it had acquired about 5% of Polaroid’s stock and requested a meeting. Faced by a potential acquirer, management decided to increase the ESOP to 18.5% (an ESOP greater than 18.5% would have required shareholder approval). The dramatic increase in the size of the ESOP was to be funded, in large part, by a 5% cut in employee wages. Id. at 266.

On July 12, a special board meeting was held. The board was given no written materials prior to the meeting. Management discussed Shamrock’s overtures and management’s comprehensive plan to increase Polaroid’s profitability (the ESOP was an integral part of the comprehensive plan). The board discussed the ESOP for about two hours. Although the board had never considered an ESOP as large as 18.5% or $300
On September 9, Shamrock commenced an all cash tender offer for all outstanding shares of Polaroid stock at $42 per share. The offer was conditioned on judicial invalidation of the ESOP. On September 19, Polaroid's board, based on a financial analysis of the offer and Polaroid's future prospects, rejected the Shamrock offer as inadequate.

Polaroid, over a series of meetings and negotiations, concluded that a repurchase of stock using a mix of debt and equity was the appropriate defensive response. Polaroid's directors unanimously approved the repurchase plan including an issuance of preferred stock to Corporate Partners. On February 20, 1989, Polaroid's board approved a partial self-tender for sixteen million shares at $50 per share. Shamrock challenged the repurchase plan and the issuance of the preferred stock to Corporate Partners. Shamrock sought a preliminary injunction to halt the transactions.

Unlike Polaroid I, Unocal was now clearly the appropriate test to determine whether Polaroid's board would enjoy the protection of the business judgment rule. The record showed that the board of directors satisfied the first prong of Unocal, by evidencing good faith and reasonable investigation in concluding the offer

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Note: The text is a excerpt from a legal document and contains references and notes for further reading.
posed a threat.

Although Interco had held that an all-cash offer cannot ordinarily be a continuing threat to corporate interests, Vice-Chancellor Berger found that holding inapplicable in the instant case. Foreshadowing Time, the court cited shareholder confusion as a threat to Polaroid. The vice-chancellor found that the status of the Kodak litigation\footnote{116 See supra note 109. Polaroid's officers and directors could not, without seriously weakening their bargaining position with Kodak, give a straightforward representation as to the amount of the recovery and when it might be obtained. \textit{Polaroid II}, 559 A.2d at 290.} provoked shareholder uncertainty in assessing the company's value, and shareholders might undervalue the Kodak judgment. The vice-chancellor concluded that Polaroid could treat the Shamrock inadequate offer as a threat.\footnote{117 Id.}

The vice-chancellor ruled that the preferred stock issuance and the self-tender were not unreasonable responses to the inadequate tender offer because the self-tender was not preclusive (the public still had control of Polaroid's stock and could tender their stub equity into the Shamrock offer). Also, the self-tender, in the face of an inadequate tender offer, provided value to shareholders. The preferred stock issuance to Corporate Partners was found reasonable as well, as it was not preclusive—it merely made an acquisition more expensive. In relation to the threat, the $300 million equity issuance was deemed not a disproportionate response. Thus in the absence of "improper motivation"\footnote{118 Although the vice-chancellor found no improper motivation she characterized the Corporate Partners/Polaroid transaction as "a bit too convenient." \textit{Id.} at 291.} the issuance was reasonable.

In particular, \textit{Polaroid I} and \textit{II} stand for several propositions. First, a fiscally solid ESOP that is shareholder neutral and does not act as a bar to a takeover\footnote{119 The vice-chancellor noted that the ESOP had confidential voting and tendering provisions for the employees. \textit{Id.}} is entirely fair.\footnote{120 The approval of the ESOP was also cited favorably by the Delaware Supreme Court in \textit{Time} as an example of carrying forward a pre-existing transaction in an altered form. \textit{Paramount Communications, Inc. v. Time, Inc.}, 571 A.2d 1140, 1155 (Del. 1989). The altered transaction in \textit{Time} resulted in Time incurring over $10 billion in debt and was a "reasonable and proportionate" response to Paramount's all cash offer/threat. This result, as well as the result in \textit{Polaroid I}, should lend confidence that any fiscally sound ESOP, whenever adopted, will be upheld by a Delaware court.} Secondly, a board may treat an inadequate offer as a continuing threat. Finally, a board's decision to take on an equity partner and institute a partial self-tender that makes a hostile acquisition less likely to
succeed is not unreasonable under *Unocal*. These mechanisms allowed for shareholder choice were the hostile tender offer to proceed. The *Polaroid II* opinion signals the shift from the chancellor’s proportionality review to the less restrictive *Time* interpretation. The case also revealed an array of weapons that target corporations and defensive planners could use effectively in the Delaware courts.

**B. The Revlon Trigger**

It remained to be seen just how far a corporation could go before triggering the *Revlon* duties. It was also somewhat unclear exactly what those duties were—what protecting immediate shareholder value entailed. The following cases serve to illuminate at least some of the shadowy corners of *Revlon*-land.

1. **Newmont Mining: Escape from Revlon-Land**

   In *Ivanhoe Partners v. Newmont Mining Corp.*, the Supreme Court of Delaware revealed some of a board’s broad options under *Unocal* and further delineated the parameters of *Revlon* mode.

   In 1983, Newmont and its largest shareholder, Gold Fields, signed a standstill agreement. The agreement limited Gold Fields’ interest in Newmont’s common stock and their representation on the board of directors to one third. In addition, Gold Fields could terminate the agreement if a third party acquired 9.9% or more of Newmont’s outstanding stock.

   In August 1987, Ivanhoe deliberately increased its holding in Newmont to 9.95%, thus giving Gold Fields the option of terminating its standstill agreement with Newmont. On September 8, 1987 Ivanhoe commenced a hostile tender offer for 42% of Newmont at $95 per share, later increased to $105 per share. Newmont’s board met on September 18, 1988, and after a presentation by their investment adviser, Goldman, Sachs and Company, found the revised offer inadequate.

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121 535 A.2d 1384 (Del. 1987).
122 See infra note 136 and accompanying text.
123 Ivanhoe Partners and Ivanhoe Acquisition Corporation (Ivanhoe) were both acquisition vehicles controlled by T. Boone Pickens, Jr.
124 If successful, this would have given Ivanhoe a majority (51%) of Newmont’s voting stock. Ivanhoe gave no firm commitment regarding the second step of the transaction involving the remaining shares. 535 A.2d at 1339.
125 The presentation to the board by Goldman, Sachs and Company was based, in
proposed a restructuring of Newmont that purported to deal with the "threats" posed by Ivanhoe and Gold Fields. The "proposal consisted of a large dividend [$33 per share] to be financed by the sale of Newmont's non-gold assets, and the signing of a new standstill agreement with Gold Fields to insure Newmont's independence."\(^{126}\)

By the terms of the new standstill agreement, Gold Fields could purchase up to 49.9% of Newmont's common stock and Gold Fields' representation on the board of directors was limited to 40%. The agreement was contingent on the $33 per share dividend, which would finance a street sweep of Newmont stock by Gold Fields. On September 21 and 22, Gold Fields "swept the street," purchasing Newmont shares at an average price of $98 until it owned 49.7% of Newmont's common stock. Ivanhoe sued to rescind the dividend and street sweep.\(^{127}\)

The Delaware Supreme Court found that the stringent Revlon duties were not triggered. This was because the sale or breakup of Newmont was not inevitable, as was evidenced by the standstill agreement and other defensive measures. Although, as a result of the board's actions Gold Fields owned just less than 50% of the company, Gold Fields was characterized as merely protecting its already substantial interest in the company. Additionally, Gold Fields bought shares in the street sweep only from private sellers and was limited to 40% of the board of directors. Therefore, the court found there was no change of control of the company.\(^{128}\)

The Unocal test was then applied. The first prong was satisfied by the obvious threats posed by Ivanhoe and Gold Fields.\(^{129}\) The threat posed by Ivanhoe's two-tier partial tender offer had already been characterized in Unocal as coercive and a threat to shareholder interests.\(^{130}\) Newmont's board found the offer to be

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\(^{126}\) Id.

\(^{127}\) Id. at 1337. A "street sweep" is a "rapid acquisition of securities on the open market during and shortly after the pendency of a tender offer for the same class of securities." Id.

\(^{128}\) Id. at 1345.

\(^{129}\) In applying the Unocal test to Newmont's defensive measures the court noted, "because Newmont's actions here are so inextricably related, the principles of Unocal require that they be scrutinized collectively as a unitary response to the perceived threats." Id. at 1343.

\(^{130}\) Unocal Corp. v. Mesa Petroleum Co, 493 A.2d 946, 956 (Del. 1985).
inadequate. The court held that Newmont’s board was justified in its belief that Gold Fields constituted a significant threat as well. As the largest shareholder, no longer subject to the constraints of the standstill agreement, Gold Fields could make its own play for the company in a manner similar to Ivanhoe. 

