ARTICLE

Paramount or Paradox: The Delaware Supreme Court’s Takeover Jurisprudence

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I. INTRODUCTION

On February 4, 1994, the Delaware Supreme Court handed down Paramount Communications Inc. v. QVC Network Inc.,¹ its sixth major opinion regarding the duties of a board of directors when faced with a hostile takeover bid.² The six Delaware decisions follow an apparently balanced pattern: in the first, Unocal Corporation v. Mesa

¹ 637 A.2d 34 (Del. 1994).
² The Delaware Supreme Court also addressed the duty of directors in a hostile takeover in a few other decisions. However, unlike the six major decisions, these other decisions did not involve on-going hostile takeover contests. See Polk v. Good, 507 A.2d 531 (Del. 1986) (examining settlement); Moran v. Household Int’l, Inc., 500 A.2d 1346 (Del. 1985) (discussing validity of poison pill absent specific takeover bid); Barkan v. Amsted Indus., Inc., 567 A.2d 1279 (Del. 1989) (examining settlement); Gilbert v. El Paso Co., 575 A.2d 1131 (Del. 1990) (considering suit after company had accepted hostile offer).

This balance has not necessarily appealed to commentators. They have referred to the supreme court's takeover jurisprudence as mush and mud; disparaged the court for waffling and wavering; criticized its opinions for drawing distinctions "without foundation," being "equivocal," and lacking clarity; asserted that its rulings generate "shock waves," keep changing the framework "dramatically," and "break with precedent;" and remarked that it first "boosts powers of takeover target boards" and then "boosts rights of shareholders."

The thesis of this article is that this criticism heaped upon the Delaware Supreme Court is undeserved. As this Article argues, an underlying coherent theory can explain the outcomes of these cases. Although the Delaware Supreme Court has never fully

5. 571 A.2d 1140 (Del. 1989).
7. 559 A.2d 1261 (Del. 1988).
10. See Blackman, supra note 9, at 5 (stating that some lawyers see the court as waffling).
12. Robert A. Ragazzo, Unifying the Law of Hostile Takeovers: Bridging the Unocal/Revlon Gap, 35 Ariz. L. Rev. 989, 990 (1993); see also Marc I. Steinberg, Nightmare on Main Street: The Paramount Picture Horror Show, 16 Del. J. Corp. L. 1, 31 (1991) (stating that the Time decision is "poorly reasoned"); Lyman Johnson & David Millon, The Case Beyond Time, 45 Bus. Law. 2105, 2118 (1990) (arguing that the norms underlying the distinction between Unocal and Revlon are unarticulated and unjustified).
13. Blackman, supra note 9, at 5; see also Law Firm Views on Impact of Paramount/Time Decision, Insights, May 1990, at 34. (providing excerpts from client memoraanda indicating that law firms take differing views of limits of Time decision).
14. See Garfield, supra note 8, at 33.
16. Paramount Case May Thaw Chill on Takeovers, St. Louis Post-Dispatch, Dec. 11, 1993, at 9A (stating that the QVC decision has changed the framework dramatically); James C. Freund & Rodman Ward, Jr., What's "In," "Out" in Takeovers in Wake of Paramount v. Time, Nat'l L.J., Mar. 26, 1990, at 22 (noting that the Time decision has "radically" altered the playing field).
20. For an alternative account of Delaware's takeover jurisprudence, see Gordon, supra note 11, at 1971-
Paramount or Paradox articulated this theory in a single case, the theory is grounded in the explanations provided by the court for several of its decisions. Any shortcoming of the Delaware Supreme Court lies not in a lack of doctrinal consistency or in a deficiency of policy, but at most in a failure to articulate a unified theory in a single case. This failure, of course, is inherent in the court's method of rendering opinions on a case-by-case basis.21

This Article presents a view of takeovers which explains all of the major Delaware Supreme Court pronouncements on this topic. This view is coherent and rational, and, contrary to the claims of many commentators, it can be used to predict the court's approach to many future takeover battles. This, of course, does not mean that the policy adopted by the supreme court is the best one. Many commentators have advocated, and many no doubt will continue to advocate, a different takeover policy.22 What it does mean, however, is that the accusations that the Delaware Supreme Court's decisions are unpredictable flip-flops, or that they are designed to endear the court to management23 or to promote business for the Delaware Bar,24 are not justified.

Part II of this Article describes the broad doctrinal framework the Delaware Supreme Court applies to takeovers and how this framework corresponds to an allocation of powers between directors, shareholders, and courts. The doctrinal approach adopted by the Delaware Supreme Court raises two questions: why does the Unocal test appear to have little critical bite; and why and under what circumstances does the court apply the Revlon test, which has loads of critical power? Part III presents what I believe to be the supreme court's view of takeovers and of the proper allocation of powers. Part IV shows how the view offered in Part III explains the holdings in, and resonates with the reasonings for, the various takeover cases decided by the Delaware Supreme Court.

82 (presenting a socio-economic account of the Time decision, where shift in law endorses values of continuity, loyalty, and collegial decisions and rejects hegemony of the market).

21. In QVC, the court apparently felt compelled to reiterate that this is its methodology. See QVC, 637 A.2d 34, 43 n.13 ("We express no opinion on any scenario except the actual facts before the court, and our precise holding herein. Unsolicited tender offers in other contexts may be governed by different precedent.").

22. See, e.g., Frank H. Easterbrook & Daniel R. Fischel, The Proper Role of a Target's Management in Responding to a Tender Offer, 94 Harv. L. Rev. 1161, (1981) (arguing for management passivity); Ronald J. Gilson, A Structural Approach to Corporations: The Case Against Defensive Tactics in Tender Offers, 33 Stan. L. Rev. 819, (1981) (arguing that providing information and proposing alternative transactions should be the only permissible defensive devices); Lucian A. Bebchuk, The Sole Owner Standard for Takeover Policy, 17 J. LEG. STUD. 197, (1988); Ragazzo, supra note 12, at 1035 (arguing that courts should require boards to demonstrate reasonable grounds to believe that a takeover defense will increase shareholder value); Larry E. Ribstein, Takeover Defenses and the Corporate Contract, 78 Geo. L.J. 71 (1989) (arguing that board duties should be determined by contract); Robert A. Prentice & John H. Langmore, Hostile Tender Offers and the "Nancy Reagan Defense": May Target Boards "Just Say No"? Should They Be Allowed To?, 15 Del. J. Corp. L. 377, (1990) (arguing the "just say no" defense should be permitted, subject to careful court review).

23. Martin Dickson, Barbarians Waiting at the Gate: The Importance of the Paramount Case, Fin. Times, Dec. 9, 1993, at 25 (finding that critics maintain the court is motivated by desire to keep the chairman of American companies sweet); Steinberg, supra note 12, at 32 (arguing that Time represents a quest to placate incumbent managers).

II. TAKEOVER DOCTRINE AND THE ALLOCATION OF POWERS

Two cases establish Delaware’s broad doctrinal framework for analyzing the duty of a board of directors when faced with a hostile takeover: Unocal and Revlon. In Unocal, the Delaware Supreme Court announced its well-known two-part test for assessing defensive actions by a board of directors when faced with a hostile takeover. First, the board “must show that they had reasonable grounds for believing that a danger to corporate policy and effectiveness existed.” Second, the defensive measure “must be reasonable in relation to the threat posed.”

The words of the Unocal test, of course, do not have a clear inherent meaning. Whether a defensive action passes the test depends on what counts as a threat, how intensely courts scrutinize the board’s grounds for believing whether a threat exists, and what measures constitute a reasonable response. Of particular importance is the question when a board may refuse to redeem a poison pill: modern “flip-in” poison pills, which have been adopted by a large portion of all public corporations, make it in practice impossible to complete a hostile tender offer unless they are redeemed.

As it has developed, the Unocal test demands for a rejection of a tender offer little more than the backing by the board’s independent directors and an investment banker’s opinion stating that the price offered is inadequate. Indeed, no supreme court case has ever invalidated a board’s defensive action on the basis of Unocal. And the few chancery court cases that have used Unocal to invalidate antitakeover defenses were criticized by the supreme court in Time.

