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Delaware's Omnipotent Business Judgment Rule: Who Speaks for the Shareholders

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DELAWARE'S OMNIPOTENT BUSINESS JUDGMENT RULE: WHO SPEAKS FOR THE SHAREHOLDERS?

I. INTRODUCTION

Although the American public may have become accustomed to the high-profile courtroom battles which seem to be a by-product of the 1980's takeover mania, many individuals would be surprised to learn that the law used as a basis for such decisions is itself still in the evolutionary process. In fact, the oft-stated legal truism that the law is constantly changing has no finer proving ground than in the Delaware courts' decisions which attempt to define the fiduciary duties of directors in the ever-evolving world of corporate takeovers. Such rapid change can trace its roots to the seemingly endless stream of new defensive takeover tactics which the parties to such battles create.¹

1. A variety of defensive tactics, defined in colorful terminology, have been utilized to ward off hostile takeover bids:

   "Golden parachutes" are contracts made with senior management that provide substantial benefits if the executive leaves the target corporation after a change in control. An executive protected by a golden parachute may be entitled to an amount equal to several years of compensation if displaced by a hostile takeover. Golden parachutes have the effect of increasing the cost of a takeover but are defended as creating a parity of interest between shareholders and management which allows management to act objectively in the face of a hostile takeover bid. On the other hand, many feel that executives who enter into such contracts are violating their fiduciary duties and wasting corporate assets.

   "Crown jewel options" are options granted by a target to a third party to purchase the targets' most valuable assets in order to discourage a hostile bidder from acquiring the target.

   "Poison pills" involve the issuance of authorized unissued preferred stock to shareholders with rights to purchase the company's stock at below market prices upon certain triggering events such as a takeover. These rights may "flip over" and allow the shareholders to acquire shares of the bidding company at below market prices.

   "Shark repellents" are provisions in the target company's articles of incorporation or bylaws which are designed to deter a bidder's interest in the target. Examples of shark repellents include staggering the terms of the board of directors, supermajority voting, and "fair price" provisions, which require supermajority voting unless at least a certain price is paid for the target.

   A "Pac-Man" defense is one in which the target company defends a hostile tender offer by making its own offer for the stock of the hostile bidder in an "I'll eat you before you eat me" struggle.

   A "white knight" is a third party, friendly to target management, which rescues the target from a hostile takeover by either entering into a friendly merger with the target or assisting the target in a defensive tactic such as a crown jewel option.


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The confusion sometimes caused by these decisions is understandable when practitioners look for guidance to cases which are facially similar but which result in dissimilar holdings. Subtle differences in complex and voluminous fact patterns provide the basis for different outcomes. It is therefore difficult for practitioners to find broad statements of policy in these decisions.

Cases interpreting Delaware corporation law in the context of a battle for corporate control set an intermediate standard for judicial review of board action by shifting the initial burden of demonstrating a corporate or shareholder benefit to the directors. The shifting of this burden is proper because of the "omnipresent specter" of director self-interest inherent in such high-stakes battles. When, however, the "break-up" reform in tender offer process needed due to courts' insensitivity to inherent conflict between self-interested management and shareholders, who are deprived of marketplace opportunities by management's defensive tactics.


2. An example of that confusion was the issue of whether Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1986), was a breach of loyalty or a breach of due care decision. Justice Moore of the Delaware Supreme Court resolved that issue when he stated

Following Revlon, there appeared to be a degree of "scholarly" debate about the particular fiduciary duty that had been breached in that case, i.e. the duty of care or the duty of loyalty. In Ivanhoe, we made it abundantly clear that both duties were involved in Revlon, and that both had been breached.

Mills Acquisition Co. v. MacMillan, Inc., 559 A.2d 1261, 1284 n.34 (Del. 1989) (emphasis in original) (citing Ivanhoe Partners v. Newmont Mining Corp., 535 A.2d 1334, 1345 (Del. 1987)). For a discussion of how the application of the original "Revlon duty" may have been expanded in subsequent cases to encompass bright-line criteria implicit in words like "sale" and "change in control," see Reder, The Obligation of a Director of a Delaware Corporation to Act as an Auctioneer, 44 Bus. Law. 275, 281 (1989).

3. See Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985). The holding in Unocal requires the directors of the target company to demonstrate to a court's satisfaction that, as a threshold matter, the board has fulfilled its duty of loyalty before being afforded the protection of the business judgment rule. See Andre, supra note 1, at 891.

4. Unocal, 493 A.2d at 946. The Unocal court stated that although a board's decisions when combatting a hostile takeover attempt are entitled to the same deference as any other business judgment, the "omnipresent specter that a board may be acting primarily in its own interests, rather than those of the corporation and its shareholders" created an enhanced duty that directors must fulfill before the protections of the business judgment rule can be conferred. Id.

Directorial self-interest may be present where a target board approves a bid because of promised post-transactional benefits or where a board rejects a bid in order to insure their own job security. Gilson & Kraakman, Delaware's Intermediate Standard for Defensive Tactics: Is There Substance to Proportionality Review?, 44 Bus. Law. 247, 247-48 (1989). Although the latter interest may be self-evident, the
of the corporate entity appears "inevitable," the Delaware Supreme Court expressly limits directors' responsibilities to the corporation's shareholders. The directors are then charged with the so-called "Revlon duty," as first expressed in Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., to obtain the best price for the shareholders when the company is to be sold.

Recently, the scope of this Revlon duty has been expanded. This expansion has left open the questions of how broad the duty is and what specific types of corporate actions trigger it. This duty on its face appears to limit a target board's use of defensive takeover tactics. Recent

former is more subtle and is just as pervasive. Id. at 247 n.2. The best example of this type of benefit is a third-party leveraged buyout in which target management takes an equity position. In such a transaction, target management acquires a substantial ownership interest in the company if the buyout is successful. Id. A sample of 28 companies given management buyout proposals between 1979 and 1984 showed that target management's ownership interest in the target at the time of the proposal averaged 6.5%; in the 15 consummated buyouts, target management's interest rose to an average of 24.3% after the transaction. Id.

5. Revlon, 506 A.2d at 182. One commentator has suggested that the Revlon court intended to limit the meaning of the break-up concept to "the inevitable destruction of the corporate entity." See Reder, supra note 2, at 278. This occurred in Revlon when, because of the increasing incremental bidding of Pantry Pride, "it became apparent to all that the break-up of the company was inevitable." Id. (quoting Revlon, 506 A.2d at 182). For a discussion of the expansion of the break-up concept to its present form, which includes "sales" and other corporate restructurings resulting in a "change in control," see infra notes 109-13 and accompanying text.

Initially, this concept of break-up was believed to be the crux of Revlon. In fact, "inevitability" appears to be the true Revlon trigger. Although the break-up concept of Revlon has been expanded in recent years, the Delaware Supreme Court has found inevitability to be the determinative factor in holding that corporate transactions which otherwise come within the expanded scope of Revlon do not invoke Revlon duties. See Ivanhoe Partners v. Newmont Mining Corp., 535 A.2d 1334, 1345 (Del. 1987) (decoration of dividend and amendment of standstill agreement resulting in increased ownership of largest shareholder amounted to corporate restructuring under Revlon, but because sale of company not "inevitable," Revlon duties were not invoked).

7. Id. at 182. For a discussion of the policy behind this enhanced duty, see infra notes 58-61 and accompanying text.
8. See Reder, supra note 2, at 280-81. For a discussion of the cases which expanded Revlon, and the reasons behind such expansion, see infra notes 109-13 and accompanying text. The Revlon duty facially limits the target's use of defensive tactics because these tactics are generally used to prevent the sale or restructuring of the target corporation. Without a completed transaction, the shareholder maximization duty of Revlon may be violated unless target management can justify its actions.
9. TW Servs., Inc. v. SWT Acquisition Corp., No. 10298, slip op. at 25 (Del. Ch. Mar. 2, 1989). The court noted that central to the resolution of this case was whether the target was in the "Revlon mode." See generally In re Holly Farms Corp., 564 A.2d 342 (Del. Ch. 1989); In re RJR Nabisco, Inc., No. 10389 (Del. Ch. Jan. 31, 1989), appeal denied, 536 A.2d 1070 (Del. 1989); In re Fort Howard Corp., No. 9991 (Del. Ch. Aug. 8, 1988).
decisions of the Delaware courts, however, have held that defensive tactics which "tilt the playing field" in favor of one party, and at first blush appear to jeopardize escalating corporate auctions, may be valid if a "shareholder benefit" can be demonstrated. The Delaware courts' interpretation of the concept of shareholder benefit determines just how effective Revlon and its progeny will be in preventing management entrenchment disguised as shareholder interest in the takeover arena.

This article will attempt to aid practitioners on both sides of takeover struggles by examining the most recent Delaware decisions, not only to clarify the current state of the law, but also to analyze the factors courts look to in deciding which board actions are valid and consistent with its fiduciary duties to shareholders. Armed with such knowledge, practitioners for target clients will be better able to advise directors on

10. The MacMillan court noted the theory behind this granting of a limited right to favor one bidder over others:

   We do not intend to limit the broad negotiating authority of the directors to achieve the best price available to the stockholders. To properly secure that end may require the board to invoke a panoply of devices, and the giving or receiving of concessions that may benefit one bidder over another.

Mills Acquisition Co. v. MacMillan, Inc., 559 A.2d 1261, 1287 (Del. 1988); see In re Fort Howard Corp., No. 9991, slip op. at 35 (target board may favor one bidder over others if done in good faith belief that shareholder interests will be advanced); In re J.P. Stevens & Co., 542 A.2d 770, 781-82 (Del. Ch. 1988) (Revlon does not purport to restrict powers of disinterested board in conducting company auction, board may tilt playing field if there is shareholder benefit), appeal denied, 540 A.2d 1088 (Del. 1988).

11. J.P. Stevens, 542 A.2d at 782-84. The "shareholder benefit" theory assumes that all shareholder interests are congruent, a concept of questionable validity. In TW Services the chancery court reasoned that there are both long-term and short-term shareholder interests. TW Servs., No. 10298, slip op. at 18. An example of the former are institutional and pension plan investors interested in sustained, long-term growth; an example of the latter are the arbitragers who buy stocks based upon merger rumors in hopes of a quick return on their investment. Where both interests are present, the court concluded that there arises a difference in directorial fiduciary duties owed to each group. Id. at 20. The TW Services court held that conflicts between the two groups should be resolved in favor of the long-term shareholders since their interests are congruent with the corporate entity's. Id. at 18, 20. This holding therefore completes the priority of interests a corporate director must honor, with long-term shareholder interests being primary to short-term shareholder interests, which pursuant to Revlon are primary to non-shareholder interests such as noteholders. See Revlon, 506 A.2d at 182.

12. Factors that support a target corporation's defense to breach of fiduciary duty charges when in the Revlon mode include the appointment of an independent negotiating committee consisting of independent directors and the retention of an independent financial adviser to evaluate the adequacy of the acquiring corporation's bid. See Veasey, The New Incarnation of the Business Judgment Rule in Takeover Defenses, 11 Del. J. Corp. L. 503, 510-11 (1986). This independence, however, can be disputed by a would-be acquiring corporation, as was successfully done in MacMillan. There, the Delaware Supreme Court found breaches of both the fiduciary duties of care and loyalty in spite of the target's use of such practices. MacMillan, 559 A.2d at 1264.
how to protect their corporate interests. Practitioners for would-be acquiring entities will be better able to advise their clients on the obstacles a well prepared target can place in their path. This prospective advice will help both sides avoid unnecessary litigation.

II. BACKGROUND

Under well-established principles of corporate law, the board of directors assumes the responsibility for managing the business and affairs of the corporation. In discharging this responsibility, directors of Delaware corporations become fiduciaries of the corporation and its shareholders, a legal status which imposes upon them the twin duties of care and loyalty. However, because directors need to operate without

13. MacMillan, 559 A.2d at 1280. In Delaware the responsibility for managing the business and affairs of the corporation is codified by state law. The applicable portion of the statute states: “The business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors.” Del. Code Ann. tit. 8, § 141(a) (1983).