Applying the second prong of Unocal, the court found Newmont’s actions to be reasonable in response to the coinciding threats. The Ivanhoe threat was an inadequate, two-tier, coercive bid. The $33 dividend gave value to shareholders in the face of Ivanhoe’s inadequate bid. The court found that this action, which diffused the coercive aspects of the Ivanhoe offer was reasonable under Unocal. Further, although Gold Fields had neither made a tender offer nor acted to deprive Newmont of its independence, the court found that in the context of the Gold Fields threat, the new standstill agreement and the street sweep enabling dividend were reasonable in relation to the “threat” posed by Gold Fields.

Newmont illustrated the extent to which a board may take actions to maintain the corporation’s independence without triggering Revlon. “The Newmont board acted to maintain the

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131 The board consisted of a majority of outside directors, “[t]hus, with the independent directors in the majority, proof that the board acted in good faith and upon reasonable investigation is materially enhanced.” 535 A.2d at 1343.

132 Id. at 1342.

133 The Unocal court allowed a board to give value to shareholders in the face of an inadequate, coercive bid. 493 A.2d at 959.

134 The street sweep deterred the coercive Ivanhoe bid and was viewed “as part of Newmont’s own comprehensive defensive strategy.” 535 A.2d at 1343. Thus, the Court applied an organic analysis to Newmont’s defensive actions.

135 Gold Fields was characterized by the court as a potential “unbridled majority shareholder.” Id.

136 The federal district court in Delaware had the opportunity to explore the definition of control for purposes of triggering Revlon duties in Black & Decker Corp. v. American Standard, Inc., 682 F. Supp. 772 (D. Del. 1988). Black & Decker made a tender offer for American Standard shares, to which American Standard responded with a recapitalization aimed at thwarting the tender offer. At the time of the suit, 92.6% of American Standard’s shares were controlled by the public. The recapitalization plan would result in management ownership of the outstanding stock in American Standard increasing from 4.8% to 23.9%, as well as the creation of an ESOP which would control 30.6% of the stock. Id. at 782.

American Standard argued that the ESOP’s shares should not be considered in conjunction with management holdings (Black & Decker’s contention) and, therefore, a control block was not affected. However, the fact that the court found most persuasive was that a majority of shares in the corporation would no longer be held in the public market. The court found “[t]he entire Recapitalization plan is an offer to gain control of American Standard.” Id. at 782. The court went on to distinguish Newmont by pointing out that whereas Gold Fields stopped just short of 50% ownership in its purchase of
company's independence and not merely to preserve its own control.\textsuperscript{187} The court determined that the board's agreement to finance the purchase of just less than majority ownership of the company was not equivalent to the sale or break up of the company, despite the fact that substantial assets were sold in the process. \textit{Newmont} is also noteworthy for its holding that a threat to the corporation's independence is cognizable under the standard. Moreover, substantially preclusive responses may be found reasonable to combat that threat.

2. \textit{Macmillan}: The Court of Chancery Takes a Lesson

In \textit{Mills Acquisition Co. v. Macmillan, Inc.},\textsuperscript{188} the Delaware Supreme Court clarified the board's duties under \textit{Revlon} and the simultaneous application of \textit{Unocal}. The court found the Macmillan board of directors violated their duties under \textit{Revlon} and enjoined an approved merger. The Macmillan board had been in the process of auctioning the company and was found to have violated the strict duties of loyalty and care owed to shareholders during this critical stage by failing to maximize shareholder value.

Following the enjoinder of the board's defensive maneuvers by the vice-chancellor in \textit{Macmillan I},\textsuperscript{189} the Macmillan board be-

\textsuperscript{187} Robert M. Bass Group, Inc. v. Evans, 552 A.2d 1227 (Del.Ch. 1988) (\textit{Macmillan J}). Vice-Chancellor Jacobs enjoined a planned restructuring of Macmillan which was to have the effect of blocking a hostile takeover attempt by the Bass Group. The restructuring plan, whereby management would garner a vast ownership interest in the corporation, was considered prior to any takeover activity for the company, and was (purportedly) designed to thwart such attempts.

The restructuring plan went through several incarnations, nonetheless, two cen-
gan the search for a white knight as an alternative to the offer made previously by the Bass Group. The search netted six possible suitors, including Robert Maxwell, who proposed a consensual merger at an all cash price of $80 per share.

This bid was $5 higher than the Bass bid, and as a result the Bass Group dropped out of the picture. Nonetheless, Macmillan’s management was not eager to team up with Maxwell. Instead, they accelerated discussions that had been initiated with one of the other possible suitors, Kohlberg Kravis Roberts & Co. (KKR). After the Maxwell bid, Macmillan’s management and KKR formu-

tral concepts remained constant. First Evans, Reilly and certain other members of management would end up owning absolute majority control of the restructured company. Second, management would acquire that majority control, not by investing new capital at prevailing market prices, but by being granted several hundred thousand restricted Macmillan shares and stock options. Id. at 1229. Edward P. Evans, chairman and CEO of Macmillan, and William F. Reilly, president, were the management directors and leading players in the litigation. With assistance from Reilly and Beverly C. Chell, vice president, general counsel and secretary, Evans led the corporation through almost all of its defensive maneuvers during this period with only token input from the rest of the board.

The court found the “apparent domination of the allegedly ‘independent’ board by the financially interested members of management” underscored the impropriety of the action in Macmillan I. Macmillan, 559 A.2d at 1265 (the appeal of Macmillan II). This domination continued through Macmillan II. The “apparent domination” was due, in part, to the fact that Evans hand-picked the “special committee” of independent directors and then waited two or three months to officially convene the committee. “In total, Lazard professionals worked with management on the proposed restructuring for over 500 hours before their ‘client,’ the Special Committee, formally came into existence and restrained them.” Macmillan I, 552 A.2d at 1233.

The vice-chancellor preliminarily enjoined the restructuring, under the Unocal test, finding that the Bass Group offers posed no threat (and in fact, were superior to the restructuring proposal), except to management’s entrenchment and their “expectation of garnering a 39% ownership interest in [about half of the restructured company] on extremely favorable terms.” Id. at 1241.

The Delaware Supreme Court in Macmillan, contradicting the vice-chancellor’s methods but not the result, stated that “[b]y any standards this company was for sale both in Macmillan I and II.” Macmillan, 559 A.2d at 1285. The Supreme Court here, though not rejecting the Unocal analysis of the vice-chancellor, effectively stated that the Unocal test in this context was unnecessary. This placed the company in Revlon mode during the entire period covered by both cases. In which instance, the duty of the directors in Macmillan I was clearly abrogated by their failure to react properly to the superior offer from the Bass Group. It is curious that the vice-chancellor noted that the restructuring, “although not a sale of an absolute interest, does constitute a sale of effective control” but did not apply Revlon. Macmillan I, 552 A.2d at 1242.

140 Mills Acquisition Co. was “substantially controlled by Robert Maxwell” and was referred to as the plaintiff in the case. Macmillan, 559 A.2d at 1264.

141 The court was quite convinced that the management directors were acting in their personal self-interest throughout the transaction. Evans’ ignoring of Maxwell’s overtures seems to be based on his desire to find a sweeter deal for himself. Id. at 1272.
lated a buyout plan which included senior management receiving a "substantial ownership interest" in the surviving entity.\textsuperscript{142} Five weeks later, after getting no response from Macmillan, Maxwell made a tender offer at the $80 per share price in his initial proposal.

On May 30, 1988 (during the period covered by \textit{Macmillan I}) Macmillan's investment bankers, Wasserstein Perella and Lazard Freres, valued the company at a maximum break up value of $80 per share, and represented that the then planned management restructuring (struck down in \textit{Macmillan I}) at $64.15 represented a "fair" price.\textsuperscript{143} On August 25, 1988, these same bankers issued new opinions calling the $80 Maxwell bid unfair and inadequate.\textsuperscript{144} The board rejected the Maxwell offer.

Maxwell, at that point, essentially declared that he would top any offer.\textsuperscript{145} The Macmillan management snubbed Maxwell's continuing calls for negotiation and instead (and incredibly) agreed with KKR to push a KKR merger on the board "even though KKR had not yet disclosed to Evans and his group the amount of its bid."\textsuperscript{146} In addition, KKR was permitted to see financial documents, to which Maxwell was refused access.

