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Moran And The Poison Pill: A Target'S Savior?

MORAN AND THE POISON PILL: A TARGET'S SAVIOR?

The recent increase in corporate takeovers[1] has prompted many corporate boards to adopt "poison pill"[2] stock purchase rights plans as a defense against hostile[3] tender offers.[4] Under a typical poison pill rights plan, a corporation distributes the rights (or "warrants") as a dividend on the

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1. *See* Wall St. J., Jan. 1, 1986, at 6B, col. 1 (chroniciling corporate takeover activity in 1985); BUS. WK., Mar. 4, 1985 at 80 (discussing recent proliferation of corporate takeovers).

2. *See generally* Chittur, *Wall Street's Teddy Bear: The "Poison Pill" As A Takeover Defense,* 2 J. CORP. L. 25, 25-40 (1985). "Poison pill" refers to an antitakeover mechanism that has garnered recent popularity among companies wishing to protect themselves against unfriendly takeovers. *Id.* at 25-26. Poison pills generally take the form of dividends of either preferred stock or stock purchase rights. *See id.* at 26-40 (discussing two main versions of poison pill); *infra* notes 12-22 and accompanying text (summarizing characteristics of poison pill stock purchase rights). A poison pill generally contains conversion or "flip-over" features that a board of directors designs to deter unsolicited takeovers. *See* Katcher, Chapnick, Finley & Ferleger, *Mergers and Acquisitions: Developments in Defensive Tactics 1985,* in 1 PLI, 17TH ANNUAL INSTITUTE OF SECURITIES REGULATION 408-25 (S. Friedman, C. Nathan & H. Pitt eds. 1985) (PLI Corporate Law & Practice Handbook Series No. 498) (discussing variations of poison pills as antitakeover mechanisms) [hereinafter cited as Katcher & Chapnick]; *infra* notes 21, 59 and accompanying text (discussing flip-over feature of purchase rights plan).

3. *See* M. LIPTON & E. STEINBERGER, 1 TAKEOVERS & FREEZEOUTS § 1.01[1] (1986). A hostile tender offer is an offer for a company's stock that the offeror makes directly to the shareholders of a target company, without the approval of the target company's board of directors. *Id.* A "target" company is the subject or potential subject of an offer to purchase by another acquiring person or group. *See* Troubh, *Characteristics of Target Companies,* 32 BUS. LAW. 1301, 1301-04 (1977) (discussing traits of target companies).

4. *See* Fogelson, *Some Recent Defensive Strategies in Corporate Takeovers,* in 1 PLI, HOSTILE BATTLES FOR CORPORATE CONTROL 1985 191-208 (D. Block & H. Pitt eds. 1985) (PLI Corporate Law & Practice Handbook Series No. 474) (discussing poison pill stock purchase rights dividend plan as defensive strategy against takeover attempts). Corporations that have adopted poison pill plans include Household International, Inc., Colgate Palmolive Company, Owens-Illinois, Inc., and Crown Zellerbach Corporation. *See* Household International, Inc. and Harris Trust and Savings Bank Rights Agreement (Aug. 14, 1984) [hereinafter cited as Rights Plan], *reprinted in* SHARK REPELLENTS AND GOLDEN PARACHUTES: A HANDBOOK FOR THE PRACTITIONER 422.59-422.89 (R. Winter, M. Stumpf & G. Hawkins eds. 1984) [hereinafter cited as SHARK REPELLENTS]; Colgate-Palmolive Letter to Shareholders (Oct. 12, 1984) (informing Colgate-Palmolive stockholders of newly declared common stock purchase rights dividend) [hereinafter cited as Colgate-Palmolive Letter], *reprinted in* 2 PLI, HOSTILE BATTLES FOR CORPORATE CONTROL 1985 691-92 (D. Block & H. Pitts eds. 1985) (PLI Corporate law & Practice Handbook Series No. 475); Owens-Illinois Letter to Shareholders (Sept. 10, 1984) [hereinafter cited as Owens-Illinois Letter], *reprinted in* 2 PLI, HOSTILE BATTLES FOR CORPORATE CONTROL 1985 693-95 (D. Block & H. Pitts eds. 1985) (PLI Corporate Law & Practice Handbook Series No. 475); Crown Zellerbach Corporation and The Bank of California, N.A., Rights Agreement (July 19, 1984) [hereinafter cited as Crown Zellerbach Rights Agreement], *reprinted in* SHARK REPELLENTS, *supra,* at 417-422.18. Other companies that have adopted poison pill rights plans include TRW, Inc., Annheuser-Busch Cos., International Paper Co., PPG Industries, Inc., Gillette Co. and Tambrands, Inc. *See* Wall St. J., Jan. 8, 1986, at 6, col. 2 (discussing recent popularity of poison pill plans).

outstanding shares of the issuing company's common stock.[5] The rights entitle a shareholder of a company that has adopted a poison pill rights plan to purchase common or preferred stock of that company.[6] The poisonous or defensive quality of the rights dividend is that, in the event of a merger, the rights "flip over" and authorize a rightsholder to purchase stock of an acquiring company at a substantially discounted price.[7] The purpose of the flip-over feature of the rights is to deter hostile tender offers by rendering acquisition of the target company prohibitively expensive for a potential acquiror.[8] In addition, a rights plan may encourage a potential acquiror at least to consult with a target company's board should the warrants not deter a takeover attempt.[9] To ensure that the rights do not interfere with a favorable negotiated merger, the issuing corporation normally may redeem the rights at a nominal price.[10]

While those companies that have adopted poison pill warrants have tailored the warrants to suit the companies' individual needs, most purchase rights plans are similar in structure.[11] Under a typical rights plan, a company

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5. *See* Owens-Illinois Letter, *supra* note 4, at 693 (Owens-Illinois board of directors declared dividend of preferred stock purchase rights).

6. *See id.* at 694 (Owens-Illinois rights allow stockholders to purchase one one-hundredth share of Owens-Illinois preferred stock); Crown Zellerbach Rights Agreement, *supra* note 4, at 418 (Crown Zellerbach rights entitle shareholders to purchase one share of Crown Zellerbach common stock).

7. *See* Fogelson, *supra* note 4, at 194 (upon merger of target corporation into acquiring company, each right entitles rightholder to purchase stock of acquiring company); *infra* notes 21, 59 and accompanying text (discussing flip-over provision of purchase rights plan).

8. *See* SHARK REPELLENTS, *supra* note 4, at 395 (poison pill rights to purchase acquiror's stock at discounted price render acquisition of target financially unfeasible for potential acquiror). Poison pill stock purchase rights substantially increase the acquisition cost of a target company because the acquiror will suffer an equity dilution in the event of a merger with the target. *See infra* note 24 and accompanying text (discussing dilution of raider's equity caused by rights plan).

9. *See* Moran v. Household Int'l, Inc., 490 A.2d 1059, 1066 (Del. Ch. 1985) (directors design rights plan to create uncertainty for potential acquiror); M. LIPTON & E. STEINBERGER, *supra* note 3, § 6.03[3], at 6-44 - 6-45 (complexity of rights plans can deter raider from proceeding unilaterally with tender offer for target).

10. *See* Fogelson, *supra* note 4, at 196 (discussing redemption feature of purchase rights); M. LIPTON & E. STEINBERGER, *supra* note 3, § 6.03[3], at 6-46 (redemption feature of rights prevents rights from interfering with friendly negotiated merger). The redemption feature of the rights allows a target company's board to withdraw the rights at a minimal expense in the event of an offer that the board deems favorable to the corporation, but the rights lose their redeemability after a 20% acquisition of the target's stock. *See* Crown Zellerbach Rights Agreement, *supra* note 4, at 422.15 (company may redeem rights for $.50 per right prior to 20% acquisition of company's stock). Thus, the rights could interfere with a negotiated merger after a 20% acquisition. M. LIPTON & E. STEINBERGER, *supra* note 3, § 6.03[3], at 6-46.

11. *See, e.g.*, Household International, Inc. Summary of Rights to Purchase Series A Junior Preferred Participating Preferred Stock (Aug. 14, 1984) (explaining Household Rights Agreement) [hereinafter cited as Household Summary of Rights], *reprinted in* SHARK REPELLENTS, *supra* note 4, at 422.96; Colgate-Palmolive Letter, *supra* note 4, at 691-92 (summary of Colgate-Palmolive poison pill rights plan); Owens-Illinois Letter, *supra* note 4, at 693-95 (outlining Owens-Illinois poison pill); *see also infra* notes 12-24 and accompanying text (discussing basic structure of typical

distributes a dividend of one stock purchase right for each share of outstanding common stock.[12] Each right entitles a holder to purchase, upon payment of an exercise price,[13] a certain amount of preferred or common stock of the issuing corporation.[14] The exercise price of the warrants, however, is commonly two hundred to three hundred percent of the market price of the

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rights plan).

Poison pill stock purchase rights are actually a variation of another type of poison pill that Lenox, Inc. (Lenox) initially issued in a takeover contest with Brown-Forman Distillers Corporation (Brown-Forman). *See* Wall St. J., June 16, 1983, at 2, col. 2 (highlighting takeover battle between Lenox and Brown-Forman). Instead of issuing a dividend of stock purchase rights, Lenox distributed a dividend of preferred stock that was convertible into voting common stock of any company that acquired Lenox. *See* SHARK REPELLENTS, *supra* note 4, at 395-96 (discussing Lenox poison pill preferred stock); Chittur, *supra* note 2, at 27-30 (discussing Lenox poison pill plan and Lenox' takeover battle against Brown-Forman). The conversion ratio of Lenox preferred stock into an acquiror's common stock ensured Lenox stockholders of receiving an acquiror's common stock in an amount not less than the equivalent of the price received in the initial stage of a two-tier tender offer. SHARK REPELLENTS, *supra* note 4, at 396. *See also infra* note 25 (discussing two-tier tender offer). Lenox ultimately withdrew its poison pill and accepted Brown-Forman's offer to purchase any and all of Lenox stock for $90 cash per share. Wall St. J., June 29, 1983, at 2, col. 2. After the Lenox - Brown-Forman battle, several large, publicly held corporations instituted similar plans. *See* Note, *Protecting Shareholders Against Partial and Two-Tiered Takeovers: The "Poison Pill" Preferred,* 97 HARV. L. REV. 1964, 1964 n.2 (1984) (describing origin and subsequent use of poison pill preferred stock); *see also* Certificate of Designations, Preferences and Rights of $12 Cumulative Convertible Preferred Stock of Bell & Howell Company, *reprinted in* Finkelstein, *Antitakeover Protection Against Two-Tier and Partial Tender Offers: The Validity of Fair Price, Mandatory Bid, and Flip-Over Provisions Under Delaware Law,* 11 SEC. REG. L.J. 291, 314-31 (1984) (poison pill preferred stock plan of Bell & Howell Company); Memorandum Dated June 20, 1983, *reprinted in* 2 M. LIPTON & E. STEINBERGER, TAKEOVERS & FREEZEOUTS H-3, H-3 - H-8 (1984) (summary of refined version of poison pill preferred stock dividend plan).