15. See Andre, supra note 1, at 888. The duty of care was originally a common law principle which has been codified in most states. Id. This duty requires a director to carry out his functions in good faith, in a manner which he reasonably believes furthers the best interests of the corporation, and with such care as an ordinarily prudent person in similar circumstances would use. Id. Delaware’s version of this rule increases the director’s protection by requiring gross negligence, rather than the simple negligence required under the “ordinarily prudent person” test. See Aronson v. Lewis, 473 A.2d 805, 812 & n.6 (Del. 1984). For a discussion of what the Delaware courts have interpreted “gross negligence” to mean in the context of directorial decisions, see infra note 19 and accompanying text.

The duty of loyalty requires directors to act for the benefit of the corporation and precludes them from engaging in self-interested transactions. See Andre, supra note 1, at 888-89. Upon a showing that a director had an interest in the transaction, acted in bad faith, or engaged in corporate activity for any other improper purpose, the protection of the business judgment rule cannot be invoked. Id.

Although the Delaware judiciary has never stated which of the two duties it considers to be more important, the Delaware legislature, by allowing directors of Delaware corporations to immunize themselves from breaches of the duty of due care, but not from breaches of the duty of loyalty, has implied that loyalty breaches are the more egregious of the two. See Del. Code Ann. tit. 8, § 102(b)(7) (Supp. 1988). Section 102(b)(7) of the Delaware Code enables a Delaware corporation to include in its original certificate of incorporation or an amendment thereto a provision eliminating or limiting a director’s personal liability to the corporation or its stockholders for monetary damages arising from a breach of fiduciary duty. Id. However, the statute does not permit limitation of liability for any breach of the director’s duty of loyalty to the corporation or its shareholders. Id.; see Balotti & Gentile, Elimination or Limitation of Director Liability for Delaware Corporations, 12 Del. J. Corp. L. 5, 11 (1987).

The legislative purpose asserted for this immunization from duty of care liability was that the large potential personal liability of directors had caused the cost of director’s liability insurance to skyrocket. Id. at 10. Therefore, many companies chose to forego this protection, resulting in fewer people willing to serve on corporate boards. Id. The Delaware legislature felt that this removed
fear of personal liability for honest errors in judgment, and to relieve
the courts of the burden of deciding the propriety of complex business
decisions, the Delaware courts have developed a protective device
known as the "business judgment rule." The business judgment rule,
and the standards which directorial conduct must meet to invoke it, are
particularly important in the takeover area. In actions for breach of
entrepreneurial talent from the marketplace, and attempted a statutory remedy
in § 102(b)(7). Id.; see also Pease, Outside Directors: Their Importance to the Corpora-
personal liability and difficulty in obtaining insurance create adverse effect on
corporations' ability to attract and retain experienced outside directors; amend-
ments to Delaware General Corporation Law allowing limitation of liability for
some violations of director fiduciary duties sought to remedy this situation).
Apparently, the legislature reasoned that liability for negligent, albeit good-
faith, violations of the duty of due care were a different matter than the inten-
tional acts of self-interest which accompany breaches of the duty of loyalty.
Granting statutory protection for breaches of loyalty would reduce the fiduciary
duties of corporate directors to the status of unenforceable ethical obligations.

16. See Andre, supra note 1, at 888.
17. The business judgment rule has been categorized as
a presumption that in making a business decision the directors of a cor-
poration 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.
Absent an abuse of discretion, that judgment will be respected by the
courts. The burden is on the party challenging the decision to establish
facts rebutting the presumption.
Aronson, 473 A.2d at 812 (citations omitted). One commentator has defined the
rule as follows:
[T]he Business Judgment Rule is that a transaction which involves no
self-dealing by the directors or no personal interest of the directors will
not be enjoined for misconduct of directors ... unless the record dis-
closes at least one of three circumstances or conditions: (1) that the
directors did not exercise due care to ascertain the relevance of the
available facts before voting to authorize the transaction; or (2) that the
directors voted to authorize the transaction even though they could not
have reasonably believed the transaction to be for the best interest of
the corporation; or (3) that in some other way the directors' authoriza-
tion of the transaction was not in good faith. The Business Judgment
Rule is circumscribed by two important limitations ... Those limita-
tions are: (1) it is available only to a director who has no personal inter-
est in the transaction; and, (2) only if he has paid informed attention to
his duties.
Arsht, Fiduciary Responsibilities of Directors, Officers and Key Employees, 4 Del. J. Corp.
L. 652, 660 (1979) (emphasis in original) (footnotes omitted) (author discusses
business judgment rule's application and relationship to directorial fiduciary du-
ties, and defends against charges that courts utilizing rule favor management
and deal unfairly with stockholders).
Mesa Petroleum Co., 493 A.2d 946, 954 (Del. 1985), the court noted that there
are "certain caveats" to a target board's business judgment protection when it
addresses a pending takeover bid. The Delaware Supreme Court recognized
that although there is a greater need for the protection of the business judgment
rule in the context of takeover battles, such protection was particularly suscepti-
able to abuse, and target board action must withstand the Unocal intermediate
standard of review to earn it. Id. at 954-55; see Pease, supra note 15, at 67. For a
fiduciary duty, the application of the business judgment rule places on
the plaintiff the heavy burden of establishing that the directors were
grossly negligent. However, if the plaintiff can demonstrate that the
transaction involved self-interest or bad faith, the director loses the pro-
tection of the business judgment rule, and the plaintiff need no longer
meet this heavy burden.

Due to the "omnipresent specter that a board may be acting primar-
ily in its own interests, rather than those of the corporation and its
shareholders," the Delaware Supreme Court in *Unocal Corp. v. Mesa
Petroleum Co.* declared that directors addressing a pending takeover bid
discussion of *Unocal* and the intermediate standard of review, see infra notes 21-
32 and accompanying text.

19. *Aronson*, 473 A.2d at 812. Since the Delaware courts have not elected
court judicially to define this standard, its determination is made on a case-by-case
basis. *Id.* at 812 n.6. The single common thread that runs through all the cases
is that director liability is based upon a less exacting standard than that of simple
negligence. *Id.* The *Aronson* court cited the following cases to support this
position:

- Sinclair Oil Corp. v. Levien, 280 A.2d 717, 722 (Del. 1971), rev'd 261
  A.2d 911 (Del. Ch. 1969) ("fraud or gross overreaching");
  (Del. Ch. 1969) ("gross and palpable overreaching");
- Warshaw v. Calhoun, 221 A.2d 487, 492-93 (Del. 1966) ("bad faith . . . or a gross
  abuse of discretion");
- Moskowitz v. Bantrell, 190 A.2d 749, 750 (Del. 1963) ("fraud or gross abuse of
discretion");
- Penn Mart Realty Co. v. Becker, 298 A.2d 349, 351 (Del. Ch. 1972) ("directors may
  breach their fiduciary duty . . . by being grossly negligent");
- Kors v. Carey, 158 A.2d 136, 140 (Del. Ch. 1960) ("fraud, misconduct or abuse of
  discretion");
- Al-laun v. Consolidated Oil Co., 147 A.2d 257, 261 (Del. Ch. 1929) ("reckless
  indifference to or a deliberate disregard of the stockholders").

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  indifference to or a deliberate disregard of the stockholders").


22. 493 A.2d 946 (Del. 1985). In *Unocal* minority shareholder and cele-
brated corporate raider T. Boone Pickens' Mesa Petroleum Co. (Mesa) made a
hostile two-tiered tender offer for Unocal Corporation (Unocal). *Id.* at 949.
Pickens first sought to acquire the 37% of Unocal he needed to acquire majority
control of the company through a front-end loaded cash offer of $54 per share,
and planned to acquire the remaining 49% of the shares through a back-end
offer of junk bonds purportedly the equivalent of the $54 front-end price. *Id.* at
949-50. Unocal's board rejected the Mesa offer as "grossly inadequate" and re-
responded by making a defensive self-tender offer which stipulated that upon
Mesa's acquisition of majority control through its front-end $54 cash offer, Uno-
cal would buy the remaining 49% of the outstanding shares for debt securities
with an aggregate par value of $72 per share. *Id.* at 950-51. Importantly, the
Unocal offer was made conditional upon the exclusion of Mesa from the propo-
sal, and Unocal's directors agreed to tender their own stock as a gesture of confi-
dence in the exchange offer. *Id.* at 951.

Mesa argued that because the offer was open to all shareholders except
Mesa, it was a discriminatory offer. *Id.* at 953. Mesa also alleged that by tender-
ing their own shares in the exchange offer, Unocal's directors would be violating
the fiduciary duties they owed to Mesa, and thereby would forfeit the protection
of the business judgment rule because the directors would derive a financial
benefit not available to all Unocal shareholders. *Id.* Unocal contended that its
assume an "enhanced duty" and, therefore, prior to invoking the protection of the business judgment rule, the board must meet a two-part test.23 First, the target's directors must establish that the pending bid represents a "threat,"24 i.e., that the directors had or have reasonable
directors had acted in good faith in both the rejection of a coercive two-tiered Mesa tender offer and the approval of the exclusionary self-tender offer. Id.

The Delaware Supreme Court held that a director's duty of care extended to protecting the corporation from a perceived threat, whether the source be third parties or other shareholders. Id. at 955. The court found that the coercive nature of an inadequate two-tiered tender offer by a corporate raider with a national reputation as a "greenmailer" was a threat to Unocal's shareholders. Id. at 956. The court noted that such a finding does not end the inquiry, concluding that for "a defensive measure . . . to come within the ambit of the business judgment rule, it must be reasonable in relation to the threat posed." Id. at 955. The court found that the board's stated objective of defeating Mesa's inadequate offer, or in the event that the offer should succeed, to protect the interests of the 49% of the shareholders on the back-end of the transaction, was valid. Id. at 956. Because these objectives would be thwarted by Mesa's participation in the self-tender offer (i.e., Unocal would effectively be subsidizing Mesa's $54 per share offer with a $72 back-end payout), the selective self-tender offer was held by the court to be "reasonably related to the threats posed." Id.

23. Id. at 954-55; see Gilson & Kraakman, supra note 4, at 251 (Unocal duty established intermediate standard of judicial review which contemplates genuine effort to distinguish defensive tactics that benefit shareholders from suspect tactics designed to entrench management).

24. Examples of sufficient threats include inadequacy of the price offered, the nature and timing of the offer, questions of illegality, the impact on non-shareholder constituencies, the risk of non-consummation and the quality of the securities being exchanged. Unocal, 493 A.2d at 955. As a caveat, note that Revlon holds that concern for non-shareholder constituencies must not come at the shareholders' expense. Revlon, 506 A.2d at 182-84.

The actual threat found by the court in Unocal was the fact that the offer was made by T. Boone Pickens, a man "with a national reputation as a 'greenmailer.' " Unocal, 493 A.2d at 956; see Gilson & Kraakman, supra note 4, at 252-53. "Greenmail" describes a technique whereby the target corporation repurchases its own stock from a raider at a premium price that is unavailable to other shareholders in order to prevent a takeover. Unocal, 493 A.2d at 956 n.13. If such selective stock repurchases are reasonably related to the takeover threat posed, such a plan is not unlawful. Compare Cheff v. Mathes, 41 Del. Ch. 494, 503-04, 199 A.2d 548, 554 (1964) (repurchase of stock from dissident shareholder to maintain business operations is legitimate) with Bennett v. Propp, 41 Del. Ch. 14, 20, 187 A.2d 405, 408 (1962) (repurchase of stock to maintain control of corporation is improper).

Mills Acquisition Co. v. MacMillan, Inc., 559 A.2d 1261 (Del. 1989), contains the most comprehensive Unocal threat list. To cover potential greenmail threats, MacMillan adds "the bidder's identity, prior background and other business venture experiences; and the bidder's business plans for the corporation and their effects on stockholder interests." Id. at 1282 n.29 (citations omitted); see also Ivanhoe Partners v. Newmont Mining Corp., 535 A.2d 1334, 1341-42 (Del. 1987) (citing Unocal, 493 A.2d at 955-56). Pursuant to Revlon, the MacMillan court also expressly subordinated non-shareholder interests by stating that although the board may consider the effect of both the bid and the potential acquisition on non-shareholder constituencies, it may only do so if the impact also "bears some reasonable relationship to general shareholder interests." MacMillan, 559 A.2d at 1282 n.29. Other additions to the Unocal list which merit board consideration include the fairness and feasibility of the bid, the proposed
grounds for believing that a "danger to corporate policy and effectiveness existed." Directors can satisfy this prong of the test through a showing of "good faith" and "reasonable investigation." The second part of the Unocal test, the so-called "proportionality prong," requires that the defensive measure taken by the board be "reasonable in relation to the threat posed." This proportionality prong is the major change

Evidence of the above two points can be seen in Paramount Communications Inc. v. Time Inc., where Time's board of directors claimed that Paramount's hostile bid represented a "threat" to the distinctive "Time culture". No. 10670, slip op. at 10 (Del. Ch. June 14, 1989), aff'd, 565 A.2d 280-81 (Del. 1989) (Table). The chancery court defined this culture "in part to be pride in the history of the firm . . . and in part a managerial philosophy and distinctive structure that is intended to protect journalistic integrity from pressures from the business side of the enterprise." Id. Paramount countered that the "Time culture" was nothing more than a disguised attempt to entrench present management. Id. The court held that the "Time culture" concern of Time's board was valid because there was no evidence that in satisfying this concern the directors had sacrificed or ignored their duty to seek the maximization of the long-term interests of the corporation and its shareholders. Id. at 17-18. For a discussion of the facts and holding of Time, see supra note 64 and accompanying text.