Macmillan set several auction deadlines, but the gavel was reluctant to fall. Prior to one of these "deadlines" Evans called KKR and tipped them to Maxwell's competing offer and Wasserstein, in a separate call informing KKR of the impending deadline, referred to several specific terms that Macmillan needed in the bid. The KKR bid subsequently reflected this inside information. On top of that, Maxwell was led to believe he held the highest offer.\textsuperscript{147}

\begin{itemize}
\item \textsuperscript{142} \textit{Id.} The deal provided that "senior management would receive up to 20\% ownership in the newly formed company." \textit{Id.} at 1273.
\item \textsuperscript{143} Wasserstein Perella gave a valuation range of $63 to $68 per share. Lazard Freres valued Macmillan at $72.57 per share on a pre-tax basis. \textit{Id.} at 1270.
\item \textsuperscript{144} \textit{Id.} at 1273. This is not the only time Wasserstein Perella has issued seemingly one-sided opinions. In fact, it has been noted that, "[a]t such moments, Wasserstein is more salesman for a deal than he is the wise, cautious counselor. Little wonder his detractors—and even some of his admirers—have come to call him 'Bid-em-up Bruce.'" Fanning, "Bid-em-up Bruce?", \textit{FORBES}, Aug. 7, 1989, at 60 (the article specifically refers to the conflict of interest cited by the court in \textit{Interco} as well as the inside information supplied in \textit{Macmillan}). See also supra note 84.
\item \textsuperscript{145} "Undeterred, Maxwell indicated his intent and ability to prevail in an auction for the company, as 'nobody could afford to top a Maxwell bid due to the operational economies and synergies available through a merger of Maxwell's company with Macmillan.'" 559 A.2d at 1273.
\item \textsuperscript{146} \textit{Id.} (emphasis in original).
\item \textsuperscript{147} \textit{Id.} at 1283.
\end{itemize}
KKR's ultimate bid of $90.05 was a cash and securities deal conditional on the granting of lock-up and no shop agreements.\textsuperscript{148} Maxwell's bid at that time was $89 all cash. The board accepted the KKR offer. Thereafter, Maxwell made an offer of $90.25 subject to the invalidation of the KKR agreement and filed suit to enjoin it. The vice-chancellor refused to grant the injunction and the Delaware Supreme Court reversed.\textsuperscript{149}

The Delaware Supreme Court found the Macmillan board had been operating within the confines of Revlon, as they were conducting an auction for the sale of the company.\textsuperscript{150} Therefore, the directors had the "sole responsibility" to maximize shareholder value.\textsuperscript{151} The court reiterated that these duties are triggered "whether the 'sale' takes the form of an active auction, a management buyout, or a 'restructuring' such as that which the Court of Chancery enjoined in Macmillan I."\textsuperscript{152}

The court found the lock-up and no-shop agreements did not serve the purpose of maximizing shareholder value, and hence, the intrinsic fairness standard should be applied to the transaction.\textsuperscript{153} For not only were the actions of the directors unjustifiable on the basis of protecting shareholder value, but they were not reasonable in relation to any threat to shareholder interests.

The court applied the "fairness" test and found that "[c]learly, this auction was clandestinely and impermissibly skewed

\textsuperscript{148} See supra notes 55 and 66.

\textsuperscript{149} Id. at 1288.

\textsuperscript{150} The court also briefly referred to its previous determinations of when a company is for sale, specifically citing Ivanhoe Partners v. Newmont Mining Corp., 535 A.2d 1834 (Del. 1987) and Bershad v. Curtiss-Wright Corp., 535 A.2d 840 (Del. 1987). Macmillan, 559 A.2d at 1285 n.35.

\textsuperscript{151} At a minimum, Revlon requires that there be the most scrupulous adherence to ordinary principles of fairness . . . as [u]nder these special circumstances the duties of the board are 'significantly altered' . . . . The defensive aspects of Unocal no longer apply. The sole responsibility of the directors in such a sale is for the shareholders' benefit.

Macmillan, 559 A.2d at 1285.

\textsuperscript{152} Id. The court noted that "[a] refusal to entertain offers may comport with a valid exercise of business judgment . . . . Circumstances may dictate that an offer be rebuffed, given the . . . company's long term strategic plans." Id. at 1285 n.35.

The Court also summarized what factors may be considered in assessing a bid's particular threat. These included: feasibility, risk of non-consummation, and the bidder's identity. Id. at 1282 n.29.

\textsuperscript{153} "[W]hen directors in a Revlon bidding contest grant a crown jewel lockup, serious questions are raised, particularly where, as here, there is little or no improvement in the final bid . . . . [T]he use of [a no-shop clause] is even more limited than a lockup agreement." Id. at 1286.
NOTE — THE BOARD IS PARAMOUNT

in favor of KKR.\textsuperscript{154} "It violated every principle of fair dealing, and of the exacting role demanded of those entrusted with the conduct of an auction for the sale of corporate control."\textsuperscript{155}

Certainly, \textit{Macmillan} is an extreme case. The impropriety of the managing directors’ actions was self-evident. Yet, it illustrates how the \textit{Revlon} and \textit{Unocal} tests interrelate. Once the threshold of an "auction for the sale of control" of the corporation has been crossed, the court must review the transaction under \textit{Revlon}—the shareholder value maximization test—while the \textit{Unocal} test polices conduct of directors generally. Failing either of these tests leads to the application of the entire fairness test, which forgoes all presumptions in favor of the board.\textsuperscript{156}

The court clarified these issues as it felt there was some confusion on the point in the Court of Chancery\textsuperscript{157} by saying that

\textsuperscript{154} Id. at 1281.

\textsuperscript{155} Id. at 1283.

\textsuperscript{156} See supra note 10 and accompanying text.

\textsuperscript{157} "It is not altogether clear that, since our decision in \textit{Revlon} the Court of Chancery has explicitly applied the enhanced \textit{Unocal} standards in reviewing such board actions." \textit{Macmillan}, 559 A.2d at 1287.

In \textit{In re J.P. Stevens & Co.}, 542 A.2d 770 (Del. Ch. 1988), is an example of the Court of Chancery’s confusion in applying both \textit{Unocal} and \textit{Revlon}. The facts are as follows. In March 1988, three bidders were in an active bidding war to acquire control of J.P. Stevens & Co. (the three bidders were West Point-Pepperell, Inc., Odyssey Partners, and a vehicle of J.P. Stevens’ management, Palmetto, Inc.). Palmetto’s mixed cash and debenture offer was quickly out-paced by the all cash offers of West-Point and Odyssey. West-Point was a competitor of J.P. Stevens in several textile manufacturing fields whereas Odyssey Partners was not an operating company and did not have the internal capacity to replace the management of an ongoing business such as J.P. Stevens.

On March 13, West-Point’s offer stood at $62.50 per share with a $15 million fee payable to J.P. Stevens in the event of nonconsummation. Odyssey offered $61 per share, subject to financing. Stevens’ board of directors considered the proposals. They rejected West-Point’s higher offer based on legal and investment advice that possible antitrust problems could impair the value of the offer, and accepted Odyssey’s lower offer as a better deal because it was more likely to close and to close sooner. \textit{Id. at 773-76}.

West-Point formed a partnership that allegedly would eliminate any antitrust concerns, and on March 24, sent a letter to J.P. Stevens’ management expressing a willingness to pay $64 per share cash. On March 28, the J.P. Stevens’ board entered into a revised merger agreement with Odyssey at $64 per share. The revised agreement called for Odyssey to receive a “topping fee” of up to $8 million if their offer was exceeded and an expense reimbursement clause of up to $19 million. West-Point sued, claiming that J.P. Stevens’ directors had breached their fiduciary duties under \textit{Revlon}, and sought a declaratory judgment that the reimbursement and topping fees be declared invalid and to preliminarily enjoin completion of the Odyssey offer.

The chancellor noted that when a change in control is in the works, \textit{Revlon} recognizes a board’s duty to “achieve the best possible transaction for the shareholders.” \textit{Id. at 781}. However, he found that a board’s decision to give one bidder an advantage over the other, was protected by the business judgment rule. The chancellor noted that
the board’s “responsibilities” under Revlon did not preclude the function of their “enhanced duties” under Unocal. This refers to the board’s “responsibility” to maximize shareholder value during a sale of corporate control, but “[b]eyond that, there are no special and distinct “Revlon duties.” The court was saying that the board’s actions must be reasonable in relation to the threat posed, even in the context of an auction. In other words, if a corporation enters Revlon mode, the duties of the board of directors do not stop merely with the conduct of an auction. For, the Unocal test remains lurking in the trees of “scar[y] Revlon-land,” lest any unsuspecting director stray from the narrow path of their appointed task.

C. Revlon and Unocal Become Cultured in Time

In Paramount Communications, Inc. v. Time, Inc., the Delaware Supreme Court went beyond the mere clarification of the Unocal standard (as they purported to do) and substantially narrowed the scope of review under the Unocal standard.

In 1987, Time, Inc. began exploring expansion possibilities, and Warner Communications became the focus of these plans. At the Time directors meeting, on July 21, 1988, the board

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Revlon’s board had acted in bad faith and so had not been protected by the business judgment rule. The chancellor also noted, as a matter of law, that Unocal was inapplicable to the facts of the case because the board’s actions were not “corporate measures designed to defeat a threatened change in control.” Id. at 780.

This was a misreading of when the Unocal and Revlon standards apply and the error was corrected in Macmillan. Had Unocal and Revlon been applied, any unequal treatment of bidders, to be reasonable under Unocal, must have had the purpose of increasing share value under Revlon. In J.P. Stevens, despite his assertion that the J.P. Stevens’ board decision was protected under the business judgment rule, the chancellor undertook a detailed analysis to show that the tilting of the playing field in favor of Odyssey was reasonable in relation to the advantage that J.P. Stevens & Co. sought to gain. Id. at 782-83. As it turned out, the outcome would have been the same in both instances.