12. *See* Owens-Illinois Letter, *supra* note 4, at 694 (Owens-Illinois declares distribution of one right per share of outstanding common stock).

13. *See* Crown Zellerbach Rights Agreement, *supra* note 4, at 422 (shareholders entitled to exercise rights to purchase new stock in Crown Zellerbach for $100 per right). The exercise price in a poison pill stock purchase plan normally approximates the future market value of the issuing company's common stock at the time the rights will expire. *See* M. LIPTON & E. STEINBERGER, *supra* note 3, § 6.03[3], at 6-45 (exercise price set in accordance with liberal estimate of stock's future value).

14. *See* Owens-Illinois Letter, *supra* note 4, at 694 (Owens-Illinois rights entitle stockholders to purchase one one-hundredth share of Owens-Illinois preferred stock); Crown Zellerbach Rights Agreement, *supra* note 4, at 418 (Crown Zellerbach rights entitle shareholders to purchase one share of Crown Zellerbach common). The underlying stock of the issuing company in a rights plan may be common or preferred, depending upon the sufficiency of the issuing corporation's existing authorized stock. *See* Fogelson, *supra* note 4, at 193. If a company has sufficient authorized but unissued common stock to cover the rights, the company may distribute rights to purchase common stock through the company's board of directors. *Id.* If a company has an insufficient amount of authorized common stock, the company may distribute rights to purchase participating preferred stock provided the company has sufficient authorized "blank check" preferred stock. *Id.* Companies that have neither an adequate amount of authorized but unissued common stock nor sufficient blank check preferred stock to cover the rights would need stockholder approval to authorize the requisite stock. *Id.* at 193-94.

company's common stock.[15] The prudent shareholder, therefore, has little or no economic incentive to exercise the shareholder's right to purchase new stock in the issuing corporation.[16] The purchase rights remain "attached" to the outstanding common stock until the occurrence of a triggering event.[17] For example, a purchase rights plan may provide that once a person or group acquires twenty percent of the issuing company's outstanding common stock, or announces an offer to acquire thirty percent of the company's outstanding common stock, the rights detach, and the rightsholders then may exercise the warrants and purchase stock of the issuing company.[18] The right to acquire new stock of the issuing company, however, is not the distinguishing feature of a poison pill rights plan.[19] Rather, the principal characteristic of a rights plan is the flip-over feature, which occurs in the event of a merger or other business combination of the target corporation

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15. *See* M. LIPTON & E. STEINBERGER, *supra* note 3, §6.02[3], at 6-45 (depending upon term of rights, exercise price may be 200 to 300% of company's stock); *supra* note 13 (discussing exercise price of rights).

16. *See* Nat'l L.J., Mar. 25, 1985, at 15, col. 1 (recognizing economic impropriety of exercising rights to purchase new stock in issuing company). Since an issuing company bases the exercise price of poison pill warrants on the future value of the company's stock, the present exercise of the warrants economically is unfeasible for the rightsholder. *See* Moran v. Household Int'l, Inc., 490 A.2d 1059, 1066 (Del. Ch. 1985) (at $10,000 per share, Household's newly issued preferred stock was unrealistic option).

17. *See* Fogelson, *supra* note 4, at 194. The warrants in a purchase rights plan are appurtenant to the common stock of the issuing company immediately after issuance of the rights. *Id.* Thus, until a triggering event occurs, a rightsholder may not exercise the rights, but may transfer the rights only in connection with the transfer of the holder's common stock. *See* Rights Plan, *supra* note 4, at 422.61 (rights alienable only as attached to common stock); *see also infra* notes 18, 59 and accompanying text (discussing triggering events of typical rights plan).

18. *See* Fogelson, *supra* note 4, at 194 (rightsholder may exercise rights after triggering event). The first phase of a typical poison pill stock purchase rights plan consists of distributing a dividend of the rights. *See supra* note 12 and accompanying text (company distributes dividend of one right per share of outstanding common stock). The second phase of a rights plan involves executing a rights agreement with a third party as a rights agent. *See* Rights Plan, *supra* note 4, at 422.59 (rights agreement between Household, Inc. and Harris Trust and Savings Bank); Crown Zellerbach Rights Agreement, *supra* note 4, at 417 (rights agreement between Crown Zellerbach Corporation and The Bank of California, N.A.). Upon the occurrence of a triggering event, the rights agent issues a separate rights certificate evidencing the rights to each shareholder of the issuing company. *See* Rights Plan, *supra* note 4, at 422.61. Each shareholder then may exercise the right to purchase stock in the issuing company by surrendering the rights certificate to the rights agent and paying a purchase price. *See* Crown Zellerbach Rights Agreement, *supra* note 4, at 418 (entitling shareholders to purchase one share of Crown Zellerbach common stock); Owens-Illinois Letter, *supra* note 4, at 694 (Owens-Illinois rights allow stockholders to purchase one one-hundredth of a share of Owens-Illinois preferred stock). In the event that an issuing company's stockholder declines to exercise the right to purchase new stock in the issuing company, the stockholder then would be able to purchase shares of any acquiring company in the event of a merger. *See infra* notes 21, 59 and accompanying text (discussing flip-over feature of poison pill stock purchase rights).

19. *See* Nat'l L.J., Mar. 25, 1985, at 15, col. 1 (ability of rightsholders to purchase shares of issuing company's stock at exercise price has minimal practical significance).

into another company.[20] Upon the consummation of a merger or other combination, the flip-over feature entitles each rightsholder to purchase an amount of the acquiror's common stock equivalent to the market value of twice the exercise price of each right.[21] Thus, if the exercise price of a right is one hundred dollars, and the market value of the acquiror's stock at the time of the merger is fifty dollars per share, each right entitles the holder of that right to receive four shares, or two hundred dollars worth of the acquiror's stock upon payment of the one hundred dollar exercise price.[22] Because the acquiring entity must offer its own equity at a tremendous discount[23] to rightsholders of the target company, the resulting dilution of an acquiror's capital will be immediate and potentially devastating.[24]

By effectively deterring hostile corporate raiders, a poison pill rights plan may serve a valuable purpose for shareholders in a market that is permeated

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20. *See* M. LIPTON & E. STEINBERGER, *supra* note 3, § 6.03[3], at 6-40 (discussing flip-over feature of rights); *infra* notes 21, 59 and accompanying text (same).

21. *See* M. LIPTON & E. STEINBERGER, *supra* note 3, § 6.03[3], at 6-40. In the event of a takeover, the outstanding poison pill stock purchase rights flip over and enable a rightsholder to purchase the acquiror's equity at one-half of the stock's market value. *Id. See also* Crown Zellerbach Rights Agreement, *supra* note 4, at 422.8-22.9 (entitling holders of outstanding rights to buy any acquiror's common stock at 50% discount); Owens-Illinois Letter, *supra* note 4, at 694 (rights modified upon merger to allow rightsholder to purchase $250 worth of acquiror's stock for $125).

22. *See* M. LIPTON & E. STEINBERGER, *supra* note 3, §6.03[3], at 6-45 (typical rights plan allows rightsholders to purchase acquiror's stock at one-half market price).

23. *See supra* notes 21-22 and accompanying text (poison pill warrants entitle holders to purchase stock of acquiror at 50% of stock's value in event of merger).

24. *See* Chittur, *supra* note 2, at 40 (describing dilutive effect of poison pill rights). The dilutive effect of poison pill warrants on an acquiror's equity is the significant deterrent aspect of a purchase rights plan. *Id.* For example, assume that acquiror (A) commences a tender offer for 25% of target (T) company's 100 million shares of outstanding common stock at $50 per share (the market value of T's stock is $40 per share). A can lock up 25 million shares of T for $1.25 billion (25 million shares at $50 per share). A's purchase, however, will trigger T's rights plan. *See supra* note 14 and accompanying text (acquiring 20% of target company's stock or announcing intent to acquire 30% interest in target company will trigger rights). Assuming that the exercise price of the rights is $100 per right, if A consummates a merger with T, T's rightsholders (representing 75 million shares of remaining common stock in T) can receive $15 billion worth of A's equity for a cumulative exercise price of $7.5 billion. A, therefore, would suffer a $7.5 billion dilution of equity in acquiring T, a company with a market value of $4 billion.

Although the dilution of A's equity decreases as the amount of stock in the tender offer increases, the deterrent effect of poison pill warrants remains substantial. *See* Chuttur, *supra* note 2, at 40 (dilution of acquiror's equity is related inversely to amount of target's stock for which acquiror tenders). For example, A can ameliorate the dilutive effect of poison pill rights by tendering for a greater number of the target's shares. *Id.* If A tenders for 90% of T's outstanding common stock, A can secure 90 million shares of T for $4.5 billion (90 million shares times $50 per share tender offer). If A carries out a merger with T, the rights then would enable the remaining shareholders to exercise a cumulative price of $1 billion (10 million shares times $100 exercise price) and purchase $2 billion worth of A's common stock. A, therefore, would suffer a $1 billion equity dilution, as opposed to the $7.5 billion dilution encountered if A tendered for only 25% of T's shares.

by coercive two-tier[25] and partial[26] tender offers.[27] A purchase rights plan also may allow stockholders to reject a hostile tender offer without fear of an unfair "freeze out" in a back end merger because an acquiring company would suffer a harmful dilution of equity in the second step merger phase of a two-tier or partial tender offer.[28] Finally, a rights plan may provide incentive for a potential acquiror to negotiate with a target's board of directors prior to commencing an offer for the target and thus may allow the board to procure more favorable terms for a target's shareholders.[29]

While poison pill warrants may protect stockholders in certain instances, rights plans may not always serve the best interests of stockholders.[30] For example, rights plans may deprive stockholders of the potential benefits of hostile tender offers.[31] In addition to providing a premium stock price to the shareholders of a target, a hostile tender offer or the threat of a hostile tender offer is an important monitoring device that provides management with a real incentive to operate a corporation efficiently and without self-

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25. *See* D. COMMONS, TENDER OFFER: THE SNEAK ATTACK IN CORPORATE TAKEOVERS 149 (1985). A two-tier tender offer is an offer to purchase a controlling interest in a target company at a premium cash price and the remainder of the target's shares at a lower price of cash or securities. *Id.* By offering an above-market price for an initial controlling interest in a target, an acquiring corporation can induce a target's shareholders to tender shares quickly to receive the higher price per share. *See* Note, *supra* note 11, at 1966 (two-tier tender offer coercively induces stockholders to tender shares).