This deferential aspect of the Unocal standard is not due to a withdrawal from the

26. Id.
27. See Randall S. Thomas, Judicial Review of Defensive Tactics in Proxy Contests: When is Using a Rights Plan Right?, 46 VANDERBILT L. REV. 503, 510 (1993) (stating that almost one-half of major companies have poison pills and the rest could quickly adopt them if needed).
28. Grand Metro. PLC v. Pillsbury Co., 558 A.2d 1049, 1051 & n.2 (Del. Ch. 1988) (finding that the effect of a poison pill is to make hostile acquisition “virtually a financial impossibility”).
31. City Capital Assoc. Ltd. v. Interco Inc., 551 A.2d 787, 798 (Del. Ch. 1988) (finding that a poison pill may be used only to obtain time to structure an alternative to a hostile offer; but absent coercion, it must be redeemed once that period has closed); see also Grand Metro. PLC, 558 A.2d at 1057-59 (adopting a similar approach); but see TW Services, Inc. v. SWT Acquisition Corp., Nos. 10427, 10298, 1989 LEXIS 19, at 32-33 (Del. Ch. Mar. 2, 1989) (raising the issue, but not deciding, whether the Interco rationale applies if a board continues to manage the company for the long term and does not embark on an extraordinary transaction).
32. Time, 571 A.2d at 1533. The issue is different, however, in cases where management tries to cramdown a management-sponsored alternative on the shareholders. Id. at 1154-55.
precepts that underlay Unocal. To the contrary, it was foreshadowed by Unocal itself. Unocal, of course, involved a coercive, two-tiered, front-loaded tender offer by T. Boone Pickens, a known greenmailer.\textsuperscript{33} Yet, upon closer examination, Unocal indicates that the court intended to give the board broad discretion to reject a hostile tender offer—whether coercive or not.

The Unocal court itself states that the first part of the test—reasonable grounds for the existence of a threat—is satisfied “by showing good faith and reasonable investigation,” a showing which is “materially enhanced . . . by the approval of a board comprised of outside independent directors who have acted in accordance with the foregoing standards.”\textsuperscript{34} Thus, Unocal makes evident both who initially determines whether a “threat” exists—the board—and when the court will respect this determination—if it is made by outside directors after a process designed to show good faith and reasonable investigation.

As to the second part of the test, the court found that Unocal’s discriminatory self-tender offer at $72 per share (which was itself coercive) was a reasonable response to the threat posed by Mesa’s coercive $54 offer. But of the three threats posed by Mesa’s offer—price inadequacy, coercion, and the threat of greenmail\textsuperscript{35}—only price inadequacy could have justified Unocal’s response. The threat of greenmail would have been adequately countered by just refusing to pay greenmail. And the threat of coercion would have been adequately countered by making a self-tender offer at $54 per share. At that price, shareholders would no longer be coerced into tendering to Mesa’s front end by fear that they would receive less in the back end of Mesa’s offer since any shares not tendered to (or any shares rejected by) Mesa could have been tendered to Unocal for the same $54 value. Thus, Unocal’s self-tender offer went beyond eliminating the pressure to tender into a coercive offer that shareholders do not want to accept; instead, the court sanctions a defensive device that prevents shareholders from accepting an offer that they may want to accept, but that the board thinks they should not accept because the price is inadequate.\textsuperscript{36}

This very same issue is, of course, posed by the use of poison pills. And the supreme court in Time, by rejecting Interco, answers it in the same manner as it did in Unocal: A company has great discretion in rejecting hostile tender offers—even non-coercive, all cash, all shares offers—as long as this rejection is approved by independent directors after a reasonable investigation.\textsuperscript{37}

With regard to a target board’s ability to reject a hostile tender offer, the principal impact of Unocal is then two-fold: it shifts the locus of power from the board at large,

\textsuperscript{33} Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 956 (Del. 1987). Greenmail refers to the practice of the target company buying a raider’s stock at a premium over the prevailing market price that is not available to other shareholders in order to prevent a takeover.
\textsuperscript{34} Id. at 955.
\textsuperscript{35} Id. at 956.
\textsuperscript{36} See also Ragazzo, supra note 12, at 992 (stating that the Delaware Supreme Court is “generous in finding that defensive measures were proportional responses to the threat of inadequacy”); Gordon, supra note 11, at 1943 (finding that if the board acts in good faith and in an informed manner, Time leaves no room for a court’s independent assessment of the existence of a threat).
\textsuperscript{37} Time, 571 A.2d at 1152-53.
not to the shareholders or to the court, but rather to the independent directors; and it adds to the process requirements the board is obligated to follow before making a decision. That is, Unocal subjects a decision to reject an offer to an enhanced review of the process by which this decision is arrived at, but not to an independent review of the substantive merits of the decision. Such process-oriented moves are, of course, standard moves employed by the Delaware Supreme Court in a variety of contexts.

Things look different once a company is in so-called Revlon-mode. Generally speaking, a board of directors becomes subject to Revlon when it is about to sell the company, break it up, or sell control in it. Once in Revlon-mode, procedural factors, such as the approval of independent board members and adequate information, are no longer sufficient for the court to validate the decisions by a target's board. Instead, the court forces the target to give shareholders the opportunity to accept the hostile tender offer and mandates a high degree of impartiality between the board-favored and the hostile transaction. Thus, once a company enters Revlon-mode, the locus of power shifts from the directors to the courts—who will scrutinize the substantive merits of board actions—and to the shareholders—who will ordinarily be given the opportunity to accept a hostile bid.

This bifurcated framework established by Unocal and Revlon raises two important questions. First, why is it that the court generally validates a board's rejection of a tender offer under Unocal despite the fact that a decision to reject a hostile tender offer involves obvious conflicts of interest? Second, why does the court, in some circumstances, radically depart from the apparently permissive Unocal standard and shift to the exacting Revlon test; and more importantly, why is it that some transactions—such as a sale of the company or a change of control—cause this shift, while others—such as a merger or a debt-for-equity exchange offer—do not?

38. But see infra notes 116-27 and accompanying text (arguing that Unocal requires a greater degree of review for certain active defenses that go beyond rejecting a hostile offer, refusing to redeem a poison pill, and continuing with the management of the company).

39. See, e.g., Weinberger v. UOP, Inc., 457 A.2d 701, 703 (Del. 1983) (recognizing that fair process and involvement of independent directors are elements of the entire fairness standard); Zapata Corp. v. Maldonado, 430 A.2d 779, 788 (1981) (holding that in a motion to dismiss a derivative suit, the special litigation committee has the burden of proving independence, good faith, and reasonable investigation); Smith v. Van Gorkom, 488 A.2d 858, 877-78 (1985) (criticizing the inadequate process used by the board in approving a merger agreement).

40. See, e.g., Revlon, 506 A.2d at 182 (finding that selective dealing to fend off a hostile bidder is no longer proper); Macmillan, 559 A.2d at 1288 (stating that preferential treatment of one bidder is only permissible if the action is reasonable in relation to the advantage sought or to the threat avoided); QVC, 637 A.2d 34 (Del. 1994) (noting that under Revlon, courts have to scrutinize both reasonableness of process and of substance).

41. Even in Revlon-mode, the board of directors retains some powers. QVC, 637 A.2d at 45 (noting that the court should not second-guess the board if it selected one of several reasonable alternatives). These powers, however, are significantly smaller than those retained under Unocal or under the business judgement rule. Id at 44 n.14 (stating that in evaluating alternatives, the board may consider the future value of a strategic alliance, but only to the extent that the value is reflected in the value of any noncash consideration "as of the date it will be received by the stockholders"). Moreover, given the fact that courts employ substantive scrutiny under Revlon, directors are more likely to enable shareholders to choose among competing bids rather than impose their views on shareholders and risk reversal by the courts.

42. See Johnson & Millon, supra note 12, at 2118 (recognizing that the Delaware courts have not an-
III. A THEORY OF TAKEOVER DEFENSES

Any rules applicable to the duties of a target board when faced with a pending hostile takeover must be justified in terms of the allocation of powers between directors, shareholders, and courts that these rules create. As pointed out in Part II, the Delaware takeover rules result in a shift of the locus of power to reject a hostile bid to the independent directors. The independent directors lose this power only in the limited circumstances in which a company finds itself in Revlon-mode.

The fact that the Delaware Supreme Court places so much reliance on the independent directors does not mean that the court has complete faith in them. Indeed, the court has explicitly recognized the presence of an “omnipresent specter that a board may be acting primarily in its own interests, rather than those of the corporation and its shareholders”—a specter that relates as well to independent directors, though to a lesser degree than to the inside directors. Due to this recognition, presumably, the court imposed enhanced process scrutiny under Unocal and strong, substantive scrutiny under Revlon. In other contexts, as well, the court has shown that it is unwilling to put complete trust in the decisions of independent directors that have significant effects on their board colleagues—even when these decisions are made in good faith and with adequate information.