158 559 A.2d at 1288.
159 “When Revlon duties devolve upon directors, this Court will continue to exact an enhanced judicial scrutiny at the threshold, as in Unocal, before the normal presumptions of the business judgment rule will apply.” Id. See also Nachbar, Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc. - The Requirement of a Level Playing Field in Contested Mergers, and its Effect on Lock-ups and Other Bidding Deterrents, 12 DEL. J. CORP. L. 473 (1987).
160 See supra note 71.
161 571 A.2d 1140 (Del. 1990).
162 Time’s board was composed of four inside directors and 12 outside directors. Time’s inside directors were J. R. Munro, Time’s chairman and CEO; N. J. Nicholas, Jr., president and CEO of the company since 1986; Gerald Levin, vice-chairman of the
heard reports from senior management concerning a possible merger with Warner. The board approved continuing merger negotiations, but Time's governance agenda had to be satisfied. The board considered a Time-controlled management structure necessary for the continuation of "Time Culture." Although this complicated

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163 Management informed the board that Warner was the best partner for Time; that its successful movie studio, its presence in the music business and international distribution capabilities were suited to Time's objectives. They informed the board that they had reviewed Paramount, Disney, Twentieth Century Fox, Universal and other entertainment companies and concluded that Warner was the most desirable partner. 571 A.2d at 1144-45.

164 Warner's CEO, Steven Ross, insisted on the stock for stock merger to preserve Warner shareholder's equity in the resulting corporation. Id. at 1145.

165 The Delaware Supreme Court stated that:

The primary concern of Time's outside directors was the preservation of the "Time Culture." They believed that Time had become recognized in this country as an institution, built upon a foundation of journalistic integrity. Time's management made a studious effort to refrain from involvement in Time's editorial policy. Several of Times's outside directors feared that a merger with an entertainment company would divert Time's focus from news journalism and threaten the Time Culture.

Id. at 1143 n.4.

In the opinion below, the chancellor noted that "the firm has tended to reinterpret its mission from one of supplying information to a relatively educated market segment to one in which entertainment of a mass audience plays an important role." Paramount Communications, Inc. v. Time, Inc., [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94, 514, at 93,267 (Del. Ch.), aff'd, 571 A.2d 1140 (Del. 1989). Time's focus in the publishing field confirms this trend. In the first six months of 1989, magazine average circulation fell 7.3%, while Time, Inc.'s Sports Illustrated and People magazine circulation rose 9.7% and 2.1% respectively. In addition, Time, Inc.'s newest entrant into the publishing field is a magazine entitled Entertainment Weekly. Reilly, Wall St. J., Feb. 12, 1990, § A, at 4, col. 2. This is the legacy of the important literary tradition that was artfully portrayed as "Time Culture."

The Delaware Supreme Court trumpeted the importance of Time's governance agenda in protecting "Time Culture": "Time's officers, on the other hand, made it abundantly clear that Time would be the acquiring corporation and would control the resulting board." 559 A.2d at 1145. They then paradoxically agreed to a governing structure with a 24-member board of directors with the board equally divided between 12 former Time directors and 12 former Warner directors. The company would have co-CEO's, first Ross and Munro, then Ross and Nicholas, to be followed by Nicholas alone, after Ross' retirement. Id. Additionally, though Time was the acquiring corporation in terms of the mechanism employed in the transaction, Warner shareholders would have owned 62% of the resulting corporation.

166 The board decided that Time's important "Culture" and literary heritage could only be assured by Mr. Nicholas eventually becoming the sole CEO of the Time-Warner entity. Warner's CEO, Mr. Ross, balked when Time insisted that he set a retirement date. Eventually, however, Mr. Ross was persuaded to step aside five years after the
negotiations, the companies reached an agreement.

The merger was to be a stock for stock deal with Warner shareholders receiving a 12% control premium. On March 3, 1989, the boards of both companies authorized the agreement. To lock-up the deal, they agreed to exchange a specific number of shares at the option of either party. The Time board of directors fixed June 23, the date of the annual shareholders meeting, as the date the Time-Warner merger would be presented for shareholder approval.

On June 7, Paramount announced a conditional offer to purchase all outstanding shares of Time, Inc. common stock at $175 per share, cash. At the June 16 meeting, Time's board concluded that Paramount's $175 cash offer was inadequate and

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167 The merger agreement called for Warner to merge into a wholly owned Time subsidiary, with Warner as the surviving corporation. The common stock of Warner would then be converted into the common stock of Time, Inc. and the name of the surviving entity would be changed to Time-Warner. Delaware law only required that a majority of Warner's shareholders approve the merger because it was their stock being converted. However, New York Stock Exchange rules required a shareholder vote by Time's shareholders in response to the large amount of equity shares that Time was to issue pursuant to the agreement. Id.

168 Time essentially paid the premium in exchange for the eventual ascension of Mr. Nicholas as sole CEO, which in turn would protect the "Time Culture." Id. See also Paramount Communications, Inc. v. Time, Inc. [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,514 at 93,268 (Del. Ch. 1989).

169 If the exchange agreement was triggered, Warner would have acquired 11.1% of Time, Inc., and Time would have acquired 9.4% of Warner. 571 A.2d at 1146.

170 Id.

171 The conditions of the Paramount offer were: (i) termination of the Time-Warner transaction; (ii) termination of the share exchange agreement; (iii) Paramount's approval of transfers to Paramount by Time of its cable operations; (iv) redemption of Time's poison pill; and (v) judicial determination that the Delaware Anti-Takeover Statute was inapplicable. Despite this, Time stock jumped $44 per share in one day and was $60 per share higher in June than its highest price in March and April. Id. at 1147.

Time management sent a letter to the CEO of Paramount, attacking his personal integrity and motives. They also sought to delay the government approval process Paramount would have to engage in to acquire Time's cable television businesses. Id.

172 The board's determination was, in part, based upon June valuations of Time shares that were upward of $40 per share higher than March valuations by the same investment bank, Wasserstein Perella (the March range was $189.88 to $212.25 per share, while the June valuation was greater than $250 per share). Time's counsel responded that the June analysis was for a change in control market and the March analysis was for a different purpose (however, the March analysis also yielded a range for Warner of $64.39 to $72.87 per share, and Warner's June control market value, as evidenced by the revised transaction, was $70 per share). Paramount Communications, Inc. v. Time, Inc. [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,514 at 93,272 (Del. Ch. 1989). See supra text at note 144 (where Wasserstein Perella, advising target corporation's board, over a brief span of time, dramatically increased their per share valuation of the target
resolved to recast the Warner deal in a form that would not require the approval of Time's shareholders.\textsuperscript{175} The result was that Time and Warner recast the merger transaction into a friendly LBO. The economic terms of the deal were altered dramatically.\textsuperscript{174} As the transaction was now an LBO, Warner's shareholders were to receive a large control premium. The agreed upon price for Warner shares was $70 per share.\textsuperscript{175} The governance provisions, however, remained fairly static. The incumbent directors of each entity would combine to form the new board of directors, the co-CEO concept remained intact and Mr. Nicholas would eventually be the sole CEO. Warner also contractually bound Time to follow through with the merger.

On June 16, Warner's board approved the new form of the transaction. They also exercised their option to trigger the exchange of shares. June 23, Paramount increased their bid to $200 per share, cash. Time's board of directors met on June 26 and concluded, again, not to pursue a transaction with Paramount\textsuperscript{176} and to proceed with the Warner transaction.\textsuperscript{177} Paramount and several groups of Time shareholders filed motions seeking to enjoin the transaction. The shareholder plaintiffs argued that the original merger agreement constituted a change in control under \textit{Revlon} and, accordingly the directors had a fiduciary duty to maximize shareholder value. Paramount claimed that the recast merger agreement was subject to \textit{Unocal}, that it was an unreasonable response to Paramount's non-coercive tender offer, and thus

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\textsuperscript{173} 571 A.2d at 1148.

\textsuperscript{174} The cash acquisition format created a highly leveraged Time-Warner entity with $7-10 billion worth of debt. \textit{Id.}


\textsuperscript{176} The most significant factors the board weighed in reaching their decision was their belief that the Paramount offer was inadequate (\textit{see supra} note 171) and that the Warner transaction was of greater value and did not pose a threat to "Time Culture." 571 A.2d at 1148.

\textsuperscript{177} The long-term per share valuation ranges of the re-cast Time-Warner LBO, given to the board at the June 16 meeting were as follows: 1990 - $106 to $188; 1991 - $159 to $247; 1992 - $230 to $332; 1993 - $208 to $402. The maximum value of each range, discounted to present value at 20% (conservative, given the time value of money and the highly speculative nature of the maximum range values) all yield a present value less than Paramount's $200 per share offer.