26. *See* Finkelstein, *supra* note 11, at 291. A partial tender offer is an offer to purchase an interest in a target company that will give the offeror control of the company, but the offer is for less than all of the corporation's shares. *Id.*

27. *See* Fogelson, *supra* note 4, at 192 (enumerating protections afforded stockholders by poison pill rights plan). The coercive effect of two-tier and partial tender offers upon a target's shareholders is substantial. *See generally* Brudney & Chirelstein, *A Restatement of Corporate Freezeouts,* 87 YALE L.J. 1354, 1360-62 (1978) (discussing coercive nature of two-tier bids). By loading the front end of a two-tier offer with a premium cash payment, an offeror can drive stockholders into tendering shares and "squeeze out" remaining shareholders in a second step merger for a lower cash price or securities exchange. *See* Lipton & Brownstein, *Takeover Responses and Directors' Responsibilities—An Update,* 40 BUS. LAW. 1403, 1412 (1985) (front end loaded tender offers coerce stockholders into tendering during initial phase of offer). A partial tender offer also induces stockholders to tender their shares quickly since those shareholders who refuse to tender in the initial offer will be left at the mercy of the majority shareholder if the merger succeeds. Note, *supra* note 11, at 1967. Moreover, upon acquiring a controlling interest in a target company, an acquiror with limited financial resources often finances a second step merger through the sale or "bust-up" of the target's assets. *See* M. LIPTON & E. STEINBERGER, *supra* note 3, at § 1.04[8] (discussing bootstrap takeover offers).

28. *See* Fogelson, *supra* note 4, at 192 (rights plan designed to reduce coercive element of two-tier and partial tender offers); *see also supra* note 23 and accompanying text (rights require offeror to sell equity at discounted price if offeror effectuates merger and target's stockholders exercise rights); *supra* note 24 and accompanying text (discussing dilutive effect of warrants).

29. *See supra* note 9 and accompanying text (rights plan may act as bargaining device for target).

30. *See infra* notes 31-32 and accompanying text (rights plans may deprive shareholders of benefits from tender offers).

31. *See* Edgar v. MITE Corp., 457 U.S. 624, 643 (1982) (Illinois statute that may block out-of-state tender offers deprives shareholders of opportunity to sell stock at premium); Easterbrook & Fischel, *The Proper Role of Management in Responding to a Tender Offer,* 94 HARV. L. REV. 1161, 1173-74 (1981) (discussing benefits of tender offers); Gilson, *A Structural Approach to*

interest.[32] As a result, stockholders have challenged boards of directors' decisions to adopt poison pills as a breach of the directors' fiduciary duties to the stockholders to exercise care and loyalty in managing the corporation.[33]

Corporations: The Case Against Defensive Tactics in Tender Offers, 33 STAN. L. REV. 819, 842-45 (1981) (discussing advantages of tender offers).

32. *See* Easterbrook & Fischel, *supra* note 31, at 1172 (tender offers enable prospective acquirors to keep watch over corporate management). Courts and commentators have noted that hostile tender offers may benefit shareholders. *See supra* note 31 (authorities examining benefits of hostile tender offers). Since the purpose of a hostile tender offer is to persuade a target's shareholders to tender stock to the offeror, the offeror normally offers a price that is well above the market value of the target's stock. *See* Easterbrook & Fischel, *supra* note 31, at 1173 (target's shareholders receive premium price through tender offer process). In addition, a successful tender offer can result in the discharge of inefficient management that has caused the market to underestimate the true value of the target's stock. *See id.* (prospective bidders acquire undervalued companies and improve management). Tender offers, therefore, may compel incumbent management to perform efficiently so that stock prices remain high. *See* Gilson, *supra* note 31, at 844 (tender offers significantly restrain management inefficiency). Finally, hostile tender offers effectively may enable outside acquirors to replace self-dealing incumbent management if the market value of the company's stock accurately reflects the improper activities of existing management. *Id.*

33. *See* Norlin Corp. v. Rooney, Pace, Inc., 744 F.2d 255, 264 (2d Cir. 1984); *infra* notes 129-34 (discussing *Norlin*). Courts and commentators have divided directors' fiduciary duties into a duty of care and duty of loyalty. *See* Norlin v. Rooney, Pace Inc., 744 F.2d 255, 264 (2d Cir. 1984) (two prongs of directors' obligations to corporations and shareholders are duty of care and duty of loyalty); Harrington, *If It Ain't Broke, Don't Fix It: The Legal Propriety of Defenses Against Hostile Takeover Bids,* 34 SYRACUSE L. REV. 977, 987 (1983) (traditional formulation of fiduciary obligations split into duty of care and duty of loyalty). The duty of care obligates a director to perform managerial tasks in good faith and with the care that a reasonably prudent person in a similar situation would exercise under similar circumstances. *See Norlin,* 744 F.2d at 264 (articulating duty of care under New York law); MODEL BUSINESS CORPORATION ACT § 35 (Supp. 1977) (director's duty of care). In evaluating a board of directors' duty of care, courts have developed a policy of judicial deference commonly known as the business judgment rule. *See* Auerbach v. Bennet, 47 N.Y.2d 619, 632-33, 393 N.E.2d 994, 1001-02, 419 N.Y.S.2d 920, 928 (1979) (business judgment rule applies when shareholder has charged board with breach of duty of care). The business judgment rule provides that a court will not interfere with the business judgment of a board of directors unless the court finds bad faith or self-dealing. *See* Arsht, *The Business Judgment Rule Revisited,* 8 HOFSTRA L. REV. 93, 111-12 (1979) (comprehensive statement of business judgment rule). The basic premise of the business judgment rule is that courts are reluctant to intervene in matters that are necessarily business determinations regarding corporate affairs. *See* Sinclair Oil Corp. v. Levien, 280 A.2d 717, 720 (Del. 1971) (courts will not disturb business decisions of directors regarding corporate affairs). Concerning business decisions, therefore, courts afford directors a presumption that the board made an informed decision and acted in good faith and in the honest belief that the action taken was in the best interests of the company. Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984).

In the area of corporate takeovers, courts often have accorded the protection of the business judgment rule to boards that have sought to forestall a takeover by implementing defensive mechanisms. *See, e.g.,* Gearhart Indus., Inc. v. Smith Int'l, Inc., 741 F.2d 707, 723-24 (5th Cir. 1984) (applying Texas law, court upheld use of "springing" warrants under business judgment rule); Panter v. Marshall Field & Co., 646 F.2d 271, 297 (7th Cir.) (upholding target's acquisition program designed to create antitrust obstacle for acquiror under business judgment rule), *cert. denied,* 454 U.S. 1092 (1981); Johnson v. Trueblood, 629 F.2d 287, 292-93 (3d Cir. 1980) (according business judgment rule to board's refusal to tender stock to plaintiff shareholders), *cert. denied,* 450 U.S. 999 (1981).

In challenging a director's action, the plaintiff normally bears the initial burden of rebut-

Since poison pills substantially may deter hostile tender offers or force

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ting the presumption of the business judgment rule and showing a breach of the director's fiduciary duties. *See* Panter v. Marshall Field & Co., 646 F.2d 271, 296 (7th Cir.) (burden on plaintiff to show bad faith, self-dealing, or fraud to rebut presumption of business judgment rule), *cert. denied*, 454 U.S. 1092 (1981); Smith v. Van Gorkom, 488 A.2d 858, 873 (Del. 1985) (plaintiff must rebut presumption that board made informed business decision). Once the plaintiff has rebutted the presumption of the business judgment rule, the burden shifts to the director to prove the reasonableness of the board's action. Johnson v. Trueblood, 629 F.2d 287, 293 (3d Cir. 1980), *cert. denied*, 450 U.S. 999 (1981). *But see* Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 954-55 (Del. 1985) (board initially must show reasonableness of defensive tactic before court will accord presumptions of business judgment rule because of board's inherent conflict of interest in takeover situations); *infra* note 98 (discussing *Unocal's* enhanced duty under business judgment rule for directors in takover situations); *see also* Moran v. Household Int'l, Inc., 500 A.2d 1346, 1356 (Del. 1985) (initial burden of showing reasonableness lies with directors in context of adopting defensive mechanism); *infra* notes 92-98 and accompanying text (discussing *Moran* and threshold duty of directors).

In addition to a duty of care, directors also owe a fiduciary duty of loyalty to the corporation and its shareholders. *Norlin*, 744 F.2d at 264. The duty of loyalty requires a director to demonstrate the substantive fairness of a transaction to the corporation and its shareholders once a plaintiff initially has shown a conflict of interest in the challenged transaction. *See id.* (director must show that transaction was fair if plaintiff establishes director's self-interest); Moore, *The "Interested" Director or Officer Transaction*, 4 DEL. J. CORP. L. 674, 676 (1979) (discussing fairness standard). Courts, however, often have not adhered to a general fairness analysis in takeover situations involving conflicts of interest. *See* Harrington, *supra*, at 990 (noting reluctance of courts to apply fairness standard in takeover cases); Note, *supra* note 11, at 1969 (courts do not apply fairness standard in takeover context). Rather, courts have applied, or have purported to apply, a "primary purpose" test instead of a substantive fairness standard to board transactions in takeover contexts that involve a conflict of interest. *See* Heit v. Baird, 567 F.2d 1157, 1161-62 (1st Cir. 1977) (applying primary purpose test); Cheff v. Mathes, 41 Del. Ch. 494, 504, 199 A.2d 548, 554 (1964) (board action taken for primary purpose of entrenchment is improper). Under the primary purpose test, a court determines whether directors primarily acted to effectuate a proper corporate purpose or to perpetuate the directors' management position. *Heit*, 567 F.2d at 1161-62. Theoretically, the business judgment rule only applies to challenges to a director's fiduciary duty of care, and thus is not appropriate in conflict of interest or primary purpose situations. *See Norlin*, 744 F.2d at 265 (business judgment rule governs only situations in which no conflict of interest exists); Cohen v. Ayers, 596 F.2d 733, 739-40 (7th Cir. 1979) (business judgment rule inapplicable to situations in which management has personal interest); Harrington, *supra*, at 988 (business judgment rule does not apply to managerial conflicts of interest). Several courts, however, have applied the business judgment rule in conjunction with the primary purpose test. *See* Treadway Companies, Inc. v. Care Corp., 638 F.2d 357, 382-83 (2d Cir. 1980) (applying both primary purpose test and business judgment rule); Johnson v. Trueblood, 629 F.2d 287, 292-93 (3d Cir. 1980) (court accorded directors' decision to reject financially beneficial offer protection of business judgment rule since plaintiff failed to show entrenchment was director's primary purpose), *cert. denied*, 450 U.S. 999 (1981); Northwest Indus., Inc. v. B.F. Goodrich Co., 301 F. Supp. 706, 712 (N.D. Ill. 1969) (court failed to make distinction between primary purpose test and business judgment rule); *see also* Harrington, *supra*, at 991-1001 (discussing judicial confusion regarding duty of loyalty and business judgment rule); H. Pitt, *Fiduciary Duties in Control Contests*, in 1 PLI, HOSTILE BATTLES FOR CORPORATE CONTROL 1985 46-60 (D. Block & H. Pitt eds. 1985) (PLI Corporate Law & Practice Handbook Series No. 474) (discussing judicial application of primary purpose test). Commentators have noted that courts interchangeably have applied the business judgment rule and the primary purpose test and have concluded that, in practice, the two standards produce the same result. *See* Lipton, *Takeover Bids in the Target's Boardroom*, 35 BUS. LAW. 101, 124 (1979) (while courts may purport to apply separate