25. Unocal, 493 A.2d at 955 (citation omitted). This first prong of Unocal traces its origin back to Cheff v. Mathes, 41 Del. Ch. 494, 199 A.2d 548 (Del. 1964). For a discussion of the facts and holding of Cheff, see infra notes 28-29 and accompanying text.

26. Unocal, 493 A.2d at 955 (citing Cheff, 41 Del. Ch. at 506, 199 A.2d at 555). The court also noted that an offer of such proof would be "materially enhanced" when the board which approves the transaction is comprised of a majority of outside, independent directors. Id.

Because the issue of directorial self-interest necessarily implicates facts which are peculiarly within the director's knowledge of his own subjective intent, the Delaware courts have placed the burden of proof on this issue on the directors. Veasey, supra note 12, at 509. The satisfaction of this burden requires a showing of independence and reasonable investigation. Id. Mr. Veasey interprets the "good faith" part of this test to mean "independence," and he explains what the courts look for to satisfy both elements:

[T]he court[s] noted that the board was composed of a majority of outside directors. The presence of this characteristic "heightened" the presumption available to the board with respect to their independence and their actions. The reasonable investigation element relates to the board's process or methodology which the courts will scrutinize very carefully in determining whether the directors examined all material facts reasonably available to them and exercised due care in decision making, or whether they were grossly negligent. Id. (footnote omitted). For a discussion of how independent negotiating committees are important in directors' satisfaction of the good faith requirement, and how independent financial advisers are essential to the reasonable investigation element, see infra note 139 and accompanying text.

27. Unocal, 493 A.2d at 955. Unocal attempted to put teeth into the old Cheff standard by adding a second prong to its traditional policy-conflict analysis. See Gilson & Kraakman, supra note 4, at 251. Management can no longer qualify for
from the law prior to *Unocal*, as embodied in *Cheff v. Mathes*. The *Cheff* court held that directors could satisfy their initial burden by a showing of good faith and reasonable investigation alone, provided the exercise of business judgment appeared reasonable at the time made.

Business judgment protection merely by pointing to a "danger to corporate policy" based on a carefully orchestrated record." *Id.* After *Unocal* the defensive tactic must also be demonstrated to be "reasonable in relation" to the alleged threat. *Id.* The policy behind this proportionality prong was to insure that "[a] corporation does not have unbridled discretion to defeat any perceived threat by any Draconian means available." *Unocal*, 493 A.2d at 955.

It has been suggested that the Delaware courts' application of the proportionality prong will determine whether *Unocal* becomes a true obstacle to self-interest, or, like the *Cheff* policy-conflict standard, just another legal hoop for target boards to jump through. See Gilson & Kraakman, *supra* note 4, at 251. Messrs. Gilson and Kraakman conclude that the proportionality prong could be strengthened by requiring the target board to make a showing of how and when management expects target's shareholders to do better than they would if the board accepted the hostile offer. *Id.* at 268.

28. 41 Del. Ch. 494, 199 A.2d 548 (1964). In *Cheff* the president of Maremont Automotive Parts, Inc. (Maremont) attempted to negotiate a merger with Holland Furnace Company (Holland), but Holland decided that differences in the sales practices of the two companies made such a transaction unwise. *Id.* at 499, 199 A.2d at 551. Although claiming, in light of Holland's decision, to have no further interest in the company, Maremont proceeded to secretly buy up large amounts of Holland stock, and to press for representation on Holland's board of directors. *Id.* at 499-500, 199 A.2d at 551. Holland's board, afraid Maremont would seek to change its sales practices and thus radically affect the way the company did business, addressed this threat to corporate autonomy by electing to purchase Maremont's position in the company for a price in excess of the prevailing market price. *Id.* at 500-02, 199 A.2d at 551-53. Disgruntled Holland shareholders filed a derivative suit, alleging that the purchase of the stock held by Maremont should be rescinded, as it was done for the purpose of insuring the perpetuation of control of Holland by the incumbent directors. *Id.* at 502, 199 A.2d at 553. The Delaware Supreme Court, in reversing the chancery court's finding that the purpose behind the board's purchase was to perpetuate control, held that the board had met its burden of showing it had used good faith and reasonable investigation in arriving at the conclusion that the stockholdings of Maremont represented a threat to the continued existence of Holland. *Id.* at 508, 199 A.2d at 556. The *Cheff* court concluded that the board's action was therefore entitled to the protection of the business judgment rule, and the directors would not be penalized for honest mistakes in business judgment. *Id.* at 505, 199 A.2d at 556-57.

As one commentary has stated, *Cheff*'s resolution of the problem of judicial review implicitly granted blanket protection of defensive tactics, because experienced takeover lawyers told their target clients that if, in good faith and after reasonable investigation, they could locate a policy conflict with a would-be acquirer, any defensive response would be shielded by the business judgment rule. Messrs. Gilson and Kraakman, *supra* note 4, at 249-50. *Unocal* attempted to remedy this shortcoming by adding the requirement that the defensive tactic be reasonable in relation to the threat posed. For a discussion of the facts and holding of *Unocal*, see *supra* note 22 and accompanying text.

In bringing a claim for breach of fiduciary duty, the party seeking judicial review of a board’s defensive measures must first allege specific instances of improper conduct for a court to apply the intermediate Unocal standard. Once this threshold pleading burden is met, however, the burden of proof shifts to the target’s directors, and “the challenged transaction must withstand rigorous judicial scrutiny under the exacting standards of entire fairness.” Directors subject to this “entire fairness” burden are required to demonstrate their good faith and the inherent fairness of all transactions in which they possess a financial, business or other personal interest and which do not primarily benefit the corporation or its shareholders generally.

The next watershed case after Unocal in the evolving takeover law arena was Revlon. Revlon has achieved prominence due to the Delaware Supreme Court’s imposition of the much-litigated Revlon duty.


31. MacMillan, 559 A.2d at 1279 (citations omitted); see Weinberger v. UOP, Inc., 457 A.2d 701, 710 (Del. 1983). The concept of entire fairness has two parts, “fair dealing and fair price.” Id. at 711. “‘Fair dealing’ focuses upon the actual conduct of corporate fiduciaries in effecting a transaction, such as its initiation, structure, and negotiation.” MacMillan, 559 A.2d at 1280. This element also includes the duty of candor owed by directors to disclose all material information. Id. “Fair price,” in the context of a takeover battle for corporate control, means getting the highest price reasonably available to the shareholders under the circumstances. Id.; see also Weinberger, 457 A.2d at 711. The Weinberger court, summarizing the rationale behind this fairness standard, stated that “where one stands on both sides of a transaction, he has the burden of establishing its entire fairness.” Id. at 710 (citations omitted). The court also noted that strong evidence of fairness can be obtained by the appointment of an independent negotiating committee of outside directors to deal with a would-be acquirer at arm’s length, and in fact, the existence of such a committee could have enabled the UOP directors to avoid liability in Weinberger. Id. at 710-11 n.7.

32. MacMillan, 559 A.2d at 1280; Aronson, 473 A.2d at 812; Weinberger, 457 A.2d at 710. The primary motivations courts remain wary of are management entrenchment, where target management is primarily concerned with job security, and transactions where target management receives a post-transaction benefit, such as an equity position in the new entity. For a discussion of the pervasiveness of these interests, see supra note 4 and accompanying text.

33. Although Revlon is of primary importance for its introduction of the Revlon duty, the case is cited as authority on other issues as well. For example, Revlon is cited for the proposition that although Unocal allows the consideration of non-shareholder interests in analyzing a threat under the first prong of the Unocal test, the board can only consider such interests if there is a benefit to the shareholders as well. Revlon, 506 A.2d at 182. For a further discussion of this aspect of Revlon, see supra note 24 and accompanying text.

34. Justice Moore reasoned in MacMillan that Revlon only narrows the responsibility of the board to maximize current share value, that the board’s duties were still the same ones enunciated in Unocal, and that beyond that there “are no
In *Revlon*, Revlon had repeatedly rejected Pantry Pride's attempts to initiate a friendly merger, claiming categorically that Pantry Pride's offers were far below Revlon's intrinsic value. Alleging these "grossly inadequate" offers to be threats under *Unocal*, Revlon adopted a stock repurchase plan and a poison pill Note Purchase Rights Plan ("Rights Plan") as defensive measures. In response, Pantry Pride made a hostile any-and-all cash tender offer, which was effectively blocked by the Rights Plan and the restrictive Note covenants. In spite of those two obstacles, Pantry Pride continued to raise its cash bid to the Revlon shareholders.


For a discussion of what the *Revlon* duty requires of corporate directors, see supra note 8 and infra notes 60-61 and accompanying text.


36. *Id.* at 177. The stock repurchase plan called for the purchase by Revlon of up to 10 million shares of its own stock. *Id.* Management would acquire this stock by offering one Senior Note of $47.50 at 11.75% interest and 1/10 of a share of preferred stock in exchange for one share of common stock. *Id.*

37. *Id.* Under the plan each Revlon shareholder would receive a dividend of one Note Purchase Right for each share of common stock, entitling the holder to exchange the stock for a $65 principal Revlon note at 12% interest with a one-year maturity. *Id.* The Rights were triggered whenever anyone acquired beneficial ownership of 20% or more of Revlon's stock, unless the acquirer purchased all of the company's stock for $65 cash per share. *Id.* Finally, the Rights were not made available to the acquirer and could be redeemed prior to the occurrence of the 20% triggering event for $.10 each. *Id.* For a general discussion of the poison pill defense tactic, see supra note 1.

38. Pantry Pride's offer was for 100% of all outstanding shares of Revlon stock. *Revlon*, 506 A.2d at 177. Stockholders were offered $47.50 per common share and $26.67 per preferred share, conditioned only upon (1) Pantry Pride's obtaining financing and (2) the redemption, rescission or voiding of the Rights Plan. *Id.*

39. *Id.* The Notes contained covenants that limited Revlon's ability to incur new liabilities, sell assets and pay dividends. *Id.* The assumption of these covenants served to stymie Pantry Pride's attempted takeover, since the issuance of debt securities to finance the takeover would cause Revlon to default on the Notes. *Id.*

40. *Id.* Pantry Pride incrementally raised its offer from a low of $42 per share to a high of $58 per share at the time it sought the injunction to block the Revlon-Forstmann transaction. *Id.* at 177-79.

41. For a definition of "white knight," see supra note 1.
would effect a leveraged buyout of Revlon. Forstmann was given access to confidential Revlon financial data denied to Pantry Pride. A merger between Revlon and Forstmann was announced, the terms of which included Revlon’s waiver of the costly Note covenants. Pantry Pride was not deterred, however, as it again raised its cash bid and declared its intention to top any Forstmann offer.

Upon threats of litigation from the holders of Revlon’s Notes, the value of which had dropped upon Revlon’s waiver of their covenants, Revlon and Forstmann were forced to negotiate a new merger agreement. In exchange for a higher per share price and a promise to support the value of the Notes, Revlon granted Forstmann a “lock-up option,” a “no-shop” provision and a “cancellation fee.”