The chancellor noted that the 1993 range was one "that a Texan might feel at home on." Paramount Communications, Inc. v. Time, Inc. [Transfer Binder] Fed. Sec. L. Rep. (CCH) 194,514 at 93,272-73 (Del. Ch. 1989). \textit{See supra} note 144.
should be enjoined to allow shareholders to choose between the transactions.178

1. The Chancellor’s Decision

In the Court of Chancery, Chancellor Allen approached the Revlon issue as a question of whether there was a “change in control” of Time. As no single shareholder would gain or lose a controlling interest in the company, he ruled that Revlon was not triggered because the transaction did not constitute a change of control of the corporation. “Control of both [Time and Warner] remained in a large, fluid, changeable and changing market.”179

With regard to the Unocal issue, the chancellor found the “overarching” question was “[u]nder what circumstances must a board of directors abandon an in-place plan of corporate development in order to provide its shareholders with the option to elect and realize an immediate control premium?”180 This led the chancellor into a detailed discussion of valuations and projections, a course he had taken before in Interco. Under this analysis Time’s per share valuation was determinative of whether the board’s actions were reasonable in response to the threat posed by the Paramount bid. Given the slippery world of valuations,181 the plaintiffs made an argument based on the efficient market theory, that current market values for the shares are the appropriate basis for the court’s decision as they accurately reflect the discount to present value of the prospects of the entity. The chancellor asked,

does it make any sense, given what we understand or think we understand about markets, to posit the existence of a distinction between managing for current value maximization and managing for longer term value creation—a distinction which implies, unless I am wrong, that current stock market values fail to reflect “accurately” achievable future value?182

The chancellor, after paying some lip service to the possibility of the accuracy of the efficient market hypothesis, dispensed with the theory in Holmesian fashion. “But just as the Constitution does not enshrine Mr. Herbert Spencer’s social statics, neither

178 571 A.2d at 1149.
180 571 A.2d at 1149 (as described by the Delaware Supreme Court.).
181 See supra notes 144 and 177.
does the common law of director's duties elevate the theory of a single, efficient capital market to the dignity of a sacred text."\textsuperscript{183}

That said, the chancellor proceeded with the application of \textit{Unocal}. He found that the Paramount offer was a threat to Time's corporate culture and that the valuation of Time by its board and their refusal to entertain the Paramount offer on that basis was a reasonable response to the threat.

The chancellor's decision was a logical result of the \textit{Unocal} case law. On its face, the holding that there would be no change in control, even though 62\% of the resulting company would be held by Warner shareholders, seemed puzzling. However, the \textit{Interco/AC Acquisitions} approach mandated a specific change of control analysis, and under most formulations this would not qualify.\textsuperscript{184} The rest of the opinion followed previously charted waters. Nonetheless, the Delaware Supreme Court, though it affirmed the chancellor's decision, came down quite differently on the interpretation of the \textit{Unocal/Revlon} standards.

2. The \textit{Revlon} Assertion

The Delaware Supreme Court began, as did the chancellor, with the \textit{Revlon} claim. The court took this opportunity to clarify when \textit{Revlon} duties apply. First, the court refused to accept the

\textsuperscript{183} \textit{Id.} at 93,277. The chancellor noted that "an observer blessed with perfect foresight" may have concurred with the market valuation. However, the question is not whether a director or an observer has perfect insight into the future value of a corporation. But, rather, whether the market efficiently values stocks in terms of future potential. If so, there is no reasonable argument for a director to base his opinion on anything other than public market value maximization.

Obviously, the chancellor, even if he had found the argument convincing, could not endorse what is known as the "semi-strong" efficient market theory. (The relevant aspects of the theory posit that the market for shares accurately reflects the value of the company—including future earnings, etc.—discounted to present value.) Assuming the theory is correct, the logical result of the chancellor's \textit{Interco} type analysis would be to force directors into a kind of \textit{Revlon} mode at all times. Any decision that arguably did not maximize immediate shareholder value would be difficult to justify as the director could no longer claim there was an overriding corporate purpose to the transaction for long term gain. Though a director's actions are judged daily on the floors of the exchanges, in that situation the judgment would have a direct impact on the liability of the director.

However accurate the efficient market theory may be, it is an untenable policy position for a state court to maintain—at least untenable for those courts who would seek to encourage corporate activity in their state. The chancellor could do no other than find that "[d]irectors may operate on the theory that the stock market valuation is 'wrong' in some sense, without breaching faith with shareholders." \textit{Id.}

chancellor’s discussion of the “change in control” of a corporation as the trigger for Revlon duties. The court here shifted the focus to whether the target company made the “dissolution or breakup of the corporate entity inevitable.”

Taking care not to limit Revlon’s application to specific terms, the court stated that Revlon only applies when a corporation either places itself or its assets up for sale voluntarily or, in response to a hostile bidder, offers an alternative “bust-up” transaction itself. The court reiterated that Time had adhered to its strategic plan and had not made a sale of the company inevitable. The court underscored the limits it was placing on Revlon, by saying “we decline to extend Revlon’s application to corporate transactions simply because they might be construed as putting a corporation either ‘in play’ or ‘up for sale.’”

Defenders of the corporate bastion can breathe a sigh of relief. Scary Revlon-land has been confined to a remote region of the takeover landscape. The court made it clear that Revlon will not be triggered inadvertently. The subjective intent of directors, a change in control and the adoption of structural safety devices will not, by their mere existence, trigger Revlon. In fact, the only situations this court mentions as relevant to Revlon are “bust-up” transactions and auctions of a company. Both of these situations have always been considered the obvious Revlon trig-

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185 Paramount Communications, Inc. v. Time, Inc., 571 A.2d 1140, 1150 (Del. 1989). This language was that originally advocated in the Revlon decision. However, both phrases have been a part of the subsequent case law and literature for some time. This new focus enabled the court to avoid the “large fluid pool” analysis employed by the chancellor. It also underscores the court’s narrowing of Revlon as the threshold of when the “dissolution or breakup” of a company becomes inevitable is significantly higher than the “change in control analysis”. See also infra note 186.

186 The court was careful to leave the back door wide open by stating that “generally speaking and without excluding other possibilities, two circumstances . . . may implicate Revlon duties.” 571 A.2d at 1150.

187 See infra text accompanying note 239.

188 571 A.2d at 1151. The holding clarifies Newmont, where an agreement allowing the purchase of just less than 50% of the stock in the company was deemed not a sale of control. The court cited Newmont as a clear case where the company’s actions were “only a defensive response and not an abandonment of the corporation’s continued existence . . . .” Id. at 1150. Time added that if control of the company is held in a “large fluid pool,” or in some way that avoids the inevitability of the break-up of the company, Revlon will not be triggered despite the sale of more than 50% of the company.

189 Referring to the directors’ concern that Time “may be up for sale” the court said that “such evidence is entirely insufficient to invoke Revlon duties.” Id. at 1151. This concern, as well as the defensive devices, “are properly subject to a Unocal analysis.” Id.

190 See infra text at note 239.
gers. The literature, rather, had focused on what constitutes sale of control for Revlon purposes.\footnote{See Gilson & Kraakman, supra note 184. The article referenced was written after the chancellor’s decision in Time, but before the Delaware Supreme Court’s opinion was published, in March of 1990. The article focused on the proper method of determining change of control for purposes of triggering Revlon. See also supra note 76.}

3. \textit{Unocal}’s Application: The First Prong

Next, the court turned to the \textit{Unocal} analysis of the transaction, with similarly sweeping reforms. The court began by giving the distinct impression that the “just say no defense”\footnote{“We have repeatedly stated that the refusal to entertain an offer may comport with a valid exercise of a board’s business judgment.” 571 A.2d at 1152. See Prentice & Langmore, \textit{Hostile Tender Offers and the “Nancy Reagan Defense”: May Target Boards “Just Say No”? Should they be allowed to?}, 15 \textit{Del. J. Corp. L.} 377 (1990). But see Gilson, \textit{Just Say No To Whom?} 25 \textit{Wake Forest L. Rev.} 121 (1990).} is alive and well. But, more explicitly, the court rejected the bases for most of the attacks on the “just say no” defense. The court referred to Court of Chancery cases where it was held that whatever threat existed “related only to the shareholders and only to price and not the corporation.”\footnote{571 A.2d at 1152. The reference was to City Capital Assoc. v. Interco, Inc., 551 A.2d 787 (Del. Ch. 1988); AG Acquisitions Corp. v. Anderson, Clayton & Co., 519 A.2d 103 (Del. Ch. 1986); and Grand Metro. Pub. Ltd. v. Pillsbury Co., 558 A.2d 1049 (Del. Ch. 1988).} These decisions held that all-cash, all-shares offers were not coercive and therefore not a threat to the corporate entity. This led to the ultimate conclusion that the court must inquire whether the valuations of the company were reasonable and whether the target board’s response was reasonable in light of the valuation of shares. \textit{Van Gorkom}\footnote{Smith v. Van Gorkom, 488 A.2d 858 (Del. 1985)} had long ago made valuation studies by investment bankers \textit{de rigueur} in sale of asset situations to determine the reasonableness of board action. These cases expanded on this proposition finding that if the outside bidders came in at a higher price than what the target company’s board reasonably believed was the target’s value, the board’s duty to shareholders demanded that the board at least give shareholders the opportunity to accept such an offer. This was, as shown above, the chancellor’s approach in the court below.