On the other hand, the court is also aware of its own limitations. Delaware cases abound with recitations that it is the role of the directors, and not of the courts, to manage the corporation. This role includes, as the court has repeatedly stressed, an “obligation to determine whether [an unsolicited] offer is in the best interests of the corporation.” Too much judicial intrusion “would involve the court in substituting its judgment as to what is a ‘better’ deal for that of a corporation’s board of directors.” In the court’s mind, the board should not abdicate this responsibility and turn it over to the shareholders. Until a board of directors is replaced, the directors—or, in the takeover context, the independent directors—are called upon to exercise their business judge-

\[\text{answered these questions).}\]

43. \textit{Unocal}, 493 A.2d at 954.
44. \textit{See, e.g., Zapata Corp. v. Maldonado, 430 A.2d 779, 789 (Del. 1981) (holding that the Chancery Court may exercise its independent business judgment in deciding whether to grant a motion by the special litigation committee to dismiss a derivative suit even if the committee has proven that it acted independently, in good faith, and after reasonable investigation).}\n45. \textit{See, e.g., QVC, 637 A.2d at 42 (Del. 1994) (“Under normal circumstances, neither the courts nor the stockholders should interfere with the managerial decisions of the directors.”); Time, 571 A.2d at 1153 (finding that the court should not get involved “in substituting its judgment as to what is a ‘better’ deal for that of a corporation’s board of directors”).}\n46. \textit{Unocal}, 493 A.2d at 954; \textit{Revlon}, 506 A.2d at 181.
47. \textit{Time}, 571 A.2d at 1153.
48. \textit{See Smith v. Van Gorkom, 488 A.2d 858, 873 (1985) (holding that the board may not abdicate duty of evaluating cash merger and leave only approval or disapproval of the agreement to the shareholders); Cede & Co. v. Technicolor, Inc., 634 A.2d 345, 370 (Del. 1991) (holding the same); Mills Acquisition Co. v. Macmillan, Inc., 559 A.2d 1261, 1281, 1285 (Del. 1988) (stating that the board “may not avoid its active and direct duty of oversight in a matter as significant as the sale of corporate control;” sale of control requires “intense scrutiny and participation of the independent directors”).}
ments. Absent special circumstances, neither courts nor shareholders should interfere.

The ultimate rationale for giving independent directors the power to reject a tender offer that the shareholders would like to accept is the same as for giving directors the power to manage the company in one way even if shareholders would prefer a different management style: the shareholders elected the directors to manage the company for as long as they serve as directors. As a corollary, if shareholders are dissatisfied with the way the directors manage the company, the proper response is not for courts to interfere or for shareholders to take over management, but for shareholders to elect different directors.

This rationale is most clearly expressed in Moran v. Household International, Inc., the first Delaware Supreme Court case upholding a poison pill. In Moran, the court specifically addresses the question of whether a poison pill "usurp[s] shareholders' rights to receive tender offers . . . " The court's answer is instructive. It rests essentially on two grounds. For one, the court notes that directors must comply with their fiduciary obligations under Unocal before they can reject an offer and refuse to redeem a pill. But the court does not stop there. In addition, the court mentions several ways in which a tender offer can succeed against board opposition. In particular, one could "tender[] and solicit[] consents to remove the board" or one could "solicit proxies for consents to remove the board" and redeem the poison pill. Thus, Moran is expressly premised on the fact that shareholders retain the power to override the board through the voting process.

In the court's view, the broad grant of power to the independent directors to use a poison pill to block a hostile offer is balanced by the ultimate ability of the shareholders to revoke the power: either by removal of directors between annual meetings or by voting for different directors at the next meeting. This contingent allocation of powers to the independent directors (who may have superior knowledge and expertise, but who may also have conflicts of interest) subject to the ultimate power of shareholders (who may have inferior knowledge) to vote for different directors seems preferable to the court than the alternatives: applying the ordinary business judgment rule, invalidating all defensive devices, or subjecting the board decisions to substantive review.

49. 500 A.2d 1346 (Del. 1985).
50. Id. at 1354.
51. In principle, general business decisions reviewed under the business judgement rule also implicitly create a contingent allocation of powers to directors since shareholders have the power to elect different directors who will pursue a different business strategy. The contingent allocation of power with respect to decisions to reject tender offers, however, differs from the allocation of power with respect to general business decisions in two significant respects. First, as noted, decisions to reject tender offers are subject to enhanced review of the process of decision-making. Second, as discussed in detail later, infra notes 116-27 and accompanying text, a target board's responses to a hostile tender offer which involves substantial changes in the nature of the company are subjected to substantive review. Thus, target boards are constrained in changing the status quo before shareholders have a chance to override them. For that reason, it is appropriate to describe the allocation of powers to independent directors with respect to tender offers as contingent, while the allocation of powers to directors with respect to general business decisions is more aptly described as temporary.
52. In this respect, my interpretation of Time differs from the one put forward by Professor Garfield, supra note 8, at 52. According to Garfield, Time requires courts to subject any defensive action to a substantive review and to decide independently whether it is in the interest of shareholders. Id. Garfield admits that this interpretation is inconsistent with some of the dicta in Time and does not claim that the court in Time
The reasons why the court may be attracted to this contingent allocation of powers are evident. Compared to applying the ordinary business judgment rule, it lessens the danger that directors will block a beneficial tender offer in order to perpetuate their own control. Compared to subjecting board decisions to substantive review by the courts, it keeps the courts out of the business of making business judgements. And compared to giving absolute power to shareholders to accept immediately a tender offer (even if the offer is not coercive), it has the upside of preventing shareholders from making rushed and possibly ignorant choices; it reduces the probability that the independent directors do not act as faithful agents for the shareholders; and by giving shareholders the final say, it does not permit the board to block a beneficial offer permanently.

To be sure, one may legitimately disagree on a policy level with this allocation of

made such an independent decision. Id. Maybe Garfield’s statements are meant as an argument that the court should engage in such an independent review, rather than merely in procedural review. Similarly, Professors Gilson and Kraakman (in an article preceding Time) have argued that the court should independently evaluate management’s claims that a hostile bid is not in the interest of shareholders. See Ronald J. Gilson & Reinier Kraakman, Delaware’s Intermediate Standard for Defensive Tactics: Is There Substance to Proportionality Review?, 44 BUS. LAW. 247, 268 (1989).

53. Commentators have argued that all the information shareholders require is incorporated in the pre-takeover market price of the company’s shares. See Easterbrook & Fischel, supra note 22, at 1165-68. This argument, however, assumes that stock prices accurately reflect all information. For the relationship between stock price inaccuracies and the market for corporate control, see Marcel Kahan, Securities Laws and the Social Costs of “Inaccurate” Stock Prices, 41 DUKE L.J. 977, 1035-38 (1992).

54. To be sure, the contingent allocation of powers created by Unocal permits the independent directors to block a tender offer temporarily, and the resulting delay may cause a raider to reduce the premium or to withdraw the offer. Nevertheless, the danger of permanently blocking beneficial offers is relatively low. To see this, consider the reasons why a raider may reduce the premium or withdraw.

One reason is that the (actual or perceived) value of the target as an independent entity has increased or that the target board has offered an alternative transaction which offers greater value to its shareholders. In that case, the initial raider may withdraw, but target shareholders are benefitted.

Secondly, changes in economic circumstances may have reduced the value of the target. In that case, target shareholders may be hurt by a delay. There is, however, a priori no reason to believe that changes in economic circumstances will reduce, rather than increase, the value of the target. To the contrary, to the extent that the process review under Unocal is effective, it is more likely that the value of the target will increase rather than decrease (since, if the independent directors believe that the value will increase, they will block the hostile bid, but they will accept it if they believe that value will decrease).

Thirdly, the target board may intentionally use the delay to reduce the value of the target to the raider, without changing the independent value of the target (e.g., by entering into contracts that give the other party additional rights upon a change of control), or take other actions that obstruct the consummation of a tender offer (e.g., placing a large block of shares into the hands of a white squire). Such actions could impede offers more permanently. However, the danger of such actions is greatly reduced by the substantive review the court applies to responsive business changes. See infra text accompanying notes 103-127.

On the other hand, if the hostile offer is expected to result in real gains—whether by synergies, by the elimination of inefficient management, by tax savings, and so on—and the target cannot achieve these gains unilaterally, it is unlikely that these gains would generally be substantially lower after the delay created by not letting shareholders accept an offer immediately.