42. Revlon, 506 A.2d at 178. A leveraged buyout occurs when an investor purchases a publicly held corporation through debt that is secured by the acquired corporation’s assets. Note, Post-Tender Offer Purchases: Rebalancing the Scales, 65 Tex. L. Rev. 185, 204 n.134 (1986).
43. Revlon, 506 A.2d at 178.
44. Id.
45. Id. At a meeting between representatives of Pantry Pride, Forstmann and Revlon, Pantry Pride announced that it would engage in “fractional bidding,” topping any offer made by Forstmann with a slightly higher one. Id.
46. Id.
47. Id. at 178-79. A lock-up refers to the competitive advantage which a target corporation will grant to a white knight to purchase valuable assets or stock of the target at a favorable price, usually below market value. See Note, Lock-Up Options: Toward a State Law Standard, 96 Harv. L. Rev. 1068, 1068 & n.1 (1983). However, “[i]f the lock-up price equals the market value of the assets, there is no real bite or value to the lock-up.” Herzel, Colling & Carlson, Misunderstanding Lockups, 14 SEC. REG. L.J. 150, 175 (1986). This is because the competing bidder may not care whether he is acquiring the asset that is the subject of the lock-up or its cash equivalent. Id. Therefore, for the lock-up to work, the asset must be important enough and the price advantageous enough to make the target corporation an undesirable acquisition upon exercise of the deterrent. Id. Such a transfer “facilitates acquisition by that acquirer and impedes acquisition by other potential acquirers by either making the acquisition more expensive or less attractive.” 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, 487 (1987) (footnote omitted).

Although lock-ups are not per se illegal under Delaware law, their validity depends upon whether they benefit shareholder interests. See Revlon, 506 A.2d at 183; Thompson v. Enstar Corp., 509 A.2d 578 (Del. Ch. 1984). In the context of a Revlon auction, lock-ups that “attract competing bids will be upheld, while those which preclude competing bids will be overturned.” Nachbar, supra, at 487 (footnote omitted). Mr. Nachbar suggests that although this Revlon lock-up formulation appears to encourage competitive bidding generally, it is not helpful in deciding the validity of a lock-up in an individual case. Id. This lack of guidance occurs because all lock-ups, by their very definition, encourage the bid of the entity granted the lock-up and discourage the bids of all others. Id. at 488.

Pride then filed for injunctive relief, challenging these three provisions, as well as the Rights Plan.\textsuperscript{50}

Rev. 641, 642 n.8 (1986). These provisions are common in merger agreements and become binding on the target once the agreement is signed. See Nachbar, \textit{supra} note 47, at 480. The no-shop provision does not, however, prohibit the target board from receiving an unsolicited bid. \textit{Id}. A similar provision is the "fiduciary out" provision, in which the target board agrees to support the merger agreement, but retains the right to solicit bids and negotiate with other bidders if its fiduciary duties so require. \textit{Id}. at 480-81.

The \textit{Revlon} court held that although no-shop provisions are not \textit{per se} illegal under Delaware law, they were impermissible under \textit{Unocal} once the \textit{Revlon} duty to sell to the highest bidder was imposed. \textit{Revlon}, 506 A.2d at 184.

The general consensus is that the validity of no-shop provisions hinges upon the context in which they are given, with the most important factor being whether other interested bidders had an adequate opportunity to bid before the no-shop clause was granted. Nachbar, \textit{supra} note 47, at 483. If other bids have been accepted, then the no-shop provision may be permissible, because its grant may preserve a competitive auction by keeping bidders interested who would otherwise be reluctant to make a bid, believing they were only a "stalking horse" for higher bids. \textit{Id}.

Fiduciary Out clauses are not a directorial concern under \textit{Revlon} because, by its very definition, such a clause allows the solicitation of higher bids if the fiduciary duties of the target board so require. \textit{Id}. at 481.

49. \textit{Revlon}, 506 A.2d at 178-79. "Cancellation," "goodbye" and "break-up" fees are interchangeable terms, referring to a provision which allows a disappointed bidder to receive a lump sum cash payment should the proposed combination of bidder and target not occur. Nachbar, \textit{supra} note 47, at 485. Such an agreement's validity is determined as if it were a liquidated damages provision, in that if the amount is considered reasonable in relation to the bidder's efforts and the magnitude of the transaction, the fee will be upheld. \textit{Id}. However, when the fee becomes so large that its payment will materially impact the financial health of the target, it will be susceptible to challenge. \textit{Id}.

In \textit{Revlon}, Forstmann was granted a cancellation fee of $25 million in a $1 billion transaction, with payment conditioned upon either termination of the merger agreement or an entity becoming a 20\% shareholder in Revlon. \textit{Revlon}, 506 A.2d at 178. The \textit{Revlon} court affirmed the chancery court's enjoining of the payment, holding that the cancellation fee was part of the overall plan to thwart the hostile bidder's efforts, in violation of the director's duties. \textit{Id}. at 184; \textit{accord} Hanson Trust PLC v. ML SCM Acquisition Inc., 781 F.2d 264, 281-82 (2d Cir. 1986) ($9 million goodbye fee invalid because of risk that non-tendering shareholders would bear costs if not consummated). \textit{But see} Beebe v. Pacific Realty Trust, 578 F. Supp. 1128, 1150-51 (D. Or. 1984) (cancellation fee equal to 1\% of value of transaction upheld as reasonable where bidder granted provision made best offer after company had been shopped for some time); DMG, Inc. v. Aegis Corp., No. 7619, (Del. Ch. June 29, 1984) (court refused to enjoin transactions which precluded enforcement of losing bidder's lock-up, allowing bidder to collect $1.5 million break-up fee pursuant to merger agreement).

50. \textit{Revlon}, 506 A.2d at 179. Pantry Pride originally sought injunctive relief only from the Revlon Rights Plan, and then amended its complaint to also challenge the lock-up, cancellation fee and the exercise of the Rights and the Note covenants. \textit{Id}. In addition, Pantry Pride also sought a temporary restraining order (TRO) to prohibit Revlon from transferring any assets to Forstmann. \textit{Id}. The chancery court granted Pantry Pride's TRO request and eight days later granted its request for injunctive relief as well. \textit{Id}. The chancery court held that Revlon's directors, out of self-interested concern over their own personal liability to the company's noteholders, had breached their duty of loyalty by engaging
The Delaware Supreme Court in *Revlon* held that the *Revlon* duty should be imposed only when the break-up of a corporation appeared inevitable. This duty was imposed on Revlon's directors when the bid of Pantry Pride exceeded the value of Revlon as a going concern, but not the value that a piece-by-piece or break-up sale of the company could bring about. Thus, shareholder benefit, as measured by return on investment, would be greatest for Revlon's shareholders if the company were sold off in pieces by target management or by the would-be acquirer, a fact that Revlon's board recognized when it authorized management to negotiate a sale of the company with third parties. Because Revlon no longer faced the "grossly inadequate bid" threat to corporate policy that its board had alleged, the "question of defensive measures became moot." At this point the company was not to be sold to insure the preservation of the corporate entity, but rather was to be broken up, leaving Revlon's board only one role: get the best price possible for the shareholders.

In summary, *Revlon* requires that when the break-up of a company in the transaction with Forstmann, rather than seeking to maximize the sale price of the company in an auction for the shareholders' benefit. *Id.* Revlon then appealed the grant of the injunction to the Delaware Supreme Court. *Id.* at 175.

51. *Id.* at 182. For a discussion of the significance of an inevitable break-up in the context of imposing *Revlon* duties, see *supra* note 5 and accompanying text. For a discussion of how the Delaware courts have expanded the break-up concept since *Revlon*, see *infra* notes 109-13 and accompanying text.

52. A term used interchangeably with the break-up takeover is the "bust-up" takeover, which refers to a situation where a corporate raider seeks to finance its acquisition by selling off unwanted pieces of the target corporation, presumably at a substantial profit. *Revlon*, 506 A.2d at 181 n.12 (citing Moran v. Household Int'l Inc., 500 A.2d 1346, 1349 n.4 (Del. 1985)).

53. The *Revlon* court noted that an orderly disposition of Revlon's assets could generate between $60 to $70 per share, while the market value of the company as a whole entity was in the mid-fifty-dollar range. *Revlon*, 506 A.2d at 177.

54. *Revlon*, 506 A.2d at 182; see also *Reder*, *supra* note 2, at 278.

55. The grossly inadequate bid is target management's most popular reason for opposing tender offers. *See Andre*, *supra* note 1, at 869 n.21. This rationale serves as the rallying cry to justify target management defensive tactics that "protect" shareholder interests pursuant to *Unocal*. *Id.* Once the *Revlon* duties are triggered, however, target management loses its best defense, and is forced to look for a shareholder benefit to justify its tactics. *Revlon*, 506 A.2d at 182-83. The allegation of a shareholder benefit is required because the inevitable break-up or "change in control" occurs in a sale where the competing bids fall within a range in which an independent financial advisor considers the true value of the stock to lie, and such bids cannot be grossly inadequate. *Id.* at 181-83.

56. *Revlon*, 506 A.2d at 182; see *Reder*, *supra* note 2, at 278. The issue of defensive tactics is moot because without a threat to corporate policy sufficient to meet the first prong of *Unocal*, there is no need to inquire about the "reasonableness" of the response—any defensive tactic used in such a situation is a prima facie violation of a board's fiduciary duties.

57. *Reder*, *supra* note 2, at 278.
becomes inevitable, the duty of the board changes from the preservation of the corporate entity to the maximization of current share value at a sale for the shareholders' benefit. This holding significantly changed the board's responsibilities under Unocal. The Revlon court reasoned that a corporation involved in an inevitable break-up no longer faced any threat to corporate policy or effectiveness from a grossly inadequate bid, and therefore any defensive tactics taken by a target board would be presumed to be motivated by self-interest unless a shareholder benefit could be derived from it. In accordance with Revlon, this benefit must manifest itself in the form of a competitive auction, ultimately leading to a transaction most beneficial to shareholder interests, whether it be by maximizing share values or an otherwise "best possible transaction."

After Revlon a favored tactic of bidders challenging a target's takeover defenses is to claim that the target, at the time it instituted such defenses, had been "put in play," or in the current takeover parlance, was in the Revlon mode. Under this reasoning any defensive takeover taken by the target would be contrary to the Revlon duty of transaction

58. Revlon, 506 A.2d at 182.
59. Id. at 182-83.
60. Id. at 182. This "maximization of shareholder value" duty of Revlon has been explained as follows:

The directors are responsible only to the shareholders when it becomes clear to the directors that the corporation as an effective business entity will not survive in recognizable form. From the moment the directors perceive that clarity, their role shifts from beneficent fiduciaries for a wide range of constituencies to auctioneers with the solitary goal of achieving the highest price for the shareholders.

Reder, supra note 2, at 278-79.
61. In re J.P. Stevens & Co., 542 A.2d 770, 781 (Del. Ch. 1988). The maximization of shareholder value duty was expanded by the J.P. Stevens court to include transactions which may benefit shareholders in ways other than immediate share appreciation: "[M]aterial factors other than 'price' ought . . . to be considered and, where appropriate, acted upon by the board. Such consideration might include form of consideration, timing of the transaction or risk of non-consummation." Id. at n.6 (court held board justified in considering threat of non-consummation to proposed merger that antitrust laws posed, rather than simply looking at price offered by two bidders in auction of company). For a discussion of the facts and holding of J.P. Stevens, see infra notes 72-81 and accompanying text. For cases which adopt the best possible transaction, or the "best available transaction" test as an alternative to the maximization of shareholder value duty of Revlon, see generally Paramount Communications Inc. v. Time Inc., No. 10670 (Del. Ch. July 14, 1989), aff'd, 565 A.2d 280-81 (Del. 1989) (Table); In re RJR Nabisco, Inc., No. 10389 (Del. Ch. Jan. 31, 1989), appeal denied, 556 A.2d 1070 (Del. 1989); City Capital Assocs. v. Interco Inc., 551 A.2d 787 (Del. Ch.), appeal denied, 556 A.2d 1070 (Del. 1988); In re Fort Howard Corp., No. 9991 (Del. Ch. Aug. 8, 1988).
62. "Put in Play" and the "Revlon mode" are interchangeable terms that mean the target board must meet their Revlon duties, since the corporation faces an inevitable break-up. See Time, No. 10670, slip op. at 54 (plaintiff argued that target board's actions placed target in "Revlon mode").
maximization, since the defensive tactic could only have been intended to defeat the bids of would-be acquirers made in the course of a corporate auction which would accomplish such maximization. The most recent example of this attempt to extend Revlon occurred in Paramount Communications Inc. v. Time Inc. In Time a group of shareholder-plaintiffs argued, inter alia, that Time's planned purchase of, and eventual merger with, Warner Communications Inc. placed Time "in play" and, hence, was a corporate sale or restructuring because Warner shareholders would own more than sixty percent of the combined entity, if consummated.