outside bidders to seek board approval,[34] a board of directors that adopts a poison pill effectively may exercise control over a tender offer that an offeror made directly to shareholders.[35] In addition, a board may adopt a poison pill primarily to entrench the position of existing management, which would breach the board's fiduciary duty of loyalty to the stockholders.[36] Finally, state corporation law may not authorize the adoption of a poison pill that significantly redistributes voting power without stockholder approval.[37]

Despite the potential adverse effects of poison pills on shareholders' interests, previous litigation involving poison pill warrants[38] had failed to address adequately the validity of a board of directors' adoption of a rights plan until *Moran v. Household International, Inc.*[39] In *Moran*, the Delaware Supreme Court upheld the adoption of a rights plan by the board of directors of Household International, Inc. (Household) on the grounds that the business judgment rule[40] protected Household's adoption of a rights plan as a prospective takeover defense.[41]

In *Moran*, the Household directors had become concerned about Household's vulnerability as a takeover target.[42] While unaware of any specific,

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primary purpose test, cases turn on whether courts believed that directors acted in good faith or on reasonable basis); Note, *supra* note 11, at 1970 (courts' application of business judgment rule and primary purpose test are indistinguishable).

34. *See supra* note 9 and accompanying text (discussing warrants' ability to facilitate negotiation and deter unsolicited takeover bids).

35. *See* Moran v. Household Int'l, Inc., 490 A.2d 1059, 1076 (Del. Ch. 1985) (Household stock purchase plan allows board to act as primary negotiator of partial tender offers); Nat'l L.J., Mar. 25, 1985, at 16, col. 1 (significant argument against poison pill warrants is that board obtains sole control over hostile tender offer).

36. *See* Norlin Corp. v. Rooney, Pace, Inc., 744 F.2d 255, 266 (2d Cir. 1984) (board breached duty of loyalty by issuing stock plan that gave board voting control of company).

37. *See infra* notes 129-41 and accompanying text (discussing cases in which boards have adopted defensive mechanisms that overstepped statutory authorization).

38. *See* Gearhart Indus., Inc. v. Smith Int'l, Inc., 741 F.2d 707, 723-24 (5th Cir. 1984) (upholding issuance of "springing" warrants under business judgment rule); Crown Zellerbach v. Sir James Goldsmith, 609 F. Supp. 187, 188-89 (S.D.N.Y. 1985) (refusing to enjoin Crown Zellerbach's distribution of common stock purchase rights); Horwitz v. Southwest Forest Indus., Inc., 604 F. Supp. 1130, 1135-36 (D. Nev. 1984) (denying motion to preliminarily enjoin Southwest from issuing stock purchase rights). In addition to challenging the adoption of poison pill stock purchase rights plans, shareholders also have contested the issuance of poison pill preferred stock. *See* Brown-Forman Distillers Corp. v. Lenox, Inc., No. 82-2116 (D.N.J. June 10, 1983) (available on LEXIS, States library, Del file) (denying Brown-Forman's request to preliminarily enjoin Lenox from issuing preferred stock dividend); National Educ. Corp. v. Bell & Howell Co., No. 7278 (Del. Ch. Aug. 25, 1983) (available on LEXIS, States library, Del file) (disallowing National Education Corporation's motion to preliminarily enjoin Bell & Howell from issuing poison pill preferred stock).

39. 500 A.2d 1346 (Del. 1985).

40. *See supra* note 33 (discussing business judgment rule).

41. *See* Moran v. Household Int'l, Inc., 500 A.2d 1346, 1357 (Del. 1985) (according benefit of business judgment rule to Household board's adoption of rights plan).

42. *See* Moran v. Household Int'l, Inc., 490 A.2d 1059, 1064 (Del. Ch. 1985). In *Moran*, Household's management was aware as early as February 1984 of the company's susceptibility to a takeover. *Id.* Personnel of Dysner-Kissner-Moran Corporation (DKM), the largest stock-

impending threat of a takeover, Household's management considered various amendments to Household's bylaws that would discourage any potential takeover.[43] Meanwhile John A. Moran, a member of Household's board, initiated discussions with the chairman of Household's board, Donald C. Clark, about the possibility of a leveraged buyout[44] of Household by Dyson-Kissner-Moran Corporation (DKM).[45] Moran was Chairman of DKM, which was the largest single stockholder of Household.[46] Although Moran's proposal never amounted to anything more than discussion, Household soon sought legal and financial expertise in developing a takeover defense strategy.[47] On August 14, 1984, Household's board met to consider a defense scheme that included a poison pill stock purchase rights dividend plan.[48] After discussing the proposed rights plan with counsel and investment bankers, the Household board approved the rights plan (Rights Plan).[49]

Under the Rights Plan, each stockholder of Household received a dividend of one purchase right for each share of Household common stock outstanding.[50] Each right, which had a term of ten years,[51] allowed a holder to purchase one one-hundredth of a share of a new series of subordinated

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holder of Household, conducted a financial study of Household which revealed that the market significantly had undervalued Household's stock in relation to Household's breakup value. *Id.* DKM subsequently increased its equity position in Household by purchasing 500,000 shares of Household common stock in the open market. *Id.*

43. *See id.* at 1064 (Household analyzed various charter amendments to thwart possible takeover). Although *Moran* is unclear regarding the specific amendments that the Household board examined, typical defensive charter provisions include supermajority voting provisions, fair price provisions, and mandatory redemption provisions. *See* Hochman & Folger, *Deflecting Takeovers: Charter and By-Law Techniques*, 34 BUS. LAW. 537, 548-56 (1979) (discussing defensive charter and bylaw provisions).

44. *See* M. LIPTON & E. STEINBERGER, *supra* note 3, at § 9.03[5] (discussing leveraged buyouts). A leveraged buyout occurs when an acquiror uses the assets of the target company as financing for the acquiror's purchase. *See id.* (creditors of acquiror look to assets acquired and future earning power of target company for satisfaction of acquiror's debt).

45. Moran v. Household Int'l, Inc., 490 A.2d 1059, 1064 (Del. Ch. 1985).

46. *Id.* at 1063.

47. *Id.* at 1065.

48. *Id.* In *Moran,* the architect of Household's poison pill stock purchase rights dividend plan (Rights Plan), Martin Lipton of Wachtell, Lipton, Rosen & Katz, met with the Household board to formulate a comprehensive takeover strategy. *Id.* In addition to the Rights Plan, the antitakeover scheme included a general policy statement regarding the long term interests of the corporation, certain bylaw amendments regarding special shareholder meetings and written consents, and changes in Household's employee stock benefits plans (ESOP) that would allow the beneficial owners to tender ESOP stock in the event of a tender offer. *Id.* Before the Household directors met to consider a defensive stock purchase rights plan, Household sent a summary of the proposed Rights Plan to each member of Household's board. *Id.*

49. *Id.* In *Moran,* Household's board consisted of ten outside directors and six inside directors or members of management. *Id.* at 1064. Aside from Moran, John C. Whitehead was the only Household director to vote against the Rights Plan. *Id.* at 1066. Whitehead, a director of Goldman, Sachs & Co., expressed concern that adopting the Rights Plan would draw unwanted attention to Household. *Id.* at 1067.

50. Rights Plan, *supra* note 4, at 422.59.

51. *See id.* at 422.63 (rights expire August 31, 1994 if board does not redeem rights sooner).

participating Household preferred stock for an exercise price of one hundred dollars.[52] Each share of new Household preferred stock carried a dividend right equal to one hundred times the dividend on Household's common stock[53] and entitled a holder to one hundred votes on any matter presented to Household stockholders.[54] The Rights Plan affixed one purchase right to each share of Household common stock.[55] Prior to the occurrence of a triggering event,[56] a rightsholder could not trade the warrants separably from Household common stock.[57] The Rights Plan provided for the exercise of the rights upon one of two events: (1) a person or group announces a tender or exchange offer for thirty percent or more of Household's common stock, or (2) a person acquires twenty percent of Household's common stock, acquires the right to purchase twenty percent of Household's common stock, or announces the formation of a group representing twenty percent of Household's common stock to act together.[58] The crux of the Rights Plan, however, was that in the event of a merger or other combination of Household with an outside acquiror, each purchase right flipped over and entitled a rightsholder to purchase stock of any acquiring company at one-half the market value of the acquiror's stock.[59] Under the Rights Plan, the

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52. *Id.* at 422.60, 422.63. To cover the rights dividend, the Household board in *Moran* adopted a resolution creating 700,000 shares of preferred stock. *See* Form of Designation, Preferences and Rights of Series A Junior Participating Preferred Stock of Household International, Inc. (creating new series of preferred stock) [hereinafter cited as Preferences and Rights], *reprinted in* SHARK REPELLENTS, *supra* note 4, at 442.82-88 . The Rights Plan obligated Household to keep available a sufficient amount of preferred stock for issuance in the event that Household stockholders exercised the rights. Rights Plan, *supra* note 4, at 422.64-65. The Rights Plan in *Moran* also provided that Household may adjust the exercise price of the warrants from time to time in case of certain stock splits or reclassifications. *Id.* at 422.63.

53. *See* Preferences and Rights, *supra* note 52, at 422.83 (entitling preferred stockholders to quarterly dividend).

54. *See id.* at 422.84 (one one-hundredth of a share of series A preferred entitled holder to one vote).