Finally, anecdotal evidence suggests that a delay in the consummation of a tender offer does not hurt target shareholders. The case law is replete with instances in which a raider raised its offer after the target board rejected the initial offer. See, e.g., Interco, 551 A.2d at 797-798 (stating that experience has demonstrated that power to reject an offer induces a raider to increase the offer). By contrast, the cases where a raider withdrew or lowered its offer merely because of a delay in its ability to consummate it are much rarer.
power; and indeed many commentators argue that shareholders should have broader powers, while others advocate giving even broader powers to the directors. But viewed in the manner outlined above, the contingent power allocation adopted by the Delaware Supreme Court steers a reasonable middle-ground between fear of director self-entrenchment on one side, fear of court intrusion on the other side, and fear of ignorant and rushed shareholder decisions on the third side—a middle ground, one may add, that Delaware has tried to occupy in other instances as well.

The issue of what triggers Revlon then follows directly from the rationale for the deference paid to the independent directors under Unocal. Under Unocal, the court does not engage in a substantive review of the decision by independent directors to reject a tender offer because this decision is ultimately reversible by the shareholders themselves. If, however, shareholders are deprived of the ability to override the judgement of the independent directors, a principal rationale for the deferential review standard has evaporated. In such instances, the court's only choices are to give the directors the power to reject a tender offer irreversibly, to engage itself in a substantive review of the board decision, or to give shareholders immediate say in whether to accept the tender offer (e.g., by forcing the board to redeem a poison pill). As will be explained below, in such instances the court subjects the decisions of the board to the more stringent Revlon review or, if a target board takes certain affirmative defenses, the court will exercise substantive review under the "reasonable relationship" prong of Unocal.

IV. THE TAKEOVER CASES REVISITED

Two types of transactions most clearly deprive shareholders of the ability to reverse the decision of independent directors not to accept a tender offer by, to quote Moran, "tendering and soliciting consents to remove the board" or executing "proxies for consents to remove the board" and redeem the poison pill. These two transactions are a sale of the company or a change of control. In a sale of the company, the shareholders lose all their voting rights because their equity interest is terminated. In a change of control, shareholders may retain their shares and their voting rights, but voting control is transferred to a party chosen by (and thus presumably friendly to) the present board. Thus, although shareholders continue to have votes, they lose the ability to exercise their votes to elect different directors.

55. See supra note 22.
56. See, e.g., Zapata Corp. v. Maldonado, 430 A.2d 779, 786-87 (Del. 1981) (stating that the standard for when to accept recommendation of special litigation committee to dismiss derivative suit must balance the stockholder's interest in bringing bona fide causes of action and the company's interest in ridding itself of detrimental litigation); Roberta Romano, The State Competition Debate in Corporate Law, 8 CARDOZO L. REV. 707, 725-731 (1987) (finding that the Delaware takeover statute occupies the middle ground); Gordon, supra note 11, at 1965 (finding that the Delaware takeover statute is moderate).
57. By affirmative defenses, this article refers to responsive changes in the company's business strategy, but not structural devices (such as a poison pill) which block a tender offer but, by themselves, do not change the status quo.
58. Moran, 500 A.2d at 1354.
59. See QVC, 637 A.2d at 42 (Del. 1994) (stating that where there is a majority stockholder, stockholder votes are "likely to become mere formalities").
A. Revlon Duties in a “Sale of the Company”

This view of the sale of the company and the change of control aspects of Revlon is supported by the Delaware Supreme Court precedents. Revlon itself, of course, involves a standard sale of the company, with management of the target preferring one bidder (Forstmann) over another (Pantry Pride). The court held that Revlon’s board was not entitled to end an auction between these two bidders for the company by giving Forstmann a lock-up option and agreeing to a no-shop clause.

Viewed in a narrow light, Revlon’s holding is no surprise. The supreme court already had held one year before, in Smith v. Van Gorkom, that a board, when deciding to sell the whole company, must go through an enhanced process designed to assure that shareholders get a good deal. Revlon’s actions clearly fail under the Van Gorkom standard: Granting a lock-up option to one bidder and agreeing to a no-shop clause in exchange for a minor improvement in the bid price, without trying to get a higher price from the second bidder, can hardly be seen as getting a good deal for the shareholders. As such, Revlon could be seen more like a “sale of the company” case than like a takeover case.

Such a narrow reading of Revlon, of course, fails to take account of the actual circumstances in which the case arose and the important dicta by the supreme court. In explaining why it subjects Revlon’s board to the exacting Revlon duties, the court took pains to point out the shift in the board’s strategy. The initial defenses of the board—a precursor to a poison pill and an exchange offer for its shares—were analyzed, and approved, under Unocal. These measures, the court notes, “protected the shareholders from a hostile takeover at a price below the company’s intrinsic value, while retaining sufficient flexibility to address any proposal deemed to be in the shareholders’ best interests.” In other words, when asked to approve defensive measures that did not fundamentally affect the ability to accept a subsequent bid and that did not involve a major change in the company’s business, the court accepted (without substantive review) the board’s judgement that the takeover bid was too low.

The lock-up and the no-shop clauses, however, were different. At that point, the court noted “the company was for sale.... The 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....” And again:

The original threat posed by Pantry Pride—break-up of the company—had become a reality which even the directors embraced. Selective dealing to fend off a hostile but determined bidder was no longer a proper objective. Instead, obtaining the highest price for the benefit of the stockholders

60. 488 A.2d 858 (Del. 1985).
61. Van Gorkom, 488 A.2d at 874-78 (1985) (holding that the board breached its duty of care by approving a merger agreement without adequate information as to the value of the company).
63. Revlon, 506 A.2d at 181.
64. Id. at 182.
should have been the central theme guiding director action.\textsuperscript{55}

What the court seems to say here is not merely that directors have the obvious duty to sell any assets (and, a fortiori, the whole company) at the best terms for their shareholders. In addition, the court stresses the directors' shift in strategy. If the board had continued to "defend the corporate bastion," and (in a manner of speaking) returned the corporation to its shareholders at the end of its term, the court would have had little trouble with Revlon's actions. But because the board decided to alter fundamentally the nature of the company by agreeing to sell it to Forstmann (and, as discussed later, by embracing a break-up)\textsuperscript{56}—a change that would have been irreversible by Revlon's shareholders—the court intervened.\textsuperscript{57}

Thus, Revlon goes beyond the simple proposition that a board cannot, in compliance with its fiduciary duties, reject a higher bid for the company in favor of a lower bid. And the reasons for the exacting Revlon scrutiny are integrally tied to the board's failure to continue to "defend the corporate bastion" and instead to embrace a transaction that constituted a fundamental change in the company's affairs.

B. Revlon Duties in a "Change of Control"

Revlon is the only Delaware Supreme Court case dealing directly with a sale of a company. The other supreme court cases elaborating on Revlon involve situations that come closer to a change of control. Revlon itself does not specifically mention a change of control as a circumstance that triggers enhanced Revlon duties. The first time the supreme court refers to this term is in Macmillan where it states that "Revlon requires that there be the most scrupulous adherence to ordinary principles of fairness... in the conduct of an auction for the sale of corporate control."\textsuperscript{58} Macmillan, however, elaborates neither on what constitutes a sale of control nor on why it triggers Revlon duties;\textsuperscript{59} and as the facts of Macmillan involve an auction for the sale of the company, an analysis of Macmillan is not helpful in deciding when Revlon duties are triggered.\textsuperscript{60}

Time, QVC, and Ivanhoe Partners, on the other hand, all contain important lessons about the meaning and significance of a sale of control. Time involved a merger of Time and Warner. After the merger, Time's shareholders would retain a thirty-eight percent interest in the combined entity. Time's shareholders were not to receive any

\textsuperscript{65} Id.

\textsuperscript{66} See infra text accompanying notes 94-115.

\textsuperscript{67} See also In re Holly Farms Corp. Shareholder Litig., No. 10350, 1988 WL 143010, at *4 (Del. Ch. Dec. 30, 1988) (analyzing stock swap agreement with white knight under Revlon because it "came in response to, and as an alternative to" hostile offer).

\textsuperscript{68} Macmillan, 559 A.2d at 1285. As the Delaware Supreme Court made clear in QVC, the terms "change of control" and "sale of control" are used interchangeably. QVC, 638 A.2d at 42 n.10.