The Delaware Supreme Court specifically rejected this approach taken in \textit{Interco} “and its progeny”\footnote{Paramount Communications, Inc. v. Time, Inc., 571 A.2d 1140, 1153 (Del. 1989).} where the court was put in the position of determining what was the better deal for
the shareholder: staying with the current management, or taking
the outside offer. The court cut short this entire discussion of
long term versus short term value maximization to which the
chancellor had given much time. "Thus, the question of 'long-
term' versus 'short-term' values is largely irrelevant because direc-
tors, generally, are obliged to charter a course for the corporation
which is in its best interests without regard to a fixed investment
horizon."

Recent cases interpreting Unocal had seemed to indicate that
a board's powers were limited when confronted with an all-cash,
all-shares, tender offer. However, the court rejected the idea
that no threat, other than one to shareholder value, existed.
The court recognized Gilson and Kraakman's analysis of the
threats that may be posed under Unocal, and implied it was
utilizing the "substantive coercion" prong in its decision, noting
that the authors "suggest [the substantive coercion analysis] would
help guarantee that the Unocal standard becomes an effective inter-
mediate standard of review."

Structural coercion, as defined by Gilson and Kraakman, has
always been recognized by the court, while Time represents a clear
case of substantive coercion. But the court refused to treat it any

196 "[I]t would involve the court in substituting its judgment for what is a 'better'
deal for that of a corporation's board of directors. To the extent that the Court of
Chancery has recently done so in certain of its opinions, we hereby reject such approach
as not in keeping with a proper Unocal analysis." Id.
197 See supra notes 182-83.
198 571 A.2d at 1150.
199 See City Capital Assoc. v. Interco, Inc., 551 A.2d 787 (Del. Ch. 1988); AC Acquisi-
tions Corp. v. Anderson, Clayton & Co., 519 A.2d 103 (Del. Ch. 1986); Mills Acquisi-
200 "[T]he only conceivable threat, plaintiffs argue, was inadequate value. We disap-
prove of such a narrow and rigid construction of Unocal . . . ." 571 A.2d at 1153
(footnote omitted).
201 Under Gilson and Kraakman's analysis there are three cognizable threats under
Unocal:

(i) opportunity loss, or the [AC Acquisitions] dilemma that a hostile offer might
deprive target shareholders of the opportunity to select a superior alternative
offered by target management; (ii) structural coercion, or the risk that disparate
'treatment of non-tendering shareholders might distort shareholders' tender deci-
sions; and, finally, (iii) substantive coercion, or the risk that shareholders will mis-
takenly accept an underpriced offer because they disbelieve management's repre-
sentations of intrinsic value.

See Gilson & Kraakman, supra note 23, at 267 (emphasis in original). The court in Time,
quoted the bulk of this passage. 571 A.2d at 1153 n.17.
202 571 A.2d at 1153 n.17 (emphasis added).
differently. Gilson and Kraakman state that for a court to fairly recognize the substantive coercion element it must proceed with a detailed valuation analysis. The court effectively rejected this when it stated that valuation was not an issue the court would review.

Indeed in our view, precepts underlying the business judgment rule militate against a court's engaging in the process of attempting to appraise and evaluate the relative merits of a long-term versus a short-term investment goal for shareholders. To engage in such an exercise is a distortion of the Unocal process.

(So much for the court invoking the Gilson and Kraakman "guarantee.")

In addition, the Time board could reasonably view the ignorance of their shareholders as part of the threat of Paramount's offer. That shareholders purportedly could not comprehend the business synergies involved in the Time-Warner combination was viewed by the court as a legitimate basis for director concern in evaluating the threat. Added to this was the allegation that the timing of the offer was an attempt to disrupt the Time shareholder vote. The Court held that both of these factors could reasonably be viewed as threats to "corporate policy and effectiveness."

4. The Second Prong

Time's response to Paramount's threat was restructuring the Warner transaction into an LBO with $10 billion of new debt. The court stated, "management actions that are coercive in nature or force upon shareholders a management sponsored alternative to a hostile offer may be struck down as unreasonable and non-proportionate responses." This statement, viewed in isolation, could be looked upon with optimism by shareholders. However, the Delaware Supreme Court has only held an alternative coercive if the it precludes the tender offer. Merely having a significant anti-takeover effect does not make a board's defensive response a

203 This valuation would include a demonstration, by management, of how and when management expects a target's share value to exceed the offer. See Gilson & Kraakman, supra note 23, at 268. The court apparently found this element of "substantive coercion" superfluous. 571 A.2d at 1153.
204 Id.
205 Id.
206 Id. at 1154.
preclusive alternative.\footnote{207} The court drew a distinction between defensive actions which are merely management-sponsored alternatives and defensive actions which promote a corporate plan. "Directors are not obliged to abandon a deliberately conceived corporate plan for a short-term shareholder profit unless there is clearly no basis to sustain the corporate strategy."\footnote{208} Time's purchase of Warner, although a defensive response, was part of Time's corporate plan. The response was \textit{proportionate}, $10$ billion of debt notwithstanding, "so long as the directors could reasonably perceive the debt load not to be so injurious to the corporation as to jeopardize its well being."\footnote{209} Accordingly, a board's defensive response with significant anti-takeover effect (that is, as a practical matter, preclusive), that is related to a pre-conceived plan and doesn't appear to put a company into bankruptcy, is reasonable.

\textit{Time} not only solidified the notion that a response just short of precluding a tender offer is reasonable, but also provided a new weapon in the board's arsenal. The board may point to a corporate plan as justification for its practically preclusive actions as it is merely taking the steps necessary to pursue its pre-existing corporate policies.\footnote{210}

\footnote{207} See \textit{supra} notes 93, 117-20 and accompanying text.

\footnote{208} 571 A.2d at 1154. It appears that for a corporation's defensive response to be unreasonable, so long as it was consistent with its corporate plan, and not preclusive, the corporation would have to be in \textit{Revlon} mode.

\footnote{209} Id. at 1155.

\footnote{210} A previous Chancery court case, Grand Metro. Pub. Ltd. v. Pillsbury Co., 558 A.2d 1049 (Del. Ch. 1988), is instructive in showing how \textit{Time} has defined the parameters of the \textit{Unocal} rule. The court in Pillsbury followed the chancellor's now discredited reasoning in \textit{Interco} and ruled a board's actions unreasonable in relation to a takeover threat.

In May 1988, Pillsbury became aware of Grand Metropolitan's interest in acquiring them and began formulating alternative transactions. Grand Metropolitan, in October 1988, began a fully financed tender offer for all common stock of Pillsbury Co. that rose to $63 per share, all cash. The offer was about 60\% more than the closing price of Pillsbury on September 30, 1988. On October 17, the Pillsbury board met and unanimously rejected Grand Metropolitan's offer as inadequate. They also declined to redeem their outstanding poison pill. \textit{Id.} at 1052.

In addition, the Pillsbury board had developed a plan which, it said, produced better long term value for its shareholders. The plan included: (i) a spin-off of a fast food subsidiary (Burger King) into an independent, privately held company; (ii) a sale of its Steak & Ale restaurants for cash within six months; (iii) a sale of other food businesses not specified; and (iv) a sale of both Burger King and the remains of Pillsbury within the next 2\% to 5 years. \textit{Id.} at 1057.

Pillsbury's experts maintained that shareholders would realize a present minimum value of $68 per share but would have to wait until 1992 or 1993 to realize it. There were no competing offers for Pillsbury. As in \textit{Interco}, the litigation surrounded the target
IV. THE STRUCTURE AND PARAMETERS OF THE UNOCAL STANDARD THROUGH PARAMOUNT V. TIME

From this substantial line of cases the Unocal standard has developed a distinct structure of application, though some of the parameters of the duties within that structure remain fuzzy. The period of development has been short for a significant common law standard of review, but its gestation was necessarily accelerated by the pace of events in the corporate world of the past decade. The Time opinion caps a significant segment of the development of Delaware common law with regard to takeover defense tactics.

The court applied the Unocal standard of review to the actions of Pillsbury’s board. The tender offer had caused an increase of $1.5 billion in the market value of the shares of Pillsbury. According to the court, the real threat to shareholder value, in such a situation, was the possibility of the tender offer being withdrawn. With no competing offers to support the price, the stock would, in all likelihood, plummet back to its September value. The Board’s action, leaving the poison pill in place, was not reasonable in relation to the threat posed. Therefore, under the Intero interpretation of Unocal, the decision to keep the pill in place was not protected by the business judgment rule. Id. at 1060.

With regard to the spin-off of Burger King, the court found that to allow it to occur before the litigation had ended would “invite chaos.” Id. at 1061. The court enjoined the board’s decision to restructure the company by spinning-off Burger King. Pillsbury’s board was thwarted and the sale to Grand Met was completed shortly thereafter.