Of the recent Delaware cases, Mills Acquisition Co. v. MacMillan, Inc., its progeny, and In re J.P. Stevens & Co. are most indicative of

63. See, e.g., Time, No. 10670 (Del. Ch. July 14, 1989); In re Holly Farms Corp., 564 A.2d 342 (Del. Ch. 1989); In re RJR Nabisco, Inc., No. 10389 (Del Ch. Jan. 31, 1989).

64. No. 10670 (Del. Ch. July 14, 1989), aff'd, 565 A.2d 280-81 (Del. 1989) (Table). In Time, Time Inc. (Time) and Warner Communications (Warner) sought to consummate a friendly combination of their companies which both believed would be "of extraordinary benefit and promise" to their shareholders. Time, No. 10670, slip op. at 3. Time was to purchase 100 million shares of Warner at $70 per share, making Time the acquiring company in the deal. Id. at 1. Just 10 days before the transaction was finalized, Paramount Communications (Paramount) made a $175 per share hostile bid for Time, which was eventually raised to $200 per share. Id. at 25, 40. This offer was rejected by Time's board. Id. at 27-28.

Paramount sought to enjoin the Time-Warner merger, alleging that Time's board had a fiduciary duty to present the Warner transaction to Time's shareholders. Id. at 3. Paramount believed Time's shareholders would reject the merger in order to tender their shares to Paramount because Paramount's $200 per share bid represented a substantial premium over Time's pre-offer market value. Id. at 2. In addition, a group of shareholder-plaintiffs who were joined with Paramount in this consolidated action argued that the Time-Warner deal had put Time into the Revlon mode because although Time was technically acquiring Warner, the transaction was a corporate restructuring which culminated in 62% of the combined entity's shares in the hands of former Warner shareholders. Id. at 54-56.

Time countered these charges by claiming that Paramount's initial $175 offer was inadequate and that the Warner transaction was in the best long-term interests of the shareholders. Id. at 29-30. Time claimed it was not bound by Revlon and thus was not required to seek short-term share value maximization because it was the acquiring corporation, not the target, and thus the transaction entailed no change in control. Id. at 55-56.

The chancery court held that the directors had used reasonable business judgment in finding the initial Paramount offer inadequate, and that, outside of the Revlon mode, directors acting in good faith and in an informed manner are free to seek long-term value even at the cost of immediate gains. Id. at 50-51. The court found that since the Time board did not expressly resolve to sell the company, and the merger agreement did not contemplate a change in control, Revlon did not bind the board. Id. at 58-59.

65. Id. at 54, 56.


67. See In re Holly Farms Corp., 564 A.2d 342 (Del. Ch. 1989); In re RJR

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how the Delaware courts are currently applying the *Revlon* standard. Each of these cases involved competing bids by would-be acquirers of target corporations which had already reached an auction stage of negotiations. Accordingly, it was undisputed that the threshold question of *Revlon*'s applicability had been answered in the affirmative. 69 Similarly, each involved a hostile bidder being pitted against a target board-favored white knight. 70 This situation is precisely the kind of potentially self-interested board transaction against which *Revlon* was designed to protect target shareholder interests. 71

In *J.P. Stevens* the board had to choose between a hostile all-cash offer from West Point, Inc. ("West Point") of $62.50 per share, where the deal's consummation could be threatened or at least delayed due to potential antitrust claims, and an all-cash offer of $64 per share from a management favored white knight, Odyssey Partners ("Odyssey"). 72 Odyssey offered target management equity positions in the new entity as well as job security, since Odyssey was only an operating company with no capacity to run the newly formed enterprise. 73 Management chose

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68. 542 A.2d 770 (Del. Ch. 1988). For a complete discussion of *J.P. Stevens*, see infra notes 72-81 and accompanying text.

69. See *Holly Farms*, 564 A.2d at 343; *MacMillan*, 559 A.2d at 1264; *RJR Nabisco*, No. 10389, slip op. at 1-2; *J.P. Stevens*, 542 A.2d at 770, 772.

70. See *Holly Farms*, 564 A.2d at 343; *MacMillan*, 559 A.2d at 1264; *RJR Nabisco*, No. 10389, slip op. at 1-2; *J.P. Stevens*, 542 A.2d at 770, 772. For a definition of "white knight," see supra note 1. For a discussion of how a "white knight" was utilized: in *Revlon*, see supra notes 41-50 and accompanying text; in *J.P. Stevens*, see infra notes 72-81 and accompanying text; in *MacMillan*, see infra notes 83-93 and accompanying text.

71. *Revlon*, 506 A.2d at 184. The *Revlon* court expressly warned target boards that "when bidders make relatively similar offers, or dissolution of the company becomes inevitable, the directors cannot fulfill their enhanced *Unocal* duties by playing favorites with the contending factions." *Id.*

72. *J.P. Stevens*, 542 A.2d at 772, 774. Because West Point and Stevens were both engaged in the home furnishings textile business, evaluation of West Point's proposal involved a consideration of antitrust concerns not presented by the Odyssey offer. *Id.* at 774. Stevens' legal advisers gave a preliminary opinion that a merger with West Point would "raise serious antitrust concerns" that might delay a merger for a substantial period. *Id.* Significantly, West Point refused to include in the merger agreement a contract provision requiring it to divest itself of whatever assets the Federal Trade Commission (FTC) found objectionable from an antitrust perspective, and had not otherwise cooperated in seeking FTC guidance. *Id.* at 778. Therefore, Stevens' Special Committee concluded that "the risks presented by the antitrust concerns continued to render West Point's proposal less advantageous" than Odyssey's offer. *Id.* Odyssey posed no such antitrust concerns, as it was not an operating company, but rather a New York partnership existing only as a conduit for affiliates JPS Acquisitions Corp. and JPS Holding Corp. to acquire other corporate entities. *Id.* at 772, 774.

73. *Id.* at 779. The court noted that Odyssey was considered a white knight by Stevens management for three reasons: (1) Odyssey had no capacity to run
the Odyssey offer, despite the fact that (1) the antitrust claims regarding
the West Point offer were speculative, (2) West Point had expressed a
willingness to top the $64 Odyssey offer,74 and (3) the Odyssey offer was
made contingent upon the granting of a “topping fee,”75 a $19 million
break-up fee76 and a fiduciary-out agreement.77 The chancery court
held that, upon these facts, “entire fairness” did not mandate a neutral
playing field for all the players,78 and “the board may tilt the playing
field if . . . it is in the shareholders’ interest to do so.”79 The court
concluded that Odyssey’s last pre-litigation offer was higher and, due to
the antitrust issue, more likely to close quickly, and that these factors
provided a rational basis for the board’s favoring of the Odyssey offer.80

Stevens; (2) Odyssey indicated it wanted present management to stay on; and (3)
Odyssey indicated that equity participation by Stevens management was possi-
bie. Id.

74. Id. at 778.

75. Id. at 777. A topping fee guarantees a favored bidder a fee based on a
percentage of the premium the target’s shareholders actually receive over and
above the favored bidder’s price from the ultimate purchaser. Id. In J.P. Stevens,
Odyssey would receive 20% of any amount over $64 per share that Stevens
shareholders ultimately realized upon sale of the corporation to West Point,
subject to an $8 million or $.40 per share cap. Id.

76. Id. For a definition and discussion of the effect and permissibility of
“break-up fees,” see supra note 49 and accompanying text.

77. J.P. Stevens, 542 A.2d at 777-78. For a discussion of the effect and per-
missibility of “fiduciary out clauses,” see supra note 48 and accompanying text.

78. J. P Stevens, 542 A.2d at 781-82; see Weinberger v. UOP, Inc., 457 A.2d
701, 711-12 (Del. 1983) (“entire fairness” standard first articulated). For a dis-
cussion of the elements of the entire fairness standard, see supra note 31 and
accompanying text.

79. J.P. Stevens, 542 A.2d at 782. The court reasoned that shareholder ben-
efit is a target board’s goal, and if favoring one party helps further that goal,
such tactics are permissible. Id. This marked an important step by the chancery
court, because prior to J.P. Stevens, it was thought that Revlon required, as West
Point argued, a “level playing field,” which precluded the favoring of one bidder
over another in the context of a corporate auction. Id. at 781. The J.P. Stevens
court rejected West Point’s argument:

Revlon recognizes that once a change in control is conceded in the
works, the responsibility of the board is limited to a [sic] facilitating
and achieving the best possible transaction for the shareholders. . . .
While it is true, that once agreements of this kind are in place, they do
have the effect of tilting the playing field in favor of the holder of such
rights, that fact, alone, does not establish that they necessarily are not
in the best interest of the shareholders. It is the shareholders to whom
the board owes a duty of fairness, not to persons seeking to acquire the
Company. To continue with the metaphor, the board may tilt the play-
ing field if, but only if, it is in the shareholders’ interest to do so.
Id. at 781-82.

80. Id. at 785. The court held that the J.P. Stevens board complied with its
Revlon duty by taking what it in good faith believed to be the best possible trans-
action for the shareholders. Id. at 781 n.6. Because choosing the best possible
transaction can involve board consideration of factors other than price, the court
held that the J.P. Stevens board’s good faith concern that the risk of non-con-
summation posed by the potential antitrust problems involved in a merger with
Moreover, the marketplace offered West Point an adequate remedy because West Point remained free to top Odyssey’s offer. 81

In MacMillan white knight Kohlberg Kravis Roberts & Co. (KKR) and hostile-bidder Mills Acquisition Co. (controlled by financier Robert Maxwell, and thus hereafter referred to as “Maxwell”), were involved in a Revlon auction for MacMillan. 82 Despite a representation to the chancery court that very morning that MacMillan would conduct a fair auction, Edward P. Evans, MacMillan’s chief executive officer, telephoned KKR to disclose the supposedly confidential details of Maxwell’s bid. 83 In addition, MacMillan’s supposedly independent financial adviser, Bruce Wasserstein, in relaying instructions to both bidders prior to the submission of their final bids, gave additional information to KKR alone, consisting of changes MacMillan’s board needed from KKR before the board could approve KKR’s offer. 84 Prior to either disclosure, KKR’s bid was $89.50 per share, $82 of which was cash, with the balance consisting of subordinated securities, and was conditioned upon the granting of a $950 million lock-up and a no-shop provision. 85 Maxwell’s bid was an unconditional all-cash offer of $89 per share. 86 KKR used the information from both tips in making a revised bid of $90.00 per share.

West Point justified their selection of the Odyssey offer. Id. The court also noted that although West Point’s requested relief of striking down the provisions granted to Odyssey would financially benefit shareholders, “shareholders possess no right in equity to rescind a valid corporate agreement simply because to do so would redound to their financial benefit.” Id. at 785. For a discussion of the reasoning behind the best possible transaction test, see supra note 61 and accompanying text.