55. Rights Plan, *supra* note 4, at 422.59.

56. *See infra* text accompanying note 58 (discussing triggering events).

57. *See* Rights Plan, *supra* note 4, at 422.61 (before triggering event activates rights, rightsholders may not transfer rights separately from Household common). Until an event triggered the rights, the stockholders' certificates of common stock evidenced the existence of the rights in *Moran*. *Id.* One share of Household common stock represented one stock purchase right. *Id.* Upon activation, the warrants "detached" from the common stock, and separate rights certificates represented the Household warrants. *Id. See also* Right Certificate, Household International, Inc. (form of right certificate), *reprinted in* SHARK REPELLENTS, *supra* note 4, at 422.89. The Rights Plan obligated Household's rights agent, Harris Trust and Savings Bank, to issue the rights certificates to Household stockholders, and enforce the rights in the event that rightsholders exercised the warrants to purchase new preferred stock. *See* Rights Plan, *supra* note 4, at 422.61, 422.63-64 (instructing rights agent to issue right certificates and requisition preferred stock).

58. Rights Plan, *supra* note 4, at 422.61. *See also Moran,* 490 A.2d at 1066 (discussing triggering events of Rights Plan).

59. *See* Nat'l L.J., March 25, 1985, at 15, col. 1 (primary significance of Rights Plan surfaces upon consummation of merger); Rights Plan, *supra* note 4, at 422.72 (flip-over feature of warrants). The Rights Plan in *Moran* allowed rightsholders to purchase an amount of an ac-

Household board could redeem the rights for fifty cents per right at any time prior to a twenty percent acquisition of Household's common stock.[60]

Subsequent to the adoption of the Rights Plan, Moran and DKM filed suit in the Delaware Court of Chancery, alleging that the Rights Plan unjustifiably impinged upon the fundamental rights of Household shareholders to market Household shares and that the Rights Plan restricted the right of Household shareholders to conduct a proxy contest.[61] The Delaware Court of Chancery upheld the adoption of the Household Rights Plan as an appropriate managerial decision under the business judgment rule.[62] Moran and DKM then appealed the chancery court's decision to the Delaware Supreme Court, again challenging the Rights Plan's purported usurpation of shareholder rights, and disputing the power of the Household board to adopt the Rights Plan.[63]

In addressing the validity of the Household board's adoption of the Rights Plan, the Delaware Supreme Court in *Moran* placed fundamental significance upon the applicability of the business judgment rule to the board's decision.[64] Citing its recent decision in *Unocal Corp. v. Mesa Petroleum Co.*, the Delaware Supreme Court noted that the business judgment rule was an appropriate standard to evaluate a board of directors' decision regarding pending takeover bids.[65] The *Moran* court added, more-

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quiring company's stock having a market value of twice the exercise price of the warrants. Rights Plan, *supra* note 4, at 422.72. By merging or consolidating with Household, any acquiring company assumed the duties and obligations of Household under the Rights Plan, including the obligation to provide for the purchase of the acquiror's common stock for one-half of the stock's market value. *See id.* (acquiror liable for duties and obligations of Household under Rights Plan). The Rights Plan precluded Household from consummating any merger or consolidation without first executing an agreement with an acquiror binding the acquiror to the Rights Plan. *Id.* at 422.73.

60. Rights Plan, *supra* note 4, at 422.79. *See also supra* note 10 and accompanying text (discussing redemption feature of poison pill rights plan).

61. *Moran*, 490 A.2d at 1064.

62. *Id.* at 1083. The business judgment rule accords a board of directors a rebuttable presumption that the directors acted on an informed basis, in good faith, and in the honest belief that the action taken served the best interests of the company. Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984). *See also supra* note 33 (discussing business judgment rule).

63. *Moran*, 500 A.2d 1346, 1351 (Del. 1985).

64. *See id.* at 1350 (court's central concern is applicability of business judgment rule to Household board's decision). In *Moran*, neither Moran nor DKM alleged that the Household board adopted the Rights Plan for entrenchment purposes. Consequently, the Delaware Supreme Court did not engage in a duty of loyalty and primary purpose analysis. *See id.* at 1356 (no allegations of conflict of duty of loyalty breach); *supra* note 33 (discussing judicial application of primary purpose test).

65. *Moran*, 500 A.2d at 1350. In *Unocal Corp. v. Mesa Petroleum Co.*, the Delaware Supreme Court addressed the validity of an exchange offer by Unocal of Unocal's outstanding stock for debt securities as a defense against Mesa's hostile takeover bid. Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 951 (1985). Unocal's exchange offer excluded Mesa, which held approximately 13% of Unocal's stock, from participating in Unocal's exchange of debt securities for outstanding Unocal common stock. *Id.* In determining the applicability of the business judgment rule to the Unocal board's discriminatory exchange offer, the *Unocal* court determined that a board should enjoy the same discretion regarding a pending takeover bid that a board enjoys with other business decisions. *Id.* at 954.

over, that applying the business judgment rule to a board's preplanned, prospective takeover defense is even more appropriate than applying the rule to a board's decision to adopt a defensive mechanism in the heat of a takeover battle.[66] The court reasoned that prospective planning for the possibility of a hostile takeover bid may reduce the likelihood that a board, acting under the pressure of an imminent takeover attempt, will fail to exercise prudent judgment.[67]

The *Moran* court recognized that applying the business judgment rule necessitated an initial inquiry into the Household board's authority to adopt the Rights Plan.[68] While Moran and DKM contended that Delaware corporate law did not authorize the adoption of the plan,[69] the *Moran* court disagreed and found sufficient statutory authority for adopting the Rights Plan.[70] The court held that section 157 of the Delaware General Corporation Law (DGCL),[71] which allows a corporation to issue purchase rights, and section 151(g) of the DGCL,[72] which provides for issuing new stock, authorized the Rights Plan.[73] The *Moran* court also found that section 141(a)[74] of the DGCL, which confers certain inherent powers upon a board of directors, supplemented the Household Board's authority to enact the Rights Plan.[75] In addressing Moran and DKM's contention that the Rights Plan constituted

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66. *Moran,* 500 A.2d at 1350. *See Moran,* 490 A.2d at 1064-65 (Household's management was unaware of any specific impending takeover threats when Moran filed suit).

67. *Moran,* 500 A.2d at 1350.

68. *Id.*

69. *See id.* at 1351 (appellants asserted that adoption of Rights Plan fell outside parameters of Delaware law).

70. *Id.* at 1353, 1357. *See infra* notes 71-75 and accompanying text (discussing Household's statutory authority for Rights Plan).

71. *See* DEL. CODE ANN. tit. 8, § 157 (1983). Section 157 of the Delaware General Corporation Law (DGCL) states in pertinent part:

> Subject to any provisions in the certificate of incorporation, every corporation may create and issue, whether or not in connection with the issue and sale of any shares of stock or other securities of the corporation, rights or options entitling the holders thereof to purchase from the corporation any shares of its capital stock of any class or classes, such rights or options to be evidenced by or in such instrument or instruments as shall be approved by the board of directors.

Id.

72. *See* DEL. CODE ANN. tit. 8, § 151(g) (1983). Section 151(g) of the DGCL provides in part:

> When any corporation desires to issue any shares of stock. . .of which the voting powers, designations, preferences and. . .other rights. . .shall not have been set forth in the certificate of incorporation. . .but shall be provided for in a resolution. . .adopted by the board of directors pursuant to authority expressly vested in it by. . .the certificate of incorporation. . . , a certificate setting forth a copy of such resolution. . .shall become effective. . . .

Id.

73. *Moran,* 500 A.2d at 1363.

74. *See* DEL. CODE ANN. tit. 8, § 141(a) (1984). Section 141(a) of the DGCL gives a board of directors authority to manage the business and affairs of a corporation. *Id.* The *Moran* court maintained that § 141(a) conferred inherent powers upon the Household board that supplemented the board's authority to enact the Rights Plan. *Moran,* 500 A.2d at 1353.

75. *Moran,* 500 A.2d at 1353.

an unauthorized usurpation of Household shareholders' right to consider tender offers, the *Moran* court downplayed the deterrent effect of the Rights Plan and cited several means by which shareholders or an outside offeror could circumvent the Rights Plan and allow a tender offer to succeed.[76] The *Moran* court found that a person or group could condition a tender offer for Household's common stock on the Household board's redemption of the purchase rights or the acquisition of a high percentage of the rights.[77] The court also maintained that a potential acquiror could solicit consents from Household shareholders to remove the Household board and redeem the rights, or acquire fifty percent of Household's shares and force management to self-tender for the rights.[78] While maintaining that the Rights Plan did not wrongfully restrict shareholders' ability to consider hostile tender offers, the *Moran* court emphasized that in the event of a tender offer or a request to redeem the purchase warrants, the Household board still must satisfy the board's fiduciary duties in determining whether to accept or reject the offer or request.[79]

In addition to alleging that the Household board wrongfully impinged the shareholders' ability to consider hostile tender offers, Moran and DKM claimed that the Household board's adoption of the Rights Plan would effectuate an additional, unauthorized transfer of power from stockholders to directors.[80] Moran and DKM asserted that by deterring tender offers, the

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76. *Id.* at 1354.

77. *Id.*

78. *Id.* As an example of a hostile takeover bid succeeding against a poison pill defense, the *Moran* court noted Sir James Goldsmith's takeover of Crown Zellerbach Corporation (Crown Zellerbach). *See id.* (Goldsmith's acquisition of Crown Zellerbach represents circumvention of poison pill rights plan); Wall St. J., July 26, 1985, at 3, col. 1 (describing takeover of Crown Zellerbach). In response to Sir James Goldsmith's hostile takeover threat, Crown Zellerbach adopted a poison pill stock purchase rights plan similar to the Household Rights Plan. *See* SHARK REPELLENTS, *supra* note 4, at 396-97 (discussing Crown Zellerbach's poison pill); Crown Zellerbach Rights Agreement, *supra* note 4, at 417 (text of Crown Zellerbach's stock purchase rights plan). The Crown Zellerbach Agreement activated upon the occurrence of events similar to the Household Rights Plan and, like the Household plan, allowed Crown Zellerbach rightsholders to purchase shares of an acquiror's common stock at a 50% discount in the event of a merger. *See* Crown Zellerbach Rights Agreement, *supra* note 4, at 422 (triggering events for Crown Zellerbach rights are 20% acquisition of Crown Zellerbach common stock or announcement of intent to purchase 30% of outstanding stock); *see also id.* at 422.8-22.9 (entitling rightsholders to purchase stock of any acquiror at one-half stock's market value). Crown Zellerbach's rights plan, however, did not prevent Goldsmith eventually from acquiring Crown Zellerbach. Wall St. J., July 26, 1985, at 3, col. 1. Goldsmith overcame Crown Zellerbach's antitakeover defense by steadily increasing his interest in Crown Zellerbach to 52% of Crown Zellerbach's common stock. *Id.* Although Crown Zellerbach issued the rights after Goldsmith had purchased 20% of Crown Zellerbach's common stock, Goldsmith eluded the poison pill by acquiring majority control of Crown Zellerbach through open market purchases without consummating a complete merger. *Id.* at 12. *See infra* notes 120-22 (discussing purchase of controlling interest as means for circumventing purchase rights plan).