However, the court, relying on Intero, was on (what turned out to be) shaky ground. A correct application of Unocal (as defined in Macmillan and Time) might have gone as follows. First, Pillsbury had abandoned their long-term strategy and, in the face of the tender offer, were seeking to break-up and sell the company. Pillsbury was in Revlon mode. Pillsbury’s board had a duty to maximize short-term shareholder value. Second, Pillsbury’s poison pill and spin-off of Burger King must have been, under Unocal, reasonable in relation to the advantage sought, clearing the way for the application of their Revlon duties. The poison pill would be reasonable if it could fairly be said to be a bargaining tool to obtain a higher price. The spin-off, as an effort to delay shareholder value recovery until 1993, would not be reasonable under Unocal given the board’s Revlon duty to maximize short-term value, assuming that five years would not be within the scope of what the court meant by “short-term.” Regardless of its legal method, the result in the Court of Chancery in Pillsbury was probably the same as if the proper Unocal/Revlon course had been followed.

211 Gilson and Kraakman have noted their concern that the development of this important standard has occurred without benefit of substantive and reflective commentary. Their piece was an attempt to interject such commentary into the process. Specifically, they encouraged a more substantive review under the reasonable response prong of the test which they refer to as the “proportionality test.” See Gilson & Kraakman, supra note 23, at 248 and 274.
A. The Structure of the Unocal Standard

Through the Macmillan and Time opinions, the Delaware Supreme Court has more sharply delineated the interplay of the duties of care and loyalty.\(^{212}\) A short walk through the mechanics of review as it now stands, before getting into the specifics of the standard, may prove helpful.

*Unocal* provides the standard for judicial review of board actions taken in response to a hostile takeover attempt, or even a perceived takeover threat.\(^{213}\) Applying the first prong of *Unocal*, the inquiry is whether there exists a threat to corporate policy and effectiveness.\(^{214}\) Unlike the business judgment rule, the burden of proof throughout *Unocal* is on the board of directors.\(^{215}\) If there is a cognizable threat the inquiry moves to the second prong of the *Unocal* analysis. If there exists no threat to the corporation, the only threat being that to immediate shareholder value (as in the case of a sale of assets or a bust-up sale), then the inquiry shifts to a *Revlon* analysis.\(^{216}\)

The *Revlon* analysis is a sub-set of the *Unocal* standard, which effectively shifts the focus of the inquiry without leaving the purview of the original test. Under *Revlon*, defensive actions are impermissible unless they serve to maximize immediate shareholder value.\(^{217}\) Most basically, this means the board must auction the company to the highest bidder. The conduct of the auction however, is still within the scope of the *Unocal* test, as there remains the possibility of director self-interest throughout. Under these circumstances, the Delaware Supreme Court has mandated that the directors either secure a level playing field for all bidders or, if the playing field is tilted, that the tilting is subjected to a

\(^{212}\) See supra text accompanying notes 156 and 188.
\(^{213}\) See supra text accompanying note 46.
\(^{214}\) Paramount Communications, Inc. v. Time, Inc., 571 A.2d 1140, 1152 (Del. 1989).
\(^{215}\) In Comment, Judicial Review of Antitakeover Devices Employed in the NonCoercive Tender Offer Context: Making Sense of Unocal, 138 U. PA. L. REV. 225 (1989), the author seems to confuse the duties of loyalty and care in terms of when the intrinsic fairness test applies. The lower courts have done this as well. See supra note 153. However, it is important for the proper understanding of the mechanics of the interrelationship of these duties to make certain distinctions. Primarily, the business judgment rule is associated with the duty of care and the intrinsic fairness test is associated with the duty of loyalty. The *Unocal* test stands as the threshold test between them in the case of actions taken in response to takeover threats, where both duties necessarily come into play. See infra notes 245-46 and accompanying text.
\(^{216}\) See infra text accompanying note 239.
Unocal analysis.\(^{218}\)

The second prong of Unocal asks whether the response was reasonable in relation to the threat posed. If the court finds the response reasonable, the board is given the protection of the business judgment rule. The business judgment rule standard (essentially: whether the directors were grossly negligent)\(^{219}\) has, for all practical purposes, been satisfied by the previous inquiry, and further review is unnecessary.

If, on the other hand, the response of the board is found unreasonable, the directors' actions are reviewed under the intrinsic fairness standard.\(^{220}\) In this case, the court reviews the transaction for fairness, fully substituting its judgment for that of the board.\(^{221}\)

B. The Range of Threats

As the cases have shown, the Unocal threat prong has been reduced to a brief litany. The threat prong is specifically that "the burden will lie with the board to prove . . . reasonable grounds for believing that a danger to corporate policy and effectiveness existed."\(^ {222}\) The court always follows this statement with language from Cheff, "[d]irectors satisfy the first part of the Unocal test by demonstrating good faith and reasonable investigation."\(^ {223}\) The question is what sorts of situations give rise to reasonable grounds for believing such a danger exists.

The type of threat most readily discernible is the "coercive threat." Coercive threats are those considered to force shareholders to tendering into an offer. Two-tier freeze-out mergers are the quintessential example. Clearly, where the shareholder is threatened with the possibility of receiving junk bonds if they wait to

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218 See supra text accompanying note 154. The playing field may be tilted if the purpose is to secure greater value for shareholders. "[W]hile those lock-ups which draw bidders into a battle benefit shareholders, similar measures which end an active auction and foreclose further bidding operate to the shareholders detriment." Mills Acquisition Co. v. Macmillan, Inc., 559 A.2d 1261 (Del. 1988) (quoting Revlon, 506 A.2d at 183).

219 See supra note 13 and accompanying text.

220 This is derived from the duty of loyalty owed shareholders by directors. See supra note 16.

221 See supra note 75.


223 Id. "Directors satisfy their burden by showing good faith and reasonable investigation; the directors will not be penalized for an honest mistake of judgment, if the judgment appeared reasonable at the time the decision was made." Cheff v. Mathes, 41 Del. Ch. 494, 506, 199 A.2d 548, 555 (1964).
tender into the back end of the offer while the front-end receives cash, the shareholder is substantially coerced to tender early. This has been labeled by Gilson and Kraakman as "structural coercion, or the risk that disparate treatment of non-tendering shareholders might distort shareholders' tender decisions." This type of coercion has long been recognized by the courts as a serious threat to both corporate and shareholder interests.

Nevertheless, there are other situations where shareholders may be led to accept inadequate offers, or where the threat of an inadequate offer tends to preclude a rational choice as to whether to tender into the offer or not. This occurred in AC Acquisitions where the chancellor referred to the first prong of the test as "a particularization of the more general requirement that a corporate purpose, not one personal to the directors, must be served by the [defensive action]." The language appears to recognize that the threat prong of the test is essentially the Cheff "policy conflict/primary purpose" test which merely required directors to identify some conflict with the potential acquirer with regard to a valid corporate policy.

The Time opinion solidifies the Cheff approach to the threat prong. The court endorsed the Time board's contention that continuing a long term business strategy was a valid corporate purpose and a threat to the existence of that strategy was a threat under Unocal. Under this characterization of the threat prong it would be difficult at this point for a board to be unable to articulate a threat to corporate policy and effectiveness. Merely the threat to a properly prepared, long-term business plan will enable the board to point to a cognizable threat. Even shareholder ignorance with regard to a corporate strategy is a threat, as shareholders, unaware of the facts at the disposal of the board, may not have the information necessary to make rational decisions. Thus, threats to corporate policy and effectiveness in-
clude offers that may disrupt an ongoing corporate plan that the board views as more valuable "without regard to a fixed investment horizon." In essence, almost any tender offer can be found to constitute a legally cognizable threat to corporate policy and effectiveness. In addition, the board, even after the fall of the house of Drexel, in most instances will be able to claim that the potential threat of hostile offers exist in the particular industry, regardless of the threat of an actual tender offer.

C. Proportional or Merely Reasonable in Relation?

The Delaware Supreme Court has made it clear that preclusive actions by the target board are not a reasonable response. However, to be considered as such, the board's response must be absolutely preclusive. In *Time*, the merger with Warner was, for all practical purposes, preclusive. Nonetheless, the court cited the RJR Nabisco deal as evidence that it was possible for some acquirer to bid for the resulting Time-Warner entity.

Gilson and Kraakman have argued that for *Unocal* to be more than just a speed bump in the race to the bottom, in the second prong of the test, the court must actually weigh the proportionality of the response to the threat. However, their remonstrations have gone unheeded. Instead, the Delaware Supreme Court demonstrated in *Time* that as long as there is a threat of some kind to corporate policy and effectiveness, then any defensive strategy short of precluding the acquisition entirely is reasonable. The court specifically rejected a valuation method analysis of the response. Such an analysis would require a "showing of

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229 571 A.2d at 1150. Recall that the chancellor found that the board placed preservation of "Time Culture" ahead of any strategic benefits that a merger with Warner could have provided. See supra note 166 and accompanying text. See also Paramount Communications v. Time Inc., [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94, 514 (Del. Ch.), aff'd, 571 A.2d 1140 (Del. 1989).


231 See supra notes 96-106 and accompanying text.

232 571 A.2d at 1154-55. One wonders how persuasive this argument would sound today after the collapse of the junk bond market.