81. J.P. Stevens, 542 A.2d at 785.
82. MacMillan, 559 A.2d at 1264. For a definition of “white knight,” see supra note 1.
83. MacMillan, 559 A.2d at 1275. Compounding an already egregious breach of loyalty, Evans remained silent and concealed his misconduct from his fellow directors during the meeting at which the MacMillan board approved KKR’s bid. Id. at 1277. At that meeting, “independent” financial adviser Bruce Wasserstein falsely claimed that the auction had been conducted on “a level playing field... where both parties had equal opportunity to participate.” Id. Wasserstein himself had leaked confidential information to KKR during the auction. Id. at 1276.
84. The additional information read as follows:
To KKR: Focus on price but be advised that we do not want to give a lockup. If we granted a lockup, we would need: (1) a significant gap in your bid over the competing bid; (2) a smaller group of assets to be bought; and (3) a higher price for the assets to be bought.
Id. In contrast, when Maxwell asked during the auction if it was the highest bidder, Wasserstein would only tell him to submit his highest bid before the close of the auction. Id.
85. Id. at 1275. For a definition and discussion of the effect and permissibility of “lock-up” provisions, see supra note 47 and accompanying text. For a definition and discussion of the effect and permissibility of “no-shop” provisions, see supra note 48 and accompanying text.
86. MacMillan, 559 A.2d at 1275.
hours after the final deadline for the submission of bids. The following day, the MacMillan board accepted a revised KKR offer of $90.05 per share that was $1.05 per share higher than Maxwell’s competing all-cash bid of $89 per share, but which included subordinated debt and was contingent upon the granting of lock-up, break-up and no-shop provisions. The Delaware Supreme Court enjoined the transactions, citing among other things, the bad faith of interested directors who fed tips to their white knight in a supposedly confidential auction. The MacMillan court concluded that the bad faith conduct exhibited by the MacMillan directors failed to meet enhanced Unocal scrutiny, and thus was not entitled to the business judgment rule. The court added, however, that when director conduct does meet such scrutiny, it must be proven by a preponderance of the evidence. 88 For a definition and discussion of the effect and permissibility of “lock-ups,” see supra note 47 and accompanying text. 89 For a definition and discussion of the effect and permissibility of “break-up fees,” see supra note 49 and accompanying text. 90 For a definition and discussion of the effect and permissibility of “no-shop provisions,” see supra note 48 and accompanying text. 91 MacMillan, 559 A.2d at 1275, 1277-78. 92 The court found numerous examples of bad faith in the MacMillan board’s conduct throughout the negotiation and bidding processes. First, there were the inside tips provided to KKR during the auction by MacMillan’s CEO Edward P. Evans. For a more detailed discussion of these events, see supra notes 83-87 and accompanying text. Furthermore, there were additional instances of bad faith during the negotiations with both bidders immediately following the auction. MacMillan, 559 A.2d at 1276-77. For a more detailed discussion of these events, see supra note 87 and accompanying text. The court stated that almost all of the actions taken by the board seemed motivated by two self-interested considerations: (1) to repel any third party suitors unacceptable to management, and (2) to transfer an enhanced equity position in a restructured MacMillan to the management group. MacMillan, 559 A.2d at 1272. 93 MacMillan, 559 A.2d at 1264-65. The divided loyalties of certain directors, and the absence of any real oversight by the independent directors led the court to conclude that the conduct of MacMillan’s board did not meet the entire fairness test. Id. at 1265.
tiny, "there is no further judicial inquiry into the matter." 94

Among the most recent decisions, In re Holly Farms Corp.,95 and In re

94. Id. at 1288 (citations omitted). These words are significant, because the court implies that when choosing between competing offers in a corporate auction, Unocal is primary to Revlon:

If on the basis of this enhanced Unocal scrutiny the trial court is satisfied that the test has been met, then the directors' actions necessarily are entitled to the protections of the business judgment rule. . . . We stated in Revlon . . . that in a sale of corporate control the responsibility of the directors is to get the highest value reasonably attainable for the shareholders. Beyond that, there are no special and distinct "Revlon duties."

Id. (emphasis added) (citation omitted). This choice of language implies that defensive tactics in the context of a corporate auction which favor one bidder, but can withstand the scrutiny of Unocal, may be granted the protection of the business judgment rule even if they may prematurely end the auction, and thus violate Revlon's duty of transaction maximization. It is submitted that this is exactly what occurred in Holly Farms and RJR Nabisco. For a discussion of the facts and holding of Holly Farms and RJR Nabisco, see infra notes 95-98 and accompanying text.

95. 564 A.2d 342 (Del. Ch. 1989). In Holly Farms, two suitors, Tyson Foods, Inc. (Tyson) and ConAgra, Inc. (ConAgra) each sought a merger with Holly Farms Corporation (Holly Farms), and were each told by Holly Farms board that it believed shareholders interests were best served by Holly Farms' continued independence. No. 10350, slip op. at 3 (Del. Ch. Dec. 30, 1988). The board reaffirmed this position by adopting a poison pill stock rights plan (Rights Plan). Id. Tyson showed continued interest, however, eventually proposing a merger of the companies. Id. at 4. At a November 16, 1988 board meeting, the board examined its alternatives, which included: (1) approval of Tyson's all-cash tender offer, now at $54 per share, (2) approval of a stock swap proposal from ConAgra with a face value at the time of the board meeting of $57.75 per share, but a discounted value of only $54 per share, and (3) elect to do nothing and retain Holly Farms' independence. Id. at 5.

The board concluded that a sale of the company was in the best interests of the shareholders and that the ConAgra proposal was the best available transaction financially. Id. at 6. The board came to this conclusion although the Tyson and ConAgra offers, once ConAgra's was discounted for present value, were both $54 per share, and the ConAgra offer required the grant of a substantial lock-up option, a termination fee of $15 million, and expense reimbursement if the deal was not consummated. Id. at 6. Tyson and a group of Holly Farms shareholders then sought a preliminary injunction to enjoin the above granted provisions and to compel the board to redeem the Rights Plan. Id. at 2.

The court found that the Revlon duty to maximize shareholder interests did apply to the board from the time during the November 16 meeting that the board decided to sell the company. Id. at 10. The court held that Holly Farms board had favored ConAgra throughout the negotiations, believing ConAgra would allow the company to remain intact, while Tyson would break the company up. Id. at 11. This lack of good faith led to a flawed bidding process that could not possibly maximize shareholder values, as was required by Revlon, and thus the board action was not 'rational' and failed to comply with Unocal. Id. at 11-12.

The two bidders then resumed their attempts to acquire Holly Farms. Holly Farms, 564 A.2d 342 (Del. Ch. 1989). Tyson proceeded to make an all-cash offer of $63.50 per share, and began to negotiate a payment to ConAgra for removal of the lock-up, which would ensure the success of that offer. Id. at 345. The negotiations fell apart, however, and ConAgra submitted an improved offer with a face value of $74.81 per share and a discounted cash value of between $66-67
RECENT DEVELOPMENTS

RJR Nabisco, Inc.96 both proclaim MacMillan as the new standard for jub-

per share, and which, although it was between $2.50-$3.50 per share higher than Tyson’s offer, still included the lock-up. Id. at 345-46. The Holly Farms board tried to reach Tyson to see if it would submit an improved bid, but the Tyson negotiating team had disassembled, after claiming it no longer wished to participate in a “patently unfair and flawed auction process.” Id. at 346-47.

The board then proceeded to approve the ConAgra offer, despite the fact that ConAgra required no response for two more days. Id. at 347. Tyson again sought a preliminary injunction based upon the conducting of an unfair auction by the Holly Farms board. Id. at 343. The board claimed that its decision was rational under Unocal and entitled to business judgment protection because the risk of losing ConAgra’s higher bid should the two bidders come to a collusive settlement outweighed its concerns as to any obstacles the ConAgra agreement placed in the way of any potential future bids of Tyson. Id. at 347.

The court held that Holly Farms’ board had again favored ConAgra in the bidding and therefore failed to meet its “MacMillan burden” of equal and fair treatment to bidders during a Revlon auction. Id. at 348-49. This occurred when Tyson was not given a fair opportunity to submit either a bid free of the ConAgra lock-up option, or a bid conditioned upon that provision’s removal. Id. at 348. Even when a conditional bid was permitted by the board, Tyson was granted only a few hours to prepare one. Id. at 349. Despite this finding, the court upheld the deal, stating that the board was justified in its belief that a collusive deal between ConAgra and Tyson might still occur at any moment, and if it did ConAgra would withdraw its $66-67 offer, leaving the shareholders with Tyson’s $63.50 bid. Id. Because Revlon requires that the board consider the interests of shareholders, and not the possible prejudice to the interests of a bidder, the court held that the board’s decision was “reasonable in relation” to the threat posed to shareholder interests and entitled to the protection of the business judgment rule, and “there is no further judicial inquiry into the mat-

ter.” Id. (quoting MacMillan, 559 A.2d at 1288).

In Holly Farms self-interested directors were able to choose their preferred suitor, despite the fact that in both auctions they treated hostile-bidder Tyson unfairly, because their decision saved the shareholders from a potential economic loss. The fact that this situation was created by the board’s own earlier self-interested decision to grant ConAgra a lock-up provision did not effect the court’s resolution of the case.

96. No. 10389 (Del. Ch. Jan. 31, 1989), appeal denied, 556 A.2d 1070 (Del. 1989). In RJR Nabisco, the Nabisco board instigated a public auction for the company which resulted in “substantially equivalent” bids approximating $25 billion being submitted by investment firm Kohlberg Kravis Roberts & Co. (KKR) and by a senior management group (Management) led by CEO F. Ross Johnson. Id. at 2. Upon receipt of these two offers, the Special Committee appointed by the board to conduct the auction selected the KKR offer without inquiring whether either bidder wished to increase its offer, and the board concurred with this decision. Id. at 3.

A group of shareholder-plaintiffs then sought a preliminary injunction to bar KKR from closing its deal and to revive the auction of Nabisco. Id. The plaintiffs asserted three theories of recovery, the most significant being that the Revlon duty to run a fair auction and maximize shareholder benefit was violated by the premature termination of the auction. Id. at 4-7. The Special Committee and the Nabisco board claimed that, in accordance with Revlon, “the best interests of the shareholders” had been the only motive underlying their actions, which were taken in good faith and with due care, and therefore, the business judgment rule entitled their decision to deference. Id. at 7-8.

The chancery court rejected all three of plaintiffs’ theories, holding on the Revlon claim that Revlon does not require a board receiving equivalent bids in the context of an auction to solicit additional bids, but rather a good faith exercise of
The central theme in the resolution of both cases was that absent a showing of bad faith on the part of the target’s directors, the board’s choice of one offer over another during a Revlon auction will be granted the protection of the business judgment rule.

III. Analysis

The Unocal and Revlon decisions appear to be pro-shareholder decisions since they place the burden upon the target’s board to allege a reasonable basis, grounded in a corporation or shareholder benefit, for any defensive action it might take. The insertion of this intermediate burden of proof presumably would deny the protection of the business judgment rule to target boards whose primary goal is to entrench management. The most recent decisions applying these standards, however, have demonstrated that there is still room for self-interested business judgment is all that is required to protect the board’s decision. Id. at 8-9, 57-58. The court noted that the Delaware Supreme Court’s as yet unissued opinion in MacMillan would clarify the role of the courts in reviewing board decisions made during an ongoing corporate auction. Id. at 56. Despite not having a written MacMillan opinion for guidance, the RJR Nabisco court reached the same conclusion as Holly Farms, which did have such guidance. See supra note 95 and accompanying text. Relying on the fact that the Special Committee’s make-up of disinterested directors provided for an arm’s length transaction, thus minimizing fears of board self-interest, the RJR Nabisco court also subscribed to MacMillan’s implication that compliance with Unocal obviates the need to meet the transaction maximization duty of Revlon. RJR Nabisco, No. 10389, slip. op. at 1-2, 56-58.

Therefore, without proof of bad faith, directors choosing between two substantially equivalent bidders in the context of a corporate auction are implicitly granted the business judgment rule’s protection, under the facts of RJR Nabisco. Id. at 57-58. Moreover, the court found that the Nabisco board’s judgment that the two bids were in fact substantially equivalent, because it was based upon the opinion of independent financial advisers, was also a valid exercise of the board’s business judgment. Id. at 29, 44-45. It is submitted that a decision by Nabisco’s board that the two bids were not, in fact, substantially equivalent would be granted the same deference by a reviewing court. Therefore, the only check on a board’s power in this area appears to be the opinion of its independent financial adviser.

97. See Holly Farms, 564 A.2d at 348 (court stated that MacMillan sets forth procedure to be followed when reviewing attempt by board to sell company): RJR Nabisco, No. 10389, slip op. at 56 (court stated that MacMillan opinion would clarify court’s role in reviewing decisions of target board during sale of company).

98. See Holly Farms, 564 A.2d at 349 (business judgment rule protection granted directors despite unequal chance to bid given parties in auction): RJR Nabisco, No. 10389, slip op. at 58 (board acting in good faith gets business judgment protection when evaluating bids).

99. See generally Revlon, 506 A.2d at 182-83; Unocal, 493 A.2d at 954-55; see also Gilson & Kraakman, supra note 4, at 251 (Unocal and Revlon force management to show reasonableness of defensive tactics).