\textsuperscript{69} Macmillan states that a "sale" can take "the form of an active auction, a management buyout, or a 'restructuring' such as that which the court of chancery enjoined in Macmillan I." Id. at 1285 (citing Revlon, 506 A.2d at 181-82). These transactions, however, essentially amounted to a sale of the company, and not merely of control.

\textsuperscript{70} A subsequent case, Barkan v. Amsted Indus., Inc., 567 A.2d 1279, 1286 (Del. 1989), also mentions a change of control as triggering Revlon duties, but also involves a sale of the company. See id. (stating that Revlon applies to "every case in which a fundamental change of control occurs or is contemplated).
money in the merger. In response to Paramount’s hostile tender offer for Time, the original merger agreement was revised to a cash tender offer by Time for Warner shares. The supreme court held that the merger and the “defensive” tender offer did not trigger Revlon. The court gave several reasons for this holding. This Article focuses on the two reasons that bear most directly on the change of control issue. First, the supreme court endorsed the reasoning of the chancery court that the merger involved no change in control since control remained “in a fluid aggregation of unaffiliated shareholders representing a voting majority—in other words, in the market.” Second, the court stressed that the defensive tender offer by Time neither constituted an abandonment of a strategic plan nor made it impossible for Paramount to make a tender offer for the combined Time-Warner entity.

Both of these rationales harmonize with the notion that Revlon duties are meant to protect shareholders’ ability to override the board’s decision to reject a tender offer. What is important about the fact that “control” remains in the hands of unaffiliated shareholders, “in the market,” is that all these unaffiliated shareholders have virtually identical interests with respect to the company: to maximize the value of their shares. Thus, the new Time-Warner shareholders are as likely as the old Time shareholders to tender their shares into a beneficial offer or to oust the board if they believe that it put up undue resistance to the offer. The situation would be entirely different if “control” had shifted to a single shareholder aligned with management. Such a shareholder, who exercises real and direct control (as opposed to the market, which exercises only potential and indirect control), may for various reasons oppose a tender offer favored by the public shareholders in the market.

71. In addition to the two reasons discussed, the court noted that the merger involved neither a sale of the company nor a break-up. Time, 571 A.2d at 1150. The court, by failing to mention a sale of control as a possible trigger for Revlon duties created some doubt as to whether a sale of control could ever trigger Revlon (even though the court specifically noted that it did not exclude other possibilities for when Revlon is triggered). Id. However, in QVC, the court removed all doubts as to that matter. QVC, 637 A.2d at 45-46 (stating that a change in control triggers Revlon).

72. Id. at 1150.

73. Id. at 1151.

74. The implications of the theory of Revlon presented in Ronald J. Gilson & Reinier Kraakman, What Triggers Revlon?, 25 WAKE FOREST L. REV. 37 (1990), differ, in this respect, fundamentally from those derived in this article. Gilson and Kraakman argue that even a merger in which control remains in the market should trigger Revlon if the management of one company loses its de facto control. Id. at 52-55. Gilson and Kraakman take this position because they view Revlon as addressing the conflict of interest faced by managers who relinquish control. They fear that the change of control transaction in itself may hurt existing shareholders (e.g., because managers bargain for increased severance payments instead of a higher price payable to shareholders).

By contrast, this article takes the position that Revlon is meant to protect shareholders’ ability to reverse a board’s decision to reject a hostile bid. As this issue is not implicated by whether the managers of the target company relinquish control in a merger, Revlon would not be affected by this circumstance. Under this view, the possibility that the change of control transaction itself hurts management, depending on the circumstances, is analyzed under Van Gorkom or under the standard duty of loyalty. See also Ronald J. Rinaldi, Radically Altered States: Entering the “Revlon Zone”, 90 COLUM. L. REV. 760, 773-74 (1990) (making a similar argument).

75. Bershad v. Curtiss-Wright Corp., 535 A.2d 840, 844-45 (Del. 1987) (finding that the majority shareholder has no duty to sell his shares, even if such sale would benefit the minority); see also generally Marcel
Second, the court noted that Time’s tender offer for Warner was a continuation, rather than an abandonment, of its strategic plan and did not make a subsequent tender offer by Paramount impossible. Thus, Time’s action comes close to a mere continuation of management policies—the paradigm case for when the relaxed *Unocal* standard applies. The fact that the continuation of a pre-existing business plan has the incidental effect of making it harder (though not impossible) for Paramount to stage a hostile tender offer is not enough to trigger *Revlon* duties.76

*QVC*, of course, involves a scenario exactly opposite to *Time*. The merger agreement between Paramount and Viacom would have resulted in Viacom’s chairman, Sumner Redstone, gaining voting control over the combined entity. Thus, “control” would have moved from the market to a single person.77 After the merger agreement was executed, QVC made a hostile tender offer for Paramount.

The court held that Paramount’s defensive actions were subject to a *Revlon* analysis.78 In explaining its holding, the court noted that Paramount’s shareholders would lose any power to elect directors or to veto charter amendments, mergers, consolidations, sales of all assets, and dissolutions. Further, they could at any time be frozen out by Redstone in a cash-out merger and would have no leverage in the future to demand another control premium.79

A preliminary issue raised by the prior discussion is why the merger agreement with Viacom (or, for that matter, any merger agreement) creates *Revlon* duties. After all, shareholders can always vote against the merger. Thus, one could argue that the merger agreement by itself (and, therefore, the decision by Paramount’s board to reject QVC’s hostile offer)80 was reversible by Paramount’s shareholders.81 This argument would be persuasive if the merger agreement had not been protected by a “draconian” termination fee and stock option82 which would have been triggered had Paramount’s shareholders not voted in favor of a merger.83 These measures severely constrained the ability of Paramount’s shareholders to “reverse” the merger

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76. See also *Time*, 571 A.2d at 1155 n.19 (citing approvingly to *Shamrock Holdings*, in which chancery court upheld establishment of an employee stock ownership plan in the face of a takeover bid because such establishment constituted a continuation of a pre-existing business plan).
77. *QVC*, 637 A.2d at 43 (Del. 1994).
78. *Id.*
79. *Id.*
80. To be sure, at the time of the court decision, the transaction with Viacom was no longer structured as a merger but as a coercive tender offer. However, the court made clear that even the original structure triggered *Revlon*. *QVC*, 637 A.2d at 49.
81. That is, Paramount’s shareholders could have voted down the merger and elected a different board receptive to QVC’s offer. I am grateful to Reinier Kraakman for alerting me to this issue.
82. The merger agreement was also protected by a “no-shop” clause which in effect purported to prohibit Paramount’s board from considering any competing offer subject to any material financing contingencies, regardless of whether such a consideration was necessary to comply with the board’s fiduciary duties. *QVC*, 637 A.2d at 39 (indicating that the board is only permitted to consider a competing offer if required by fiduciary duties and the offer is not subject to financing contingencies). As one would expect, the Court found this provision invalid. *Id.* at 48 (holding that a no-shop provision can not define or limit fiduciary duties).
83. *Id.* at 39.
agreement, just as the lock-up option Revlon granted to Forstmann severely constrained shareholders’ ability to reverse Revlon’s decision to reject Pantry Pride’s offer. Indeed, as the Court pointed out, “[t]hose defensive measures, coupled with the sale of control and subsequent disparate treatment of competing bidders” implicated Revlon scrutiny.

The supreme court’s enumeration of the dangers to Paramount’s shareholders created by the change of control also raises the issue whether structural safeguards designed to address some (but not all) of these dangers would have taken the transaction out of Revlon’s scope. Given the focus on a potential freeze-out in the chancery court opinion and in the oral argument in front of the supreme court, this issue is particularly critical for safeguards that protect minority shareholders against freeze-outs—such as supermajority or majority of minority voting requirements—but leave the majority shareholder in control of the board. Such anti-freeze-out safeguards could easily be incorporated into merger agreements without changing the fundamental nature of the transaction.

This Article suggests that structural safeguards that merely protect minority shareholders against freeze-outs should have no effect on the applicability of Revlon. The possibility of a freeze-out is just one example of shareholders’ loss of power—perhaps the most glaring example is a case like QVC where Paramount’s defense was premised on the notion that a deal with Viacom offered higher long-term benefits to its shareholders. The fundamental problem of a change of control—which would not be remedied by such safeguards—is, however, that Paramount’s shareholders (even with the

84. Id. at 49 (emphasis added). An interesting hypothetical situation would arise if a board entered a merger agreement which, if approved, would result in a change of control but which is not protected by such defensive measures. Could a board in such a case refuse to redeem a poison pill for a noncoercive hostile bid by a third party if the target finds that the hostile bid is inferior to the merger agreement? My analysis suggests that such a case would be analyzed under Unocal and Van Gorkom, but not under Revlon since the merger agreement is not irreversible and the target board does not directly discriminate among potential acquirors. To be sure, when both parties offer cash or similar consideration, a board decision to reject a higher value hostile bid in favor of a lower value merger agreement would be invalid even under Unocal and Van Gorkom. However, when the offer consists of consideration that is more difficult to compare, Unocal and Van Gorkom would offer the board greater leeway in determining which bid is superior since target shareholders would be free to vote against the merger if their assessment differed from the one by the board.