233 See supra notes 199-204 and accompanying text. Gilson and Kraakman were likely well aware that it was late in the day to persuade the Delaware courts to give real substance to the *Unocal* standard. Though the court did use the term "proportional" in *Time* it will likely give rise to no more than a semantic application.

234 See supra notes 205-210 and accompanying text.
how—and when—management expects a target's shareholders to do better." The court declined to take up this approach by saying that the “investment horizon” of the valuation is up to the board. It is unnecessary for the directors to show “how and when” they expect greater value to materialize for the shareholder.

The Delaware Supreme Court's rejection of the Interco/AC Acquisitions analysis makes it clear that Unocal does not provide a meaningful proportionality review of a board's response to a takeover threat. In fact, as long as the board remains within the scope of reasonable action—just short of precluding non-management alternatives—their business judgment as to the response will be protected. The specific relationship of the response to the level of threat appears to be meaningless. For, as in Time, the threat posed by Paramount's offer was of the lowest level, yet Time's "reasonable" response was practically preclusive.

D. The Revlon Trigger

The Delaware Supreme Court in Time found that there are at least two (and maybe only two) circumstances in which a board of directors may find itself subject to Revlon duties.

The first, and clearer one, is when a corporation initiates an active bidding process seeking to sell itself or to effect a business reorganization involving a clear break-up of the company. However, Revlon duties may also be triggered where, in response to a bidder's offer, a target abandons its long-term strategy and seeks an alternative transaction also involving the breakup of the company . . . . If, however, the board's reaction to a hostile tender offer is found to constitute only a defensive response and not an abandonment of the corporation's continued existence, Revlon duties are not triggered, though Unocal duties attach.

This constitutes, in sum, the Revlon trigger. The standard's history further illustrates this holding. In Revlon, the court first recog-
nized the fact that when sale of the corporation has become inevitable there exists only the threat to shareholder value. Time underscored that the Revlon duties are not conferred upon the board unless there is "substantial evidence" to suggest the "dissolution or breakup of the corporate entity was inevitable."\textsuperscript{240} Newmont, on the other hand, illustrated how high this threshold of "inevitability" is—as an agreement for control of just less than 50% of the company by a single entity and the sale of substantial assets did not trigger Revlon. In Time, though over 60% of the company was transferred to new shareholders, it was not deemed a dissolution or breakup and therefore did not trigger Revlon. Additionally, Macmillan clarified that Revlon was yet a subset of Unocal and that directors continue to be held to that standard when acting in Revlon-mode.

The court in Time reiterated that in the Revlon situations cited above, the board no longer faces a threat to corporate policy and effectiveness.\textsuperscript{241} The corporation is terminating its existence so no threat to it can exist. Without such a threat defensive tactics are impermissible, except to increase shareholder value.\textsuperscript{242} Actions that can reasonably lead to an increase in the share price in an auction for the sale of the company will be upheld.

Though the court in Time was careful to protect its flank when delineating at least two Revlon situations,\textsuperscript{243} the Revlon trigger can be reduced to the absence of a threat to corporate policy in the context of a takeover. If there is no threat, there can be no reasonable response other than to maximize shareholder value. Consequently, board action that fails to maximize shareholder value will be reviewed under the intrinsic fairness test. Of course, practically speaking, given the court's present formulation of a Cheff-type threat, outside of the Revlon triggers delineated by the court in Time, most boards will be able to identify a sufficient threat to preclude such drastic review, at least initially.\textsuperscript{244}

\textsuperscript{240} 571 A.2d at 1150 (emphasis added).
\textsuperscript{241} Id. at 1150 n.13.
\textsuperscript{242} See supra note 157 and accompanying text.
\textsuperscript{243} 571 A.2d at 1150.
\textsuperscript{244} "The adoption of structural safety devices alone does not trigger Revlon. . . . [S]uch devices are properly subject to a Unocal analysis." Id. at 1151. Though the court precludes "safety devices" alone from triggering Revlon that does not mean that safety devices adopted in the complete absence of a threat would not trigger Revlon. But, as discussed above, it is almost impossible to imagine a situation where there would be a complete absence of threat to the corporate entity.
E. Unocal: Threshold Test

Due to the lack of any real inquiry into the specific proportionality of an action in response to a threat to corporate control, Unocal is no more than a threshold test. A threshold test is an appropriate response to the tension between the duties of care and loyalty—the business judgment rule and the intrinsic fairness test. When adjudicating the propriety of directors' actions with regard to a particular threat to corporate policy, it would be premature for a court to proceed with a detailed analysis of the "proportionality" of their actions. This is because it would be, albeit in a limited way, substituting its judgment for that of the board—a modified fairness test. Instead, what is required (and what the court has formulated) is an initial test to determine whether the business judgment rule or the intrinsic fairness test should be applied. Unlike the business judgment rule, the burden is on the directors to prove the existence of the threat and the reasonable response; and unlike the fairness test, the directors' good faith judgment is given deference. Though some commentators have argued for more "substantive" review at this stage, the danger is that the court will be forced to wade into rather deep and uncharted waters.

For similar reasons, the Delaware Supreme Court in Time wisely removed itself from the discussion of valuation and scope of investment issues. Disputes in this area do not lend themselves to bright lines. Interjecting further into the judicial process the opinions of those who make valuations for a living cannot serve any useful purpose. Without any meaningful possibility of

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245 If the proportionality standard is a threshold test, any hostile offer that is arguably coercive would give management a free hand without further scrutiny by the courts. By contrast, if the standard is a regulatory test, management would be forced to justify its choice of defensive actions by reference to the amount of coercion associated with a particular bid.

Gilson & Kraakman, supra note 23, at 254. Gilson and Kraakman also point to the AC Acquisitions opinion for support of the "regulatory test." However, the court held that the management "alternative" was "preclus[e] as a practical matter," AC Acquisitions v. Anderson Clayton & Co., 519 A.2d 103, 113 (Del. Ch. 1986). The Time holding provides no basis from which to build a more relational test. See also Comment, supra note 215 (The author advocates a formula for use in determining proportionality. Unfortunately, the Time decision has plainly made such valuation determinations irrelevant.).

246 See supra note 144 and accompanying text. Besides, after Van Gorkom, sometimes called the "Investment Bankers Relief Act of 1985," do investment banks really need more involvement in the process?
clarifying this problem through scrutiny of the relative values of competing strategies offered by targets and acquirers, a threshold inquiry is a "reasonable response."

V. CONCLUSION

It may have been merely a coincidence that Pennsylvania was in the process of approving the nation's most aggressive anti-takeover legislation just before the publication of the *Time* opinion. But, the race to the bottom is not merely a theoretical construction of academicians and corporate lawyers. Rather, it is an important race for Delaware in terms of shaping its internal policy. The substantial legal economy and the inordinate amount of attention drawn to the state by the presence of so many corporations is not something that Delaware will easily relinquish.

The Delaware Supreme Court was obviously aware of these considerations when writing the *Time* opinion. And, there will no doubt be those who will say the direction taken by the court in *Time* was in large measure a result of the fact that it was an important time to send the message to America's boardrooms that Delaware still stood firmly behind them.

The *Time* opinion was, instead, necessitated by the deep doctrinal waters the Court of Chancery had waded into in *Interco* and *AC Acquisitions*. As shown above, those decisions mandated the judicial economic evaluation of competing offers and management alternatives. This is an area where bias runs rampant, and the experts rarely agree. Even the sophisticated corporate judiciary of Delaware would find it difficult to draw any reliable lines. The path the Chancery court was forging (at the urging of Gilson and Kraakman) was bound to lead the judiciary of Delaware over their heads into a sea of theories and formulas that produce questionable results at best. The Delaware Supreme Court deftly extricated itself from this danger by holding that the entire discussion is irrelevant—management is the sole arbiter of the investment horizon of the company. In this important area of corporate law, a bright line was necessary. A valuation based method was untenable because it was unpredictable.

Of course, there are always costs for bright lines, and share-

248 See supra note 144.
249 See supra note 203 and accompanying text.
holders bear the brunt of this one. Shareholders lose a significant ability to reap windfall profits during the early period of a hostile takeover. But, their traditional ability to control the corporation is unaffected. Though the *Time* holding may have constrained shareholders’ ability to capitalize on the Paramount offer, it did not constrain their substantive rights as shareholders. The trade-off was justifiable.\textsuperscript{250}

The *Time* decision was a reasoned solution to the competing interests of the business judgment rule and the intrinsic fairness test. A threshold test was a necessary step to allow an initial level of review of directors’ actions in the context of a hostile tender offer. For a court to go further and review in detail the virtues of a particular offer, evaluate the management response and then select the superior alternative, is to invite uncertainty. Reliability in the judicial process, no less than in corporate management, is a necessary and important policy objective. The *Unocal* test, as currently construed, appropriately serves this end.

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*Stephen P. Wink*

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\textsuperscript{250} The rash of anti-takeover legislation in the last couple of years points to a general acceptance of the notion that limiting takeovers at the expense of some shareholder control is a necessary policy choice.