100. The Delaware Supreme Court opted to insert the intermediate standard of review in a genuine effort to differentiate between defensive tactics that
boards to operate, and that it would be wise for the takeover forces to "watch what the Delaware courts do and not what they say."\(^{101}\)

In practice the courts' application of these standards in recent cases\(^ {102}\) indicates that *Unocal* and *Revlon* may be no more successful than *Cheff* in deterring well camouflaged instances of management self-interest.\(^ {103}\) Because of this potential for abuse, the image of Delaware as a pro-management haven will be sustained.\(^ {104}\)

In both *Unocal* and *Revlon* the Delaware Supreme Court clearly articulated the principle that whenever shareholder interests are not benefiting from a target board-implemented defensive tactic, director self-interest will be presumed to be the motive behind the board action.\(^ {105}\)

If the company is deemed to be in the *Revlon* mode, target management can no longer claim it is defending any corporate policy sanctioned by *Unocal*.\(^ {106}\) *Revlon* held that *Unocal* threats do not exist for corporations might benefit shareholders and questionable tactics designed to entrench management. See Gilson & Kraakman, *supra* note 4, at 250-51.  

101. *Id.* at 274.

102. *See*, e.g., *Holly Farms*, 564 A.2d at 342; *MacMillan*, 559 A.2d at 1261; *RJR Nabisco*, No. 10389, slip. op. at 1; *J.P. Stevens*, 542 A.2d at 770.

103. The *Cheff* policy-conflict standard required only that the target board, in good faith and after reasonable investigation, identify a potential policy conflict with a would-be acquirer in order to shield the use of self-interested defensive tactics with the business judgment rule. See *supra* note 28 and accompanying text. *Unocal* attempts to remedy the ease with which this test was circumvented by requiring that the board also demonstrate that the defensive action taken is reasonable in relation to the threat posed. See *supra* notes 21-27 and accompanying text. *Revlon* attempts to further limit defensive tactics taken in the context of an auction for corporate control, by allowing such tactics only if the end result is the best available transaction for shareholders. See *supra* notes 58-61 and accompanying text. However, *MacMillan* and its progeny imply that, minus a showing of bad faith, the business judgment rule protects board conduct when selecting between two bidders in a *Revlon* auction. See *supra* notes 94-98 and accompanying text. These cases leave the door open for directors to sacrifice *Revlon*'s transaction maximization duty in the name of self-interest, thereby inviting a return to the ineffective days of *Cheff*.

104. Hyman, *The Delaware Controversy-The Legal Debate*, 4 DEL. J. CORP. L. 368, 370 (1979). Mr. Hyman contends that because of Delaware's success in attracting corporations (in 1979, over 40% of the firms listed on the New York Stock Exchange were incorporated in Delaware), and as a result of its leadership role in the "'liberalization'" of corporate law, Delaware is the favorite target of those who believe corporate statutes are far too pro-management. *Id.* Although Mr. Arshy defends the state against such criticism, he does so only after conceding that this "pro-management" image of Delaware exists. See *Arsht*, *supra* note 17, at 652. For evidence that this image was alive and well in 1989, see Gilson & Kraakman, *supra* note 4, at 274 (widespread view that Delaware is against hostile acquisitions).

105. *See* *MacMillan*, 559 A.2d at 1280; *Revlon*, 506 A.2d at 180; *Unocal*, 493 A.2d at 954.

106. The most recent example of an attempt to shove a transaction into the *Revlon* mode in order to disqualify otherwise valid *Unocal* defensive tactics occurred in Paramount Communications Inc. v. Time Inc., No. 10670 (Del. Ch. July 14, 1989), aff'd, 565 A.2d 280-81 (Del. 1989) (Table). Paramount's argu-
seeking current share value maximization, since an entity facing an inevitable break-up has no policies to defend. Therefore, central to the resolution of many of the recent takeover cases is a threshold question of whether the target corporation is in the Revlon mode.

Revlon was originally limited to corporations facing an inevitable bust-up pursuant to a hostile takeover. A series of recent decisions, however, have expanded Revlon’s scope. Revlon’s duty of transaction maximization is now imposed during any auction for the sale of corporate control, whether the sale takes the form of an active auction, a management buyout, or another type of corporate restructuring.

One commentator believes that the Delaware courts have grasped for easy, objective criteria implicit in words like “sale” and “change in control,” and have expanded Revlon’s express application beyond “break-ups” because they fear the line-drawing task that would be required to interpret a “break-up” in today’s complex business environment. At the same time the Delaware Supreme Court expanded the

ment that Time’s purchase of Warner Communications was a corporate restructuring resulting in Warner shareholders possessing 62% of the combined entity and therefore placing the acquiring corporation (Time) into the Revlon mode, was given little sympathy by the chancery court. Id. at 56. A contrary ruling would have been the death knell of friendly mergers, because all parties to a negotiated, consensual transaction would be leaving themselves open to the risk of becoming the subject of a Revlon auction. This case illustrates how far the takeover forces will strain to convince a court that the target is in the “Revlon mode.” For a discussion of the facts and holdings of the Time case, see supra note 64 and accompanying text.

107. Revlon, 506 A.2d at 182. At this point, the directors have no other way to measure the performance of their duties than through “the bank accounts of the shareholders.” Reder, supra note 2, at 281. Such directors have no corporate entity to protect because “the entity will cease to exist.” Id.

108. The MacMillan court explained the importance of this threshold determination: “Because the effect of the proper invocation of the business judgment rule is so powerful and the standard of entire fairness so exacting, the determination of the appropriate standard of judicial review frequently is determinative of the outcome of derivative litigation.” MacMillan, 559 A.2d at 1279 (quoting AC Acquisitions Corp. v. Anderson, Clayton & Co., 519 A.2d 103, 111 (Del. Ch. 1986)).

109. See Revlon, 506 A.2d at 182.

110. See Ivanhoe Partners v. Newmont Mining Corp., 535 A.2d 1334, 1345 (Del. 1987) (Revlon duties arise when it is inevitable company will be sold); Yahn v. Scientific Leasing Inc., Nos. 9596, 9561 (Del. Ch. Feb. 5, 1988) (court imposed Revlon duty during private auction of target, but excused board’s discrete treatment of sale due to fact that major players in market were aware company was for sale); Freedman v. Restaurant Assoc., No. 9212 (Del. Ch. Oct. 16, 1987) (court expressly stated that Revlon duties arise when corporation is subject to change in control). For a discussion of why these duties have been expanded, see Reder, supra note 2, at 280-81.

111. See MacMillan, 559 A.2d at 1285. The court stated that only under these special circumstances are the duties of the board significantly altered pursuant to Revlon. Id.

112. See Reder, supra note 2, at 281. For example, if the proposed acquisition would require the selling off of just one division in order to finance the
scope of Revlon, however, it also sought to discourage the idea that such expansion was without limits. The MacMillan court expressed this position when it stated that "[c]learly not every offer or transaction affecting the corporate structure invokes the Revlon duties." The net effect of these decisions is that although the scope of Revlon has been expanding, courts have carved out exceptions where the duty does not apply, and therefore practitioners on both sides of a takeover battle must be aware that there are no bright line rules.

Even when a would-be acquiring corporation is able to convince a Delaware court that the target corporation was indeed in the Revlon mode, defensive tactics used by target management to repel hostile takeover bids are still not necessarily prima facie violations of Revlon. In Revlon mode cases, defensive tactics are permissible when they create a shareholder benefit by assisting the continuation of an auction which will maximize transaction value. Therefore, the use of defensive tac-
tics is no more restricted under Revlon than under Unocal. The only difference between the two is that the shareholder interest that justifies such tactics is much narrower under Revlon. 116

Although the MacMillan court claimed entire fairness to be a rigorous test, that case may be proof that Revlon duties will only be judicially enforced in the most blatant cases of board malfeasance. 117 As noted by the court, the indiscretions of the board in MacMillan would have gone undetected but for the integrity of the white knight's counsel, who reported the improprieties. 118 Without this information the supreme court may have decided, as the chancery court did in J.P. Stevens, that it was a reasonable exercise of business judgment for the board to take the higher offer, regardless of the number of conditions attached to it. 119 Since it will be the rare case where the court has evidence of such gross director misconduct, MacMillan would appear to be an exception, and J.P. Stevens the rule.

Finally, the Delaware courts seem to have come full circle from Cheff to RJR Nabisco and Holly Farms. In those cases the chancery court held that the board's choice of one offer over another during a Revlon auction may be granted the protection of the business judgment rule. 120 Since the whole point of applying Unocal and Revlon was to ascertain, as a threshold matter, 121 whether target management was even entitled to

116. This clarification of the interrelationship between Unocal and Revlon relates back to Justice Moore's comment in MacMillan, where he stated that only the responsibilities of the board change under Revlon—the duties are still Unocal's. MacMillan, 559 A.2d at 1287. However, Justice Moore noted that the application of Unocal's two-prong test to corporations deemed to be in the "Revlon mode" is, of necessity, somewhat different:

At the outset, the plaintiff must show . . . that the directors of the target company treated one or more of the respective bidders on unequal terms . . . [and] the trial court must . . . examine whether the directors properly perceived that shareholder interests were enhanced. In any event the board's action must be reasonable in relation . . . to the threat which a particular bid allegedly poses to stockholder interests.

Id. at 1288 (citation omitted).

117. Id. at 1265.

118. Id. at 1275 n.23. Even the plaintiff in MacMillan conceded that but for the integrity of opposing counsel, it is unlikely that the tip from MacMillan's CEO to white knight KKR during the auction for MacMillan would have been publicly disclosed. Id. For a complete discussion of MacMillan, see supra notes 82-94 and accompanying text.

119. See J.P. Stevens, 542 A.2d at 784-85.

120. Holly Farms, 564 A.2d at 349. The court ruled that the directors' action in accepting the offer of white knight ConAgra was reasonable in relation to the threat of the potential legal liability from Holly Farms' shareholders against the directors if the offer had been withdrawn and a smaller one substituted in its place. Id. Because the Holly Farms directors had a justified belief that a collusive settlement between ConAgra and hostile bidder Tyson Foods might lead to this smaller offer, the court held that under these circumstances the directors' unequal treatment of Tyson was protected by the business judgment rule. Id.

121. For a discussion as to how the threshold question of the applicability
the protection of the business judgment rule, the court appears to have
turned these tests into latter-day applications of the Cheff standard. In effect, this automatic grant of protection means that absent the type of bad faith exhibited by the directors in MacMillan, pro-management forces should find the proportionality test of Unocal and the shareholder benefit test of Revlon rather easy to circumvent.

The series of decisions from Unocal through Time has demonstrated that takeover law has not really changed very much from the time of Cheff v. Mathes. While these recent cases force target boards using defensive tactics to jump through more legal hoops than did Cheff, they deter no more cases of board self-interest than did their predecessor.

To illustrate the ease with which target counsel can maneuver their clients around Unocal, Revlon, and their progeny, it is helpful to walk-through a hypothetical takeover situation. Suppose Target Company’s (“Target”) stock is selling on a recognized exchange for $40 per share. However, market analysts and the other knowledgeable players in Target’s line of business believe the company is undervalued, both because of bad management and because of a lack of synergy between its various divisions. These experts estimate that a break-up sale of the company would bring in $50 per share. Hostile Inc. (“Hostile”) believes that Target is undervalued and that a merger between Hostile and Target would create synergy and economies of scale that make Target subjectively worth $80 per share to Hostile. Hostile is convinced that Target is poorly run and plans on replacing Target’s board. Meanwhile, Friendly Corp. (“Friendly”) is also interested in Target, but believes the company is worth no more than $60 per share. Friendly is a holding company, not an operating company only, and would need to keep existing management in place in order to run the combined entity.

of Unocal and Revlon is often determinative of the litigation, see supra note 108 and accompanying text.

122. For a discussion of the ineffectiveness of the Cheff test, see supra notes 28-29 and accompanying text.

123. 41 Del. Ch. 494, 199 A.2d 548 (1964). For a complete discussion of Cheff, see supra notes 28-29 and accompanying text.

124. “Operational economies” and “synergies” were the major reason in MacMillan that hostile bidder Maxwell was determined to prevail in the auction for MacMillan. MacMillan, 559 A.2d at 1273. Maxwell believed that “nobody could afford” to top a Maxwell bid due to the operational economies and synergies available through a merger of Maxwell’s companies with MacMillan.” Id. In such a situation, the higher subjective value of the target means that one bidder is willing to pay a higher price than a bidder who does not believe such economies or synergies are possible.