85. The supreme court noted the absence of any protective devices, but did not express any opinion on the effect such devices would have had. QVC, 637 A.2d at 42 n.12.

86. In rejecting Paramount’s argument that a combination with Viacom would offer great long term value to its shareholders, the chancery court specifically noted that the equity interest of Paramount shareholders could be eliminated in a freeze-out merger. See QVC Network, Inc. v. Paramount Communications Inc., 635 A.2d 1245, 1266-67 (Del. Ch. 1993). The Chancery Court did not refer to the other implications of a change of control.

87. See Transcript of Oral Argument at 13, Paramount Communications, Inc. v. QVC Network, Inc., 637 A.2d 34 (Del. 1994) (Veasey, J., stating, “And a person who has voting control then has the power to take certain corporate action, merge the corporation again, change the strategic plan, cash-out minority shareholders. . . .”); id. at 21 (Moore, J., stating, “But the shareholders [of Paramount] can clearly be frozen out, can they not, at any time?”); id. at 26 (Veasey, J., stating, “But we know that Mr. Redstone has the power to cash out the minority and to change its strategic plan?”).

88. QVC, 637 A.2d at 41 (stating that the directors believed the Viacom offer was preferable due to better future business prospects than the QVC offer); id. at 50 (finding that the disparity between QVC and Viacom offer cannot be justified on the basis of future strategy).
support of Viacom’s public shareholders) would not have the power to reverse the board’s decision. As long as a change in control has this result, the actions of directors should be subjected to the heightened Revlon scrutiny. This interpretation of QVC is supported by the focus of the opinion on the importance of voting rights generally, and not merely as a protection against freeze-outs.\textsuperscript{89}

Finally, Ivanhoe Partners fits into this theory of Revlon. In Ivanhoe Partners, Newmont was faced with a hostile tender offer by Ivanhoe. Newmont differed from the typical takeover target in that it had a 26\% shareholder, Gold Fields. Gold Fields had originally agreed to a standstill agreement which limited its shareholdings to 33\,1/3\% and its board representation to one-third of the seats. However, as a result of Ivanhoe’s acquisition of 10\% of Newmont’s stock, Gold Fields had the right to terminate the standstill agreement. The board of Newmont concluded that it was in the best interest of the company to stay independent and thus to defend itself against both Ivanhoe and (potentially) Gold Fields.

In order to assure the continued independence of the company, the board of Newmont declared a $33 dividend which Gold Fields used to purchase in the open market another 23.7\% of Newmont’s stock (raising its ownership percentage to 49.7\%). At the same time, Newmont and Gold Fields entered into a new standstill agreement. Originally, this second standstill agreement limited Gold Fields’ representation on Newmont’s board to 40\%, required Gold Fields to support the board’s nominees as directors, and prohibited Gold Fields from tendering its shares in any tender offer. However, when the chancery court granted a temporary restraining order against the agreement, the agreement was revised to permit Gold Fields to tender into an offer for any or all shares that had firm financing commitments, to remove Gold Fields’ obligation to support management’s nominees, and to establish cumulative voting for Newmont’s board.\textsuperscript{90}

The Delaware Supreme Court held that Newmont’s actions did not trigger Revlon duties. In its reasoning, the court mainly relied on the fact that Newmont was never for sale, and the court does not address specifically the issue of whether there was a sale or change of control.\textsuperscript{91} However, the outcome of Ivanhoe Partners can also be justified under a “change of control” test.\textsuperscript{92} This becomes most evident when one compares the original terms of the second standstill agreement with the revised terms. Even prior to Ivanhoe’s tender offer, Gold Fields was a substantial shareholder of Newmont, a shareholder that was neither picked by nor friendly to management. The original terms of the second standstill agreement contractually obligated Gold Fields to support management (they had to vote for management’s nominees and were prohibited from tendering) and thus deprived Newmont’s public shareholders from reversing the board’s decision to stay independent. These terms, however, were revised after the chancery court issued its temporary restraining order. The revised terms of the second standstill agreement dif-

\textsuperscript{89} See, e.g. id. at 42 (noting that the Delaware courts have consistently protected shareholder voting rights and finding that enhanced scrutiny is mandated by diminution of voting power and the traditional concern of Delaware courts for stockholder voting rights).

\textsuperscript{90} Ivanhoe Partners, 535 A.2d at 1340.

\textsuperscript{91} Note that Ivanhoe Partners precedes Macmillan by one year.

\textsuperscript{92} Cf. QVC, 637 A.2d at 42 n.12.
ferred from the original terms in a fundamental respect. Gold Fields was effectively neutralized for the purpose of electing the sixty percent board members that were not Gold Fields’ nominees. Thus, the public shareholders retained potential control of the majority of the board. If they wanted to, they could elect new board members sympathetic to a tender offer by either Ivanhoe or by Gold Fields. Even if they only succeeded in electing a minority slate to the board, this minority slate could team up with Gold Fields’ representatives to eliminate the restriction imposed on Gold Fields’ ability to accept a tender offer or to acquire additional shares. Thus, Newmont’s public shareholders generally retained the power to reverse the board’s decision.93

C. Revlon Duties in a “Break-Up”

In addition to a sale of the company and a change of control, the Delaware Supreme Court has identified other actions that trigger Revlon, to wit: an inevitable “break-up”;94 a company-initiated “active bidding process seeking . . . to effect a business reorganization involving a clear break-up;”95 a defensive action in which “a target abandons its long-term strategy and seeks an alternative transaction involving [a] break-up;”96 and “an abandonment of the corporation’s continued existence.”97 The only case where the court has found that a “break-up” triggered Revlon, however, was Revlon itself.98

Based on these dicta, three questions emerge. First, why does a break-up trigger Revlon? Second, does a “strategic break-up”, such as Marriott’s decision to spin-off its hotel management business from its real estate business, trigger Revlon? Third, is there anything besides a sale of the company, a change of control, and a break-up that may trigger Revlon?

As to the first question, the argument of course is that a break-up, similar to a sale of the company and a change of control, can render it much more difficult for a company’s shareholders to reverse the decision of the board to reject a tender offer.99

What is broken up is hard to put back together. A break-up that involves such a funda-

93. One scenario in which the board’s decision would be difficult to reverse involves a tender offer by Ivanhoe which the public shareholders want to accept but which Gold Fields does not want to accept. It is, however, defensible for the court to regard this scenario as not important enough to justify the imposition of Revlon duties. First, since Gold Fields was prevented from exercising control over Newmont, they probably would want to accept a tender offer that benefits Newmont’s shareholders. Second, even prior to Ivanhoe’s offer, Gold Fields could have probably blocked a tender offer, either because its 26% shareholding was sufficient to block an offer, or because it could have easily acquired additional shares that would have empowered it to block an offer.

Note that the revised agreement also permitted Gold Fields to accept a tender offer for any or all shares if it had a firm financing commitment. My analysis suggests that this modification is less significant than the modification to Gold Fields’ voting requirements and to Newmont’s voting structure.

94. Revlon, 506 A.2d at 182; see also QVC, 637 A.2d at 47.
95. Time, 571 A.2d at 1150.
96. Id.
97. Id.
98. Revlon, 506 A.2d at 182.
99. Cf. QVC, 637 A.2d at 45-46 (“There are few events that have a more significant impact on the stockholders than a sale of control or a corporate break-up. Each event represents a fundamental (perhaps irrevocable) change in the nature of a corporate enterprise from a practical standpoint.”).
mental change that the company is no longer the same as it was before the break-up may technically still permit the shareholders to elect a new board (if they retain any equity interest). But this new board will run an entirely different company, and no bidder may emerge for that different company. Thus, a break-up in fact may deprive the shareholders of the only opportunity they have to accept a tender offer.