79. *Moran,* 500 A.2d at 1354, 1357; *see* Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 954-55, 958 (Del. 1985) (board has duty to ascertain whether offer serves best interests of company and stockholders).

80. *Moran,* 500 A.2d at 1354.

Rights Plan granted an improper plenary negotiating role to the Household board in all tender offers.[81] Moran and DKM argued that Household could not restructure the proper allocation of authority between board and shareholders without the consent of the owners of Household stock.[82] To refute the argument that the deterrent effect of the Rights Plan cast the Household board in the role of primary tender offer negotiator, the *Moran* court restated that the Rights Plan did not render Household impregnable against hostile tender offers.[83] The court again noted that the Household board did not enjoy unfettered discretion in enacting a defensive measure or refusing to redeem the purchase rights.[84]

Moran and DKM lastly contended that the Household board acted beyond its corporate authority in adopting a mechanism that wrongly restricted shareholders' rights to conduct a proxy solicitation.[85] Moran and DKM asserted that the Rights Plan prevented a stockholder or group of stockholders from accumulating enough stock to conduct an effective proxy contest.[86] According to Moran and DKM, since acquiring twenty percent of Household stock or forming a group representing twenty percent of Household's common stock to act together triggered the warrants and rendered the rights nonredeemable,[87] the Rights Plan placed an economic penalty on a person or group with twenty percent voting control and thus effectively prevented any person or group from acquiring twenty percent of Household shares before conducting a proxy contest.[88] The *Moran* court found that the

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81. *See* Opening Brief of Appellants at 63, Moran v. Household Int'l, Inc., 500 A.2d 1346 (Del. 1985) (Household board lacked power to grant itself plenary negotiating power) [hereinafter cited as Appellants' Brief]; Moran v. Household Int'l, Inc., 490 A.2d 1059, 1076 (Del. Ch. 1985) (Rights Plan allowed board to act as prime negotiator of tender offers).

82. Appellants' Brief, *supra* note 81, at 63.

83. *Moran,* 500 A.2d at 1354-55. The Delaware Supreme Court in *Moran* refused to accept Moran and DKM's argument that the Rights Plan significantly altered the fundamental relationship between Household shareholders and the board of directors. *See id.* at 1354 (adopting Rights Plan does little to change governance structure). The Delaware Chancery Court, however, found that the deterrent effect of the Rights Plan resulted in a reallocation of authority that affected the structural relationship between the board and stockholders. *Moran,* 490 A.2d at 1076. The Delaware Court of Chancery in *Moran* maintained that the reallocation of authority in the shareholder-board relationship, rather than any inherent director conflict of interest in a takeover situation, required the board to adhere to an enhanced duty of proof to demonstrate the reasonableness of the board's transaction. *Id.; see infra* notes 95-98 and accompanying text (discussing board's threshold duty of proof in takeover situations). The Delaware Supreme Court, on the other hand, agreed that the board must pass a threshold inquiry of reasonableness when taking defensive action, but based the court's conclusion on the inherent conflict of interest that exists when a board of directors considers a takeover bid. *See Moran,* 500 A.2d at 1356 (citing *Unocal* for proposition that directors must satisfy initial burden of persuasion); *infra* notes 97-100 and accompanying text (discussing board's threshold duty of proof in takeover context).

84. *Moran,* 500 A.2d at 1354.

85. *Id.* at 1355.

86. *Id.*

87. *See supra* text accompanying note 58 (discussing triggering events of Rights Plan).

88. *Moran,* 500 A.2d at 1355.

restriction upon persons or groups from acquiring a twenty percent interest in Household before commencing a proxy contest did not restrict fundamentally the shareholders' right to conduct a proxy contest.[89] While conceding that the Rights Plan could deter proxy efforts representing twenty percent or more of Household's shares, the *Moran* court concluded that the effects of the Rights Plan upon proxy contests would be minimal.[90] The court noted that insurgent shareholders with stock ownership of less than twenty percent often win proxy contests and that owning large interests in a company does not guarantee the success of a proxy contest.[91]

After affirming the authority of the Household board to adopt the Rights Plan, the *Moran* court addressed the issue of whether the Household directors, in adopting the Rights Plan, had met the board's burden[92] under the business judgment rule.[93] Following its decision in *Unocal Corp. v. Mesa Petroleum Co.*,[94] the Delaware Supreme Court maintained that, although the plaintiff normally bears the threshold burden of rebutting the presumptions accorded under the business judgment rule, when a board of directors adopts an antitakeover mechanism, the board initially carries the burden of showing reasonable grounds for believing that a threat to the company's continued effectiveness existed.[95] The court also found that a board which has adopted a challenged takeover defense must demonstrate the reasonableness of the defense in relation to the danger posed.[96] According to the *Moran* court, the existence of a majority of independent, outside directors on the company's board significantly strengthens a director's argument that the board acted

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89. *Moran*, 490 A.2d 1059, 1080 (Del. Ch. 1985).

90. *Moran*, 500 A.2d at 1355. *See Moran*, 490 A.2d at 1080 (although Rights Plan discouraged large accumulations of stock for proxy efforts, Plan did not restrict voting power of individual shares).

91. *Moran*, 500 A.2d at 1355.

92. *See infra* notes 93-98, 105-06 and accompanying text (discussing burden of Household board under *Moran* court's interpretation of business judgment rule).

93. *Moran*, 500 A.2d at 1355.

94. Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985).

95. *Moran*, 500 A.2d at 1356. *See* Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 954-55, 958 (Del. 1985) (imposing enhanced duty on board of directors in takeover situations). The Delaware Supreme Court in *Unocal Corp. v. Mesa Petroleum Co.* found that a board of directors must show reasonable grounds for perceiving the existence of a danger to corporate policy when the board has adopted a defensive mechanism. *Unocal*, 493 A.2d at 955. The *Unocal* court determined, however, that directors can satisfy the burden of reasonableness by demonstrating good faith and a reasonable investigation. *Id.* As determined earlier by the Delaware Supreme Court in *Cheff v. Mathes*, the court will not penalize a director for an honest mistake of judgment if the judgment appeared reasonable when the director made the decision. Cheff v. Mathes, 199 A.2d 548, 555 (Del. 1964); *see also supra* note 33 (discussing allocating burden of proof under business judgment rule).

96. *Moran*, 500 A.2d at 1356. *See* Unocal, 493 A.2d at 955 (defensive measure must be reasonable in relation to threat posed to receive protection under business judgment rule). In determining whether a defensive measure is reasonably related to the threat posed to corporate policy, directors must analyze the nature of the takeover bid and the bid's effect on the corporation. *Unocal*, 493 A.2d at 955.

reasonably.[97] The *Moran* court maintained that once a board of directors has shown reasonable grounds for believing that a threat to the corporation exists, and has shown that the defensive mechanism was reasonable in light of the threat, the burden of persuasion shifts to the plaintiff, who then must demonstrate that the board breached its fiduciary duties to the corporation and shareholders in adopting the antitakeover defense.[98]

While holding the Household board to a heightened burden of demonstrating the reasonableness of the Rights Plan, the *Moran* court found that Household's directors had reasonable grounds for believing that a danger to the company's continued effectiveness existed, and that the Rights Plan was a reasonable response to the threat.[99] The court explained that in adopting the Rights Plan, the Household board reacted to what the board rationally perceived as Household's vulnerability to coercive acquisition strategies.[100] The court noted that the Household board was concerned about Moran's expressed interest regarding the possible buyout of Household, and the increasing prevalence of "bootstrap" and "bust-up" takeovers, as well as coercive two-tier tender offers.[101]

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97. *Moran*, 500 A.2d at 1356.

98. *Id. See Unocal*, 493 A.2d at 954-55, 958 (discussing director's enhanced duty when adopting defensive mechanism against takeover bid). In requiring a board of directors initially to demonstrate a defensive measure's reasonableness before according the board's decision the protection of the business judgment rule, the *Unocal* court departed from the traditional allocation of proof under the business judgment rule. *See* Legal Times, Jan. 20, 1986, at 510, col. 2 (discussing "reformulated" business judgment rule under *Unocal*). A majority of courts hold that the plaintiff bears the initial burden of rebutting the presumption of the business judgment rule. *See supra* note 33 (discussing allocation of proof under business judgment rule). The *Unocal* court, however, recognized that when dealing with directors' decisions on proposed takeover bids, courts should apply the business judgment rule differently than in regular business transactions. *See Unocal*, 493 A.2d at 954-55 (discussing caveats to business judgment rule). The reason for applying the business judgment rule differently in a control context is that in addressing a proposed takeover bid, a board of directors faces an inherent conflict of interest. *Id.* at 954; *see* Bennet v. Propp, 187 A.2d 405, 409 (Del. 1962) (takeover proposal necessarily confronts management with conflict of interest); Easterbrook & Fischel, *supra* note 31, at 1175 (target's management has significant stake in maintaining company's independence); Gilson, *supra* note 31, at 825 (directors subject to conflict of interest when faced with proposal for company's acquisition). Objectively evaluating a hostile takeover bid is difficult for management since a successful hostile tender offer quite possibly will eradicate existing management's position. *See* Bennet v. Propp, 187 A.2d 405, 409 (Del. 1962) (discussing problem of objectivity that confronts management in addressing takeover bid). As a result, directors bear a burden of demonstrating the reasonableness of an antitakeover defense before a court can accord the board's decision the protections under the business judgment rule. *Unocal*, 493 A.2d at 954. If a board satisfies the standard of reasonableness, a court may accord the protection of the business judgment rule to the directors. *Id.* at 958. The plaintiff then must show by a preponderance of the evidence that the directors breached their fiduciary duty. *Id.* A plaintiff must show a breach of fiduciary duty by demonstrating that the directors, in adopting a takeover defense, primarily intended to entrench themselves in office, or that the directors acted fraudulently, in bad faith, or on an uninformed basis. *Id.*

99. *Moran*, 500 A.2d at 1357.

100. *Id.* at 1356.