125. In J.P. Stevens the fact that Odyssey was not an operating company, and therefore needed existing management to remain after the merger, was alleged to be a major reason for the favored treatment Odyssey received from target management during the auction process. J.P. Stevens, 542 A.2d at 779. A promise of equity participation by target management may have also contributed to this favored-bidder status. Id. For a discussion as to the influence of these two factors in the takeover area, see supra note 4 and accompanying text.
Upon the receipt of Hostile's $40 per share bid, Target's board can reject it as grossly inadequate, the favorite justification used by target boards to satisfy the threat prong of *Unocal*.\(^{126}\) Target can point to the fact that industry experts value it at $50 per share as a basis for their rejection of Hostile's $40 per share bid. Target's subsequent implementation of a poison pill Rights Plan will almost certainly meet the proportionality prong of *Unocal* as well.\(^{127}\) Hostile then raises its bid to $50 per share. Target's board, fearful of losing their jobs, decides that, as in *Time*, the offer is still a threat under *Unocal* because the board is putting long-term corporate and shareholder interests ahead of short-term interests, in this case by remaining independent.\(^{128}\) Target therefore rejects the offer and refuses to redeem the Rights Plan. Hostile then raises the bid to $55 per share. Sensing that they are fighting a losing battle, Target seeks out a white knight, Friendly. Friendly offers $58 per share, and since this offer signifies the beginning of an auction process with two bidders,\(^{129}\) *Revlon*'s duty to seek the highest price possible for its shareholders is triggered for Target's directors.\(^{130}\)

\(^{126}\) For a discussion of why grossly inadequate bids are target boards' principal justification for satisfying the threat prong of *Unocal*, see *supra* note 55 and accompanying text.

\(^{127}\) See *Revlon*, 506 A.2d at 180-81 (enactment of poison pill reasonable response under *Unocal* to grossly inadequate bid); *Holly Farms*, No. 10350, slip op. at 15 (enactment of poison pill plan may have role in maximizing values in future auction of company). For a definition of the “poison pill,” see *supra* note 1.

\(^{128}\) The principle that directors have discretion in seeking long-term value maximization has been stated as follows:

> 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.” . . . [Directors] may follow a course designed to achieve long-term value even at the cost of immediate value maximization.

*Time*, No. 10670, slip op. at 50-51 (citations omitted) (footnote omitted).

\(^{129}\) The fact that there are two bidders does not necessarily mean that Target is in the *Revlon* mode. In this hypothetical, the *Revlon* duty was triggered when the board sought out Friendly because this was when the sale of the company became inevitable. Up to that point, Target was free to rebuff Hostile's offer, as it could claim that Target's shareholders long-term interests were best served by remaining independent. See *Holly Farms*, No. 10350 (*Revlon* duty not triggered by negotiations with two suitors, or by tender offer of one suitor, or by board seeking out potential acquirers, but rather when board decided to sell company). For a discussion of the facts and holding of *Holly Farms*, see *supra* note 95 and accompanying text. The distinction must be drawn that while a company can, as Target has done in this hypothetical, voluntarily enter the *Revlon* mode, it cannot be involuntarily forced into this mode by the mere fact that bidders seek to acquire it—only when the bidding has reached the stage where a sale is inevitable can a board have *Revlon* duties involuntarily thrust upon it.

\(^{130}\) In situations where two bidders actively seek a target, a strong possibility exists that *Revlon* duties have been triggered. This potentiality becomes a foregone conclusion, when, as in this hypothetical situation, the target's board of directors begins to actively seek a buyer. See *MacMillan*, 559 A.2d at 1285.
Hostile responds by offering $65 per share and Friendly decides to bow out since that price exceeds its estimation of Target’s worth. Target’s board, knowing that their jobs depend upon Friendly prevailing in the auction, offers to grant a crown jewel lock-up option, a break-up fee and a no-shop provision to their white knight. This gambit causes Friendly to raise its bid to $70 per share. Hostile seeks to enjoin these defense tactics, but the chancery court finds that the tilted playing field created by these provisions is permissible under J.P. Stevens since Target board’s acceptance of these provisions led to the shareholder benefit required by Revlon. Hostile perseveres and makes an $80 per share all-cash offer. Friendly counters with its final bid of $84 per share, $70 of which is cash, with the balance of the offer consisting of junk bonds Friendly claims to be worth $14 per share. Friendly also conditions its offer on its ability to keep all of the provisions obtained in the prior negotiations between the parties.

Target’s board accepts Friendly’s offer, in spite of the fact that its independent financial expert advises the board that the attached conditions and the inclusion of the junk bonds make the discounted present

For a further discussion of what constitutes an auction giving rise to Revlon duties, see supra notes 109-13 and accompanying text.

131. For a discussion on the effect and permissibility of lock-ups, see supra note 47 and accompanying text.

132. For a discussion on the effect and permissibility of breakup fees, see supra note 49 and accompanying text.

133. For a discussion on the effect and permissibility of no-shop provisions, see supra note 48 and accompanying text.

134. The required shareholder benefit in Revlon cases is the continuation of an auction to maximize shareholder values. Revlon, 506 A.2d at 183. The granting of lock-ups, no-shop provisions and similar defensive measures which favor one bidder over another are permissible if such a shareholder benefit can be alleged. For a discussion of what board actions are permissible in view of the shareholder benefit test, see supra notes 47-49 and accompanying text.

Alternatively, a Holly Farms situation could develop if the court does enjoin the above provisions. For example, suppose that in a subsequent auction for Target, Hostile sought to pay Friendly to give up all rights under those provisions, rather than seeking judicial invalidation. Target might then accept Friendly’s latest offer, claiming it did so to protect shareholder interests from a collusive settlement which would lead to Friendly withdrawing its offer and clear the way for Hostile to submit a lower bid. Based upon Holly Farms, the court would hold that the board’s justified belief that this scenario could unfold would excuse its continued bad faith in the transaction, because shareholder interests must be protected even at the expense of prejudicing a would-be acquirer’s interest. Therefore, the Target board would have its white knight, even though Hostile was only seeking to remove obstacles to its acquisition caused by the board’s prior act of bad faith. For a discussion of the facts and holding of Holly Farms, see supra note 95 and accompanying text.

135. This situation is similar to MacMillan, where white knight KKR bid $89.50 per share, with $82 being cash and the remainder consisting of debt securities. MacMillan, 559 A.2d at 1275. This offer was also made conditional upon the MacMillan board’s granting of lock-up and no-shop provisions. Id. Maxwell, the hostile bidder in the MacMillan auction, countered with an all-cash $89 per share offer requiring neither of KKR’s conditions. Id.
value of Friendly’s deal $78, which is lower than the $80 unconditional, all-cash offer of Hostile.\(^{136}\) Hostile again seeks to enjoin the transaction, but the chancery court, citing \textit{MacMillan} and its progeny, upholds the deal since a target board’s decision when choosing between two competing offers in the context of a corporate auction is entitled to the protection of the business judgment rule.\(^{137}\)

Target’s management has, in the name of shareholder benefit, forced an inferior deal on its shareholders while primarily indulging its own self-interest. All of Friendly’s defenses to Hostile’s takeover bid in the above hypothetical have been utilized successfully in similar decisions of the Delaware courts. Although the unique facts of a particular case may have justified the courts’ grant of business judgment protection, the manipulative use of such case law to justify self-interested tactics in other contexts is not a hypothetical problem, but one for which the potential for abuse is quite real.

Because of the potential for abuse which the recent case law invites, it appears that these recent decisions will be no more of an obstacle to directorial indulgence of self-interest than was \textit{Cheff}. To alleviate this problem, judicial scrutiny of transactions where the target’s board has “tilted the playing field” must be heightened. In addition, the chancery courts should deny the automatic grant of business judgment protection to target boards’ choosing between competing offers in the context of a corporate auction.

\(^{136}\) The MacMillan board accepted KKR’s offer under circumstances similar to those posed in the hypothetical problem. \textit{Id.} at 1278. For a discussion of the facts and holdings in \textit{MacMillan}, see \textit{supra} notes 82-94 and accompanying text.

\(^{137}\) The court may reach this conclusion based upon a \textit{RJR Nabisco} theory, and hold that because the board had independent financial advice which informed it of the discounted value of Friendly’s bid, a board determination that the two bids are substantially equal, followed by a board decision favoring Friendly is a valid exercise of business judgment. Hostile could only challenge this judicial deference upon a showing of bad faith by Target’s board, which outside the type of director misconduct exhibited in \textit{MacMillan}, is a difficult burden to meet.

Moreover, even if bad faith in the form of Target board’s favoritism could be demonstrated, the court might, as in \textit{Holly Farms}, conclude that the shareholder interests which benefitted from such bad faith are primary to the prejudiced interest of bidder Hostile, and excuse such conduct.

Finally, even if the court were to enjoin the transaction and compel the parties to resume the auction of Target, the existence of those provisions could lead to a situation similar to \textit{Holly Farms}. In this scenario, any attempt by Hostile to buy the rights to Friendly’s previously granted provisions might lead the Target board to accept Friendly’s current offer, claiming that it was protecting shareholder interests from a collusive agreement which would result in Friendly’s withdrawal and Hostile’s submission of a lower bid.

For a discussion of the facts and holding of \textit{Holly Farms}, see \textit{supra} note 95 and accompanying text. For a discussion of the facts and holding of \textit{RJR Nabisco}, see \textit{supra} note 96 and accompanying text.
IV. Conclusion

Unocal and Revlon were both hailed as providing greater protection for shareholder interests against the self-interested defensive tactics of target management in the area of corporate takeovers. However, a review of the most recent decisions indicates that as the Delaware courts seek to update and clarify this new area of law, they are carving out exceptions to the strict fiduciary duties of both Unocal and Revlon that make it easy for target management, in all but the most obvious cases of director self-interest, to satisfy this judicial scrutiny.

The message of these recent decisions to practitioners in the takeover area depends upon which side of the battle one represents. To target corporation's counsel the message is that although Unocal, Revlon, and their progeny require a board to jump through a few more legal hoops than prior law, the hoops are navigable. To increase the chances of victory in such a battle, target board's counsel should make sure that the board complies with all of the formalities held to be indicative of good faith—including the hiring of an independent financial adviser and the formation of independent negotiating committees.

138. It has been suggested that the clearest counseling lesson to be gleaned from the post-Unocal takeover cases is that "whether one is advising a target or a bidder: concentrate on independence and methodology and take every reasonable step to be sure your approach passes the 'smell test.'" Veasey, supra note 12, at 512. Mr. Veasey categorizes the "smell test" as a common sense effort by the Delaware courts to determine whether the particular defensive tactic at issue is merely an entrenchment device and if there is a reasonable likelihood that the shareholders are not getting the best price obtainable. Id.

139. Id. at 510-11. The independent financial adviser must give the board advice based on present and long-term values and upon the relationship of the stock's value to the underlying breakup value of the company. Id. at 510. Delaware courts recognize the need for experts with specialized judgment as necessary to a grant of business judgment protection. RJR Nabisco, No. 10389, slip op. at 44 (advice of financial experts necessary to board's decision competing bids substantially equivalent); cf. MacMillan, 559 A.2d at 1282 (lack of independence of financial adviser who acted in bad faith during corporate auction increases board burden under Revlon). To insure a finding of adviser independence, a board would be wise to compensate its experts on a flat fee, not contingent upon the outcome of the transaction. Time, No. 10670, slip op. at 29 n.6.

The board should also have a preponderance of outside directors, or, if that is not possible, a committee of outside directors to independently consider the proposal. Veasey, supra note 12, at 510-11; see Rosenblatt v. Getty Oil Co., 493 A.2d 929, 937-40 (Del. 1985) (existence of independent board important factor in court's decision that board met burden of showing entire fairness of transaction); RJR Nabisco, No. 10389, slip op. at 2 (same); compare MacMillan, 559 A.2d at 1282 (independent negotiating committee could have insulated self-interested management from influencing improperly conducted auction); Weinberger v. UOP, Inc., 457 A.2d 701, 709 n.7 (Del. 1983) (court noted that had board selected independent negotiating committee this may have resulted in exonerating of directors found liable for fiduciary breaches).

The use of the independent negotiating committee is important in demonstrating that a transaction was conducted at arm's length and without self-interest. The existence of such a committee is a material factor in a court's
The message to would-be acquiring corporation's counsel must be that friendly, negotiated mergers should be pursued if at all possible, and that management should only make a hostile bid for a well prepared target if they accept the fact that the game will be rigged against them and that judicial intervention will be the exception, not the rule.

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determination of whether the good faith requirement of Unocal's threat prong is satisfied. The use of independent financial experts is vital in showing that the reasonable investigation requirement of that prong is met. For a discussion of the good faith and reasonable investigation requirements, see supra note 26 and accompanying text.