To be sure, many actions by boards involve major changes and may discourage bidders from making a tender offer in the future. It is clear that most of these actions do not trigger Revlon. For example, as discussed above, a merger with another company in which there is no change of control, such as the Time-Warner merger, or a major dividend, as in Ivanhoe Partners, were held not to trigger Revlon. Why then does the court single out break-ups?

Two possible responses to this question exist, and these responses relate to the two other questions posed above. The first response is that a break-up is different in degree from other transactions in that it is harder to reverse the business changes resulting from a break-up than most other business changes. This is particularly true for break-ups that completely shatter the company or amount to an abandonment of the company’s existence. In the extreme, a break-up involving a piecemeal sale of the company’s assets would be irreversible and would be subject to Revlon scrutiny, even if the shareholders retained some equity interest in a few remaining assets.

By contrast, a neat, preplanned, “strategic” break-up of a company into two pieces may arguably not trigger Revlon, especially if shareholders retain their proportionate equity interest in the resulting companies. The paradigm case for such a break-up would be Marriott’s spin-off of its hotel management operations from its real estate operations. In that transaction, Marriott’s operations where divided into two separate companies and shareholders retained a proportional equity interest in both companies. In itself, such a spin-off transaction does not significantly inhibit a raider’s ability to make a hostile tender offer. Such a “strategic” break-up would not be fundamentally different from other major actions—such as Time’s “strategic” merger with Warner—and, by implication, should not trigger Revlon duties.

On the other hand, it is possible that other transactions that involve fundamental changes in the company and are as difficult to reverse as a break-up—such as an exchange of all the company’s assets for a different set of assets—may also trigger Revlon. To be sure, so far the Delaware Supreme Court has not found that anything but a sale of the company, a change of control, or a break-up subjects a board to Revlon scrutiny. This, however, does not mean that the court would not expand Revlon in a proper case. Indeed, if the court wanted to expand Revlon, it could cite to the fol-

100. See, e.g., Time, 571 A.2d at 1150-51.
103. In the case of Marriott, of course, the Marriott family has a controlling stake in the company which could block any hostile bid.
104. As the court has made clear in QVC, its opinions only address the facts before it. QVC, 637 A.2d at 43. Indeed, the court vigorously rebuffed earlier attempts to construe the court’s enumeration of transactions that trigger Revlon as complete lists. Id. at 46-47.
lowing passage in *QVC*:

There are few events that have a more significant impact on the stockholders than a sale of control or a corporate break-up. Each event represents a fundamental (and perhaps irrevocable) change in the nature of the corporate enterprise from a practical standpoint. It is the significance of these events that justifies [the imposition of *Revlon* duties].

This passage implies (i) that there may be other events that have as much of an impact on stockholders as a sale of control and a break-up and (ii) that the significance of these other events may also justify the imposition of *Revlon* duties.

The second reason for the special status of break-ups may be that the court’s references to break-ups are meant to include primarily “defensive” break-ups that are undertaken in response to hostile tender offers. This interpretation would be consistent with the fact that *Revlon* involved a defensive break-up. Moreover, it would be consistent with the court’s hostility to defensive changes in business plans exhibited in *Revlon* where the court found the directors had “embraced” the threat posed by the hostile raider and that for that reason the board’s role changed “from defenders of the corporate bastion to auctioneers charged with getting the best price.” Finally, this interpretation would be consistent with the court’s deference to a company’s continuation of a strategic plan exhibited in *Time* where the court found that the revised Time-Warner transaction was not an abandonment of Time’s strategic plan.

This should not be taken to mean that preplanned break-ups would never trigger *Revlon* duties. Clearly, at a minimum, break-ups that amount to an abandonment of the company’s existence should trigger *Revlon* regardless of whether they are defensive or preplanned. Rather, the determination of whether a transaction is considered preplanned or defensive would be a factor in assessing whether major asset sales that leave some semblance of the company intact amount to a break-up. In such instances, given the court’s hostility to boards abandoning their strategic plans, the court may be more likely to find that a defensive asset disposition constitutes a break-up than a preplanned one.

It is interesting to note that under either of these rationales, the target’s defense in *Interco* would trigger *Revlon*. In that case, Interco, the target of a hostile bid by the Rales brothers, planned a defensive restructuring involving major asset sales, significant additional debt, and substantial dividends to shareholders in cash, debt securities, and preferred stock. In the company’s estimate, shareholders’ continuing equity interest would constitute only thirteen percent of the estimated value of the restructuring. Under the analysis above, this defensive maneuver lies at the very core of the “break-
up” language used by the court in Revlon and Time. Interco was not literally for sale, shareholders retained their nominal equity, and there was no change of control. Yet Interco’s management had clearly given up its role as “defender[] of the corporate bastion,” Interco, of course, never reached the supreme court. In the chancery court, Chancellor Allen forced Interco to redeem its poison pill under Unocal (and specifically not under Revlon). As noted, in Time, the Delaware Supreme Court had been highly critical of Interco’s interpretation of Unocal. The analysis of Revlon suggests that the supreme court would nevertheless have affirmed Interco, albeit under a reasoning different from the one used by the chancery court.

D. Other “Responsive” Changes

In light of the court’s hostility to a board changing its business plan in response to a takeover threat, are there any other “responsive” business changes that the court would subject to substantive review? For example, how would the court deal with a “responsive” asset acquisition, a “responsive” merger or sale of stock not involving a shift of control, a “responsive” asset sale falling short of a break-up, or a “responsive” commitment of major resources to a joint venture? The answer to these questions is in all likelihood that the court will in some circumstances engage in substantive review, though the court has not yet clarified whether it will apply Revlon or the proportionality prong of Unocal.

As discussed above, the court may be more likely to find that a transaction triggers Revlon if it is undertaken in response to a hostile bid than if it is preplanned. Thus, whether doctrinally or factually, Revlon may have a broader scope with respect to defensive actions than with respect to preplanned ones. More importantly, however, defensive actions may be substantively reviewed under Unocal. The clearest statements to that effect come at the end of the supreme court’s opinion in Time. The court had just concluded that the independent directors have broad leeway to find that a hostile tender offer constitutes a “threat” and addressed the second

111. Revlon, 506 A.2d at 182.
112. Time, 571 A.2d at 1150.
113. Interco, 551 A.2d at 803 (holding that defensive recapitalization is analyzed under Unocal, not Revlon).
114. Time, 571 A.2d at 1153.
115. This view of Revlon and Interco differs from the one proposed by Gilson & Kraakman, supra note 74, at 46, who suggest that an Interco-style recapitalization should be analyzed only under Unocal since the target’s managers remain vulnerable to a future takeover.
116. Substantive review should only be forthcoming if the management’s response materially affects the ability of shareholders to reverse the board’s decision to reject a tender offer. Not all “responsive” changes have such an effect. For example, if in response to a tender offer the target board were to fire the company’s management and hire different managers, this ability would not be materially affected. By its prior decisions, the court has indicated that some defensive increases in leverage that do not involve significant changes in the company’s assets or operations are likewise not subjected to stringent substantive review. See, e.g., Revlon, 506 A.2d at 181 (holding an exchange offer of debt securities for stock is a reasonable response to an offer deemed grossly inadequate on mere process review).
part of the *Unocal* test—the requirement that the response must be reasonable in relation to the threat posed—a part that hitherto had not received much attention by the supreme court. Here the court said:

... Delaware law confers the management of corporate enterprise to the stockholders’ duly elected board representatives. ... Directors are not obligated to abandon a deliberately conceived corporate plan for a short-term shareholder profit unless there is clearly no basis to sustain the corporate strategy. ...

... Here the Chancellor found that Time’s responsive action to Paramount’s tender offer was not aimed at “cramming down” on its shareholders a management-sponsored alternative, but rather had as its goal the carrying forward of a pre-existing transaction in an altered form. Thus, the response was reasonably related to the threat.

The court thus draws a clear distinction between target boards that continue a deliberately conceived corporate plan and those that abandon their plan to sponsor an alternative to the hostile bid. As to the former, the court indicates that, except in extreme circumstances, it will not engage in a substantive review. Rather, if a board’s “defense” consists merely of a rejection of a hostile bid, a refusal to redeem the poison pill, and a continuation of business as preplanned, the defense is deemed reasonable.

On the other hand, if the board abandons its strategy and tries to force upon the shareholders a management-sponsored alternative, then the response is no longer automatically deemed reasonable. Instead, the court will at least in some cases engage in a substantive review of the proportionality of the response. This review entails, as the court noted, “an evaluation of the importance of the corporate objective threatened; alternative methods of protecting that objective; impacts of the ‘defensive’ action, and other relevant factors.”