101. *Id.* A "bootstrap" or "bust-up" bid is an offer for a target that an offeror finances

Moran and DKM did not allege bad faith on the part of Household's board, or that Household adopted the Rights Plan for the primary purpose of entrenching the board in office.[102] Instead, Moran and DKM asserted that the Household board breached its fiduciary duty of care by failing to make an informed business decision in adopting the Rights Plan.[103] Under the standard enunciated by the Delaware Supreme Court in *Smith v. Van Gorkam,*[104] however, the *Moran* court found that Household's board had evaluated sufficiently the Rights Plan before voting on the measure, and thus had made an informed business decision concerning the adoption of the Rights Plan.[105] As evidence that the Household board undertook a knowledgeable decision-making process, the *Moran* court noted that the Household directors had received a three-page summary of the Rights Plan prior to the board's meeting to consider a defense strategy.[106] The court also added that the directors extensively discussed and evaluated the plan with legal counsel and financial experts.[107] Observing that the Household board had acted on an informed basis,[108] pursuant to statutory authority,[109] and under the well-founded belief that the Rights Plan responded reasonably to a significant

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with the assets of the target company. *See* M. LIPTON & E. STEINBERGER, *supra* note 3, at § 1.04[8] (discussing bootstrap bids). After the takeover, the acquiror "busts up" or sells assets of the target to retire part of the purchaser's acquisition financing debt. *Id.*

102. *See Moran,* 500 A.2d at 1356 (no allegations of bad faith or entrenchment against Household directors).

103. *Id.* Moran and DKM contended that the Household board in *Moran* negligently adopted the Rights Plan. *Id.* Moran and DKM based the assertion of an uninformed board decision upon the following: (a) the failure of Household's counsel to express an opinion on the flip-over feature of the purchase rights, (b) the lack of a statement by Household's counsel that the Rights Plan would prohibit any hostile takeover of Household, and (c) the opinion of Household's counsel that the Rights Plan would not prohibit a proxy contest and that the Rights Plan fell within the parameters of the business judgment rule. *Id.*

104. Smith v. Van Gorkom, 488 A.2d 858, 873 (Del. 1985). In *Smith v. Van Gorkom,* the Delaware Supreme Court found that courts should apply a standard of gross negligence to directors' decisions in determining whether a board of directors exercised informed business judgment. *Id. See* Manning, *Reflections and Practical Tips on Life in the Boardroom after Van Gorkom,* 41 BUS. LAW. 1, 8-14 (1985) (discussing practical implications of *Van Gorkom* decision). According to *Van Gorkom,* directors personally should review pertinent information concerning a tender offer in addressing a proposed takeover bid. *See id.* (discussing directors' standard of compliance under *Van Gorkom).* The directors' duty to inform themselves most likely extends to acquiring outside advice concerning a fair price for the target's shares and the consequences of pursuing alternative courses of action in connection with the takeover bid. *Id.*

105. *See Moran,* 500 A.2d at 1356 (Household directors were not grossly negligent in analyzing Rights Plan prior to adoption).

106. *Id.*

107. *Id.*

108. *See id.* (Household management made informed decision regarding Rights Plan); *supra* notes 105-07 and accompanying text (discussing Household board's compliance with duty to exercise informed business judgment).

109. *See Moran,* 500 A.2d at 1351-53, 1357 (§§ 157, 151 and 141 of DGL authorized Rights Plan); *supra* notes 71-75 (discussing *Moran* court's application of Delaware corporate law to Rights Plan).

threat to corporate policy,[110] the *Moran* court concluded that the business judgment rule protected the Household board's adoption of the Rights Plan.[111] Importantly, however, the *Moran* court limited the court's decision concerning the Rights Plan to the board's present prospective adoption of the Rights Plan.[112] The court stressed that the board's actual response to a specific hostile takeover bid and a request to redeem the rights must conform to the director's fiduciary duties to the corporation and shareholders when and if the board actually faced a hostile tender offer and a request to redeem the rights.[113]

The *Moran* court's endorsement of the Household Rights Plan is significant.[114] *Moran* represents the first endorsement of poison pill warrants by a state supreme court and appears to validate the adoption of a prospective purchase rights plan under Delaware law.[115] *Moran,* therefore, may influence other courts that must consider the validity of purchase rights plans under the laws of states other than Delaware.[116] In addition, many large, publicly held corporations recently have added purchase rights plans similar to the Household Rights Plan to corporate takeover defense arsenals.[117] Boards of directors, however, should recognize the limitations of *Moran* and purchase rights plans.[118] Poison pills such as the Household Rights Plan will not immunize corporations from the threat of hostile takeover bids.[119] To illustrate, since the flip-over feature of poison pill warrants normally activates only in the event of a merger,[120] a purchase rights plan would not deter an

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110. *See Moran,* 500 A.2d at 1356-57 (Household board demonstrated that directors had reasonable grounds for believing existence of danger to corporate policy and that Rights Plan was reasonable in relation to threat posed); *supra* notes 99-101 and accompanying text (discussing Household board's compliance with burden of reasonableness under business judgment rule).

111. *See Moran,* 500 A.2d at 1357 (according Household directors benefit of business judgment rule).

112. *Id.*

113. *Id. See* Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 954 (Del. 1985) (board has obligation to determine whether offer is in best interests of corporation and shareholders); Smith v. Van Gorkom, 488 A.2d 858, 872-73 (Del. 1985) (directors have duty to exercise informed business judgment).

114. *See* Wall St. J., Jan. 8, 1986, at 6, col. 2 (discussing proliferation of use of poison pills since *Moran).*

115. *See* Nat'l L.J., Feb. 24, 1986, at 22, col. 4 (*Moran* has helped establish fundamental legality of rights plan under Delaware law).

116. *See id.* at 27, col. 3 (*Moran* court's affirmation of Rights Plan under business judgment rule should be instrumental in non-Delaware forums).

117. Wall St. J., Jan. 8, 1985, at 6, col. 2. *See supra* note 4 (listing companies that have adopted poison pill plans).

118. *See infra* notes 119-60 and accompanying text (discussing *Moran's* potential restraints on purchase rights plan).

119. *See* Nat'l L.J., Mar. 25, 1985, at 18, col. 1 (discussing deficiencies of poison pill warrants); *Moran,* 490 A.2d at 1066 (author of Household Rights Plan conceded that plan does not render company takeover proof); *supra* notes 77-78 and accompanying text (discussing means of circumventing purchase rights plans); *infra* notes 121-27 and accompanying text (same).

120. *See supra* notes 21, 59 and accompanying text (discussing flip-over feature of Household Rights Plan).

acquiror that is willing to purchase a controlling interest without completing a second step merger.[121] The acquiror presumably could purchase the controlling interest either in the open market or through a partial tender offer.[122] An acquiror also could condition a cash tender offer for all of the target's stock and rights upon the acquisition of a high minimum percentage of stock and rights.[123] An offer conditioned on a high minimum percentage of stock and rights would reduce the dilutive effect of the rights in the second step merger.[124] Other means to circumvent a purchase rights plan include commencing a proxy fight and soliciting shareholder consents to gain control of the target.[125] Once in control, the acquiror can force the board to redeem or self-tender for the rights.[126]

Corporate directors also should realize that the *Moran* court's validation of the Household Rights Plan is not a sweeping affirmation of every conceivable variant of the plan.[127] Several courts have invalidated similar mechanisms in different contexts.[128] For example, the United States Court of Appeals for the Second Circuit in *Norlin Corp. v. Rooney, Pace, Inc.* refused to accord the business judgment rule to a defensive stock issuance plan by Norlin Corp. (Norlin).[129] In *Norlin,* the Norlin board of directors issued new common and voting preferred stock to a wholly owned Panamanian subsidiary and a newly created employee stock option plan (ESOP) in response to the acquisition of large blocks of Norlin stock by Rooney, Pace, Inc. (Rooney).[130] The Norlin board retained voting control over the newly issued stock, giving the board control of forty-nine percent of Norlin's

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121. *See* Katcher & Chapnick, *supra* note 2, at 415 (purchase rights plan will not avert acquisition of controlling interest in target); *supra* notes 77-78 and accompanying text (discussing means of defeating rights plans).

122. *Id. But see supra* notes 25-28 and accompanying text (discussing protection against partial and two-tier tender offers).

123. *See* Katcher & Chapnick, *supra* note 2, at 425 (discussing potential raider responses to poison pill warrants).

124. *Id. See supra* note 24 (discussing inverse relation between dilutive effect of purchase rights plan on acquiror's equity and amount of stock for which acquiror tenders).

125. Katcher & Chapnick, *supra* note 2, at 425.

126. *Id.*

127. *See infra* notes 128-41 and accompanying text (discussing cases that have disallowed variations of poison pill warrants).

128. *See* Chittur, *supra* note 2, at 44 (endorsing Household Rights Plan does not guarantee validity of other similar poison pill plans). Several cases arguably have cast doubt upon the validity of defensive mechanisms in certain circumstances. *See* Norlin Corp. v. Rooney, Pace, Inc., 744 F.2d 255, 264-66 (2d Cir. 1984) (board of directors breached fiduciary duty of care by issuing shares of stock to subsidiary and ESOP in manner that effectively assured management of voting control over company); Frantz Mfg. Co. v. EAC Indus., Inc., 501 A.2d 401, 408 (Del. 1985) (invalidating board's attempt to dilute successful acquisition through issuance of treasury shares to ESOP); *infra* notes 129-41 and accompanying text (discussing *Norlin* and *Frantz*).

129. *See* Norlin Corp. v. Rooney, Pace, Inc., 744 F.2d 255, 266 (2d Cir. 1984) (denying business judgment rule to Norlin board).

130. *Id.* at 259.

outstanding stock.[131] Imposing an injunction prohibiting Norlin's issuance of the new stock, the *Norlin* court ruled that the duty of loyalty superseded the duty of care when a plaintiff can demonstrate self-dealing or bad faith on the part of the directors.[132] The court surmised that the Norlin board issued the stock primarily to solidify management's control of the company.[133] Furthermore, the *Norlin* court found that the board failed to show that issuing the Panamanian and ESOP stock was fair and reasonable to Norlin stockholders and thus concluded that the board breached its fiduciary duty of loyalty.[134]

Another example of a court disallowing a defensive stock issuance is *Frantz Manufacturing Co. v. EAC Industries, Inc.*[135] In *Frantz,* the Delaware Court of Chancery issued a preliminary injunction to enjoin Frantz Manufacturing Co. (Frantz) from issuing treasury shares to an ESOP.[136] The Frantz board of directors issued the treasury shares to dilute the stock ownership of EAC Industries, Inc., which recently had acquired a fifty-one percent interest in Frantz.[137] The *Frantz* court held that the business judgment rule did not protect the Frantz board's retrospective defensive stock issuance.[138] One can distinguish, however, the antitakeover mechanisms in *Norlin* and *Frantz* from the Household Rights Plan in *Moran.*[139] In *Norlin* and *Frantz* the stock issuances involved redistributions of voting power to thwart takeovers, whereas the Household Rights Plan relied on an economic deterrent which the Household board designed to discourage acquisition of the company.[140] *Norlin* and *Frantz,* nonetheless, at least suggest a judicial unwillingness to grant corporate boards unbridled discretion in formulating defensive strategies against hostile acquirors.[141]

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131. *Id.*

132. *Id.* at 265. *See supra* note 33 (discussing director's fiduciary duty of loyalty).