It is significant to note that the supreme court in *Time* cites approvingly to Chancellor Allen’s opinion in *AC Acquisitions* as an instance where a coercive response has been struck down as unreasonable. AC Acquisitions (the raider) had made a non-

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117. In the three instances where the Delaware Supreme Court applied *Unocal*, it did not engage in an extensive analysis of the reasonableness of the response in relation to the threat. See *Unocal*, 493 A.2d at 955-57 (finding the defenses reasonable since the offer was coercive and inadequate and since the offeror had a reputation as a greenmailer); *Revlon*, 506 A.2d at 180-81 (finding the defenses reasonable since they increased the price offered by the raider and since the board deemed the offer inadequate); *Ivanhoe Partners*, 535 A.2d at 1342-44 (finding the defenses reasonable since the price offered was deemed inadequate, the dividend benefitted shareholders, the arrangement with Gold Fields assured the independence of the company, and the defenses were not coercive).


119. See also Gilson & Kraakman, supra note 52, at 269 (stating that even in the presence of valid threats defensive restructurings may fail the proportionality prong of the *Unocal* test).

120. *Time*, 571 A.2d at 1154.

121. *Id*. Only two pages earlier, the Delaware Supreme Court had included *AC Acquisitions* with *Interco* and *Grand Metropolitan* in its list of cases that take an unduly narrow view of what may constitute a legally recognizable threat. *Id*. at 1152. The second approving reference to *AC Acquisitions* indicates that the court disagreed with some of the reasoning, but not with the outcome, of that case.
coercive hostile offer for all the shares of Anderson, Clayton. Anderson, Clayton responded with a coercive partial self-tender offer. Some of these repurchased shares would then be sold to a newly-formed employee stock ownership plan.

**AC Acquisitions** involves peculiar facts. The target’s financial advisor found the price offered in the hostile tender offer to be fair; and the defense was billed as offering an alternative which shareholders may prefer over the hostile tender offer (while it had the effect of coercing shareholders to tender their shares to the target and not to the raider). These facts could justify an invalidation of the board’s response even under a purely process-oriented review. Yet the supreme court’s reference to **AC Acquisitions** in *Time* suggests that, even absent these peculiarities, the defense would have failed under a substantive proportionality review. That is, Anderson, Clayton may not be entitled to implement the coercive response to AC Acquisition’s noncoercive offer unless it can show that its response is substantively superior to that offer.

Indeed, for companies that have a poison pill, it will even be harder to justify a coercive response to a hostile tender offer. A poison pill, until it is redeemed, prevents the consummation of a tender offer, but otherwise does not change the status quo. Thus, to a large extent, a poison pill suffices to counter the threat of a hostile tender offer. By implication, if a poison pill is available, any further management actions that are coercive in nature, or force a management-sponsored alternative onto the shareholders, would not be reasonable in relation to the threat.

Thus, in a curious way, the logic of *Time* and *Unocal* validates the use of the poison pill for a “just say no” defense, but the very existence of a poison pill renders it more difficult for a target company to adopt other, more active defenses. If a poison pill is available, the company may be able to continue managing the business under its pre-existing plans.

122. **AC Acquisitions**, 519 A.2d at 105-10. In addition, the target’s defense was designed to achieve the same aims as an earlier recapitalization plan. This earlier recapitalization was enjoined because of inaccurate and misleading statements made by management in obtaining shareholder approval for it. The earlier recapitalization, however, was not undertaken because of its comparative strategic benefits, but because the company’s efforts to find an acquiror were unsuccessful. *Id.* at 106-07.

123. For example, a court could have found that the board did not have adequate information to conclude that AC Acquisition’s offer constituted a threat of any nature (since the board did not obtain a financial opinion that its self-tender offer is superior to the hostile bid and no other threat was claimed to have existed) or that the board was not adequately informed about the coercive aspects of its self-tender offer (since it claimed to provide merely an alternative that shareholders may want to prefer, rather than an alternative which they had concluded was preferable for shareholders).

124. A poison pill will, of course, not counter the “threat” of shareholders electing different directors who will redeem the poison pill. As this analysis suggests, the possibility of shareholders electing a different board is not a recognizable threat under *Unocal*; to the contrary, that possibility is the very basis for permitting the board not to redeem a pill and to continue managing the business under its pre-existing plans.

125. *Time*, 571 A.2d at 1154 (finding that alternative methods of protecting the objective is a factor in evaluating the reasonableness of the response).

126. In this regard, *Time* somewhat contradicts earlier chancery court decisions that have encouraged a target board to use the time afforded by a poison pill to create alternative transactions. See, e.g., Sutton Holding Corp. v. Desoto, Inc., Nos. 11221, 11222, 1990 LEXIS 15, at 23 (Del. Ch. Feb. 5, 1990 (criticizing the
paramount or paradox

is sufficient to protect the corporate objective against the threat of an inadequate offer, the nature and timing of an offer, the impact on other constituencies, and so on, then affirmative defenses that result in more far-reaching deviations from a deliberately conceived corporate plan, by definition, tend to become disproportional.127

E. Summary

The following framework emerges from the above cases. First, it matters whether a board is planning a sale of the company, a change of control, or a break-up.128 Second, it matters whether, in light of a hostile offer, the board continues on its pre-existing business plan or whether it changes its plan and adopts a defensive alternative. If no sale of the company, change of control, or break-up is involved and the board continues on its pre-existing business plan, a decision to reject the offer will be analyzed only according to process factors (e.g., whether the decision was supported by the independent directors and whether the board had adequate information). On the other pole, if the board plans a sale of the company or a change of control then, regardless of whether the transaction is preplanned or defensive, the court will force the company to give shareholders the choice between the board-supported transaction and the hostile offer or engage in a substantive review under Revlon of any discriminatory treatment of a hostile offeror.

Between these two polar cases lie some intermediate cases involving a break-up or a defensive change in business plans. With respect to these cases, some uncertainties remain mostly due to the fact that the Delaware Supreme Court has not yet dealt with appropriate cases. A break-up clearly triggers Revlon duties, but it is unclear what actions constitute a break-up. In particular, the court has not yet determined whether a strategic split amounts to a “break-up” and whether the standard for a break-up is the same if the break-up is defensive or preplanned. This Article suggests that strategic splits will not amount to a break-up and that the standard for defensive and preplanned break-ups may differ.

If the board changes its business strategy in response to a hostile takeover (other than to sell the company, break it up, or change control over it), there are some cases in which the court will engage in a substantive review under the “proportionality” part of Unocal. In such instances, the court will have to balance “the importance of the corporate objective threatened; alternative methods for protecting that objective; impacts of the ‘defensive’ action, and other relevant factors.”129 As a result of this balancing test, the court could either approve the changed strategy, enjoin it, or force the company to give shareholders the choice.

127. See Time, 571 A.2d at 1154.

128. But see supra note 116 and accompanying text (finding that Revlon may also apply to a narrow category of other fundamental changes that are hard to reverse).

129. Time, 571 A.2d at 1154 (quoting Time chancery court opinion).
V. CONCLUSION

This Article argues that an underlying coherent theory explains the Delaware Supreme Court’s takeover jurisprudence. This theory is based on two fundamental precepts: that the directors, and not courts, should make business decisions; and that shareholders, and not courts, should voice their disagreement with the substantive decisions by electing different directors.

Given the importance of hostile tender offers, and the potential for conflicts of interests when target boards decide to reject such offers, the court has adopted a two-track approach. First, the court has tried to enhance the process of the target board’s decision-making to reduce the potential of such conflicts of interest. This is manifested in the inducements provided by Unocal to give the ultimate decision-making power to the independent directors and to have these directors go through an enhanced process of information-gathering.

Second, the court has tried to preserve shareholders’ ultimate power to effectively override the decision of a target board to reject a tender offer. This is manifested by the strict review under Revlon of board actions that clearly deprive shareholders of such power. It is also demonstrated by the substantive proportionality review under Unocal of lesser board actions, undertaken in response to a hostile offer, that may substantially interfere with that power. By contrast, if the target board merely preserves the status quo or continues to pursue a pre-existing business plan, board actions are only subject to process review under Unocal.

This approach differs from the one advocated by commentators on both sides of the spectrum. Many feel that it gives too much power to management or that it encroaches too much on managerial prerogatives. But, contrary to many claims, this approach is plausible and intelligible. Criticism of the takeover jurisprudence of the Delaware Supreme Court for lack of doctrinal consistency or policy foundation are unwarranted.