133. *Norlin,* 744 F.2d at 265.

134. *Id.* at 266.

135. Frantz Mfg. Co. v. EAC Indus., Inc., 501 A.2d 401, 408 (Del. 1985).

136. *See id.* at 408 (board's primary purpose of issuing treasury shares was to perpetuate control of company).

137. *See id.* at 402 (Frantz board attempted to dilute EAC's control of Frantz voting stock by issuing shares to ESOP).

138. *See id.* at 408 (business judgment rule will not protect target board's attempt to undo takeover bid after acquiror gains against control of target).

139. *See infra* note 140 and accompanying text (discussing distinction between defensive measures in *Norlin, Frantz,* and *Moran).*

140. *See Norlin,* 744 F.2d at 259 (Norlin board's defensive stock issuance granted board control of 49% of Norlin stock); *Frantz,* 501 A.2d at 402 (Frantz board's defensive stock issuance attempted to dilute EAC's newly acquired control of 51% of Frantz stock). In addition to redistributing the voting power of Frantz Manufacturing Co., the defensive stock issuance in *Frantz* was a retrospective attempt to defeat an already successful takeover bid by EAC Industries, Inc., as compared to the prospective nature of the Household Rights Plan in *Moran. See Frantz,* 501 A.2d at 408 (declining to accord protection of business judgment rule to retrospective takeover defense). In *Norlin,* the Norlin board issued its stock in the heat of a takeover battle with Rooney, Pace, Inc. *Norlin,* 744 F.2d at 265.

141. *See Norlin,* 744 F.2d at 266 (disallowing defensive stock issuance plan); *Frantz,* 501

Although the *Moran* court accorded the protection of the business judgment rule to the Household board's decision to adopt the Rights Plan, the court required Household's directors to satisfy an initial burden of persuasion before deferring to the board's decision.[142] When considering the applicability of the business judgment rule to the adoption of a takeover defense, therefore, a court first may inquire whether a board had reasonable grounds to believe that a danger to the corporation existed and whether the defensive policy that the board exercised was reasonable in light of the threat posed.[143] A board of directors possesses a heightened duty in adopting antitakeover techniques because of the inherent conflict of interest that exists when a board takes action in response to the threat of a hostile takeover.[144] In reacting to a hostile takeover bid, a board effectively may decide whether existing management will remain intact.[145] The possibility that directors will act to sustain management positions is significant, and requires an initial judicial examination of the board's action in response to a hostile tender offer.[146] The practical effect of the judicial inquiry is to require the board of directors initially to demonstrate that the decision to approve the defensive mechanism was reasonable.[147] Once the directors have established that a reasonable basis existed for adopting the takeover defense[148] and that the

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A.2d at 408 (refusing to endorse board's retrospective takeover defense); *see also* Ministar Acquiring Corp. v. AMF, Inc., 621 F. Supp. 1252, 1257-59 (S.D.N.Y. 1985) (invalidating AMF's poison pill warrants that effectively placed veto power over mergers in select group of stockholders); Unilever Acquisition Corp. v. Richardson-Vicks, Inc., 618 F. Supp. 407, 409-10 (S.D.N.Y. 1985) (issuing preliminary injunction against Richardson-Vicks' issuance of poison pill preferred stock that entitled current stockholders to 25 votes per share but limited transferees to five votes per share); ASARCO, Inc. v. Court, 611 F. Supp. 468, 479-80 (D.N.J. 1985) (enjoining Court's defensive issuance of preferred stock that entitled owners of less than 20% of company's stock to extraordinary voting rights but excluded shareholders who owned 20% or more of corporation's stock).

142. *Moran,* 500 A.2d at 1356. *See supra* notes 92-98 and accompanying text (discussing threshold duty imposed on directors by *Moran);* Unocal Corp. v. Mesa Petroleum Co., 493 A.2d at 954-55 (board carries enhanced duty before receiving protection of business judgment rule when board addresses pending takeover bid); *see also supra* note 33 (discussing normal allocation of burden of proof under business judgment rule).

143. *Moran,* 500 A.2d at 1356; *Unocal,* 493 A.2d at 954-55. *See supra* notes 92-98 and accompanying text (discussing board's heightened duty when addressing takeover offer).

144. *See Unocal,* 493 A.2d at 954 (board faces intrinsic conflict of interest in addressing takeover offer); *supra* note 98 (discussing directors' inherent conflict of interest in addressing takeover bid).

145. *See supra* note 98 (acquiescing to takeover bid often terminates existing management's position).

146. *See Unocal,* 493 A.2d at 954 (possibility exists that biased judgment will affect board decisions on takeover bids); *supra* note 98 (discussing conflict of interest problems in defending against takeovers).

147. *See Moran,* 500 A.2d at 1356 (requiring board to show reasonableness of Rights Plan); *supra* notes 92-98 and accompanying text (discussing directors' burden of persuasion in takeover context).

148. *See Unocal,* 493 A.2d at 955 (director can demonstrate rational belief in existing corporate danger by showing good faith and reasonable investigation); *supra* note 95 and accompanying text (discussing directors' burden of demonstrating reasonableness).

mechanism was reasonable in relation to the existing danger,[149] the burden shifts to the plaintiff, who then must show a breach of the director's fiduciary obligations such as bad faith or abuse of discretion.[150] Ordinarily, if the board can articulate a rational business purpose for adopting the takeover defense, a court will refuse to second-guess the board's decision.[151] Significantly, the Delaware Supreme Court in *Moran* extended the application of the board's duty from the adoption of a defensive mechanism in the face of a pending takeover threat, as in *Unocal,*[152] to the prospective adoption of a takeover defense, such as the Rights Plan in *Moran.*[153] Thus, even though applying the business judgment rule may be particularly appropriate to the adoption of a preplanned defensive mechanism,[154] a board that approves a prospective defensive measure must be able to articulate reasonable grounds upon which the directors acted before the board can receive the protection of the business judgment rule.[155]

In addition to recognizing the duty that *Moran* imposes upon a board wishing to adopt a defensive mechanism, directors should realize that properly adopting a purchase rights plan will not ensure the validity of the subsequent use of the plan to thwart a specific tender offer.[156] The *Moran* court specifically stated that the court was endorsing only the present adoption of the Rights Plan, which the Household board undertook as a preventive, pre-tender offer defense.[157] The *Moran* court observed that in the event of an ultimate takeover bid and request to redeem the rights, the Household board still would have to satisfy its fiduciary duties to both the corporation and the Household shareholders.[158] While Household's initial adoption of the Rights Plan survived judicial scrutiny, the Household board would have to show that the decision not to redeem the rights in response

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149. *See Unocal,* 493 A.2d at 955 (directors must analyze nature of takeover bid and potential effect on corporate enterprise); *supra* note 96 and accompanying text (discussing duty of directors to demonstrate reasonableness of takeover defense in light of threat to corporation).

150. *Moran,* 500 A.2d at 1356. *See supra* note 98 and accompanying text (discussing allocation of burden of persuasion under business judgment rule in *Unocal* and *Moran).*

151. *Unocal,* 493 A.2d at 954. *See supra* note 33 (discussing judicial application of business judgment rule).

152. *See Unocal,* 493 A.2d at 954-55 (pursuing initial judicial inquiry of board's action when board addresses pending takeover bid).

153. *See Moran,* 500 A.2d at 1356 (demanding enhanced duty of board to show reasonableness of antitakeover mechanism when directors act prospectively to thwart potential takeover attempts).

154. *See id.* at 1350 (discussing applicability of business judgment rule to prospective takeover defense).

155. *See id.* at 1356-57 (requiring Household directors to demonstrate ratinal basis for adopting Rights Plan); *Unocal,* 493 A.2d at 954-55 (inquiring into board's reasons for commencing selective tender offer); *supra* notes 99-101 and accompanying text (discussing Household's basis for adopting Rights Plan).

156. *See Moran,* 500 A.2d at 1354, 1357 (court will judge ultimate response to takeover bid and request to redeem rights separately from initial adoption of Rights Plan).

157. *Id.*

158. *Id.*

to a pending tender offer and a request to redeem was in the best interests of the corporation and shareholders.[159] Thus, a court relying on *Moran* could find that a board of directors' failure to redeem poison pill warrants in the face of certain takeover bids violated the directors' fiduciary duties to the corporation and shareholders.[160]

The Delaware Supreme Court had the opportunity to examine the responsibilities of a board when faced with an active hostile takeover bid in *MacAndrews & Forbes Holdings, Inc. v. Revlon, Inc.*[161] In *Revlon*, the court upheld the Revlon Board's adoption of a poison pill purchase rights plan,[162] but intimated that the court would not allow the warrants in Revlon to obviate the bidding process for Revlon stock.[163] In *Revlon,* Pantry Pride, Inc. (Pantry Pride) expressed an interest to Revlon, Inc. (Revlon) in consummating a friendly acquisition of Revlon.[164] In response to Pantry Pride's overtures concerning the purchase of Revlon, the Revlon board adopted a takeover defense plan, part of which included a poison pill rights plan (Revlon Rights Plan) similar to the Rights Plan in *Moran.*[165] Under the Revlon Rights Plan, the Revlon board distributed a dividend of one note purchase right for each share of Revlon common stock outstanding.[166] Each right entitled a holder to exchange one share of Revlon common stock for a sixty-five dollar principal amount of Revlon notes that yielded twelve percent interest and

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159. *See id.* (*Moran* court's endorsement of Household Rights Plan adoption will not relieve directors of fiduciary obligations in addressing actual takeover bid); *Unocal,* 493 A.2d at 954 (board has duty to determine whether tender offer serves interests of corporation and shareholders).

160. *See Moran,* 500 A.2d at 1354, 1357. According to *Moran,* a board's decision not to redeem poison pill warrants in response to a tender offer and request to redeem the warrants is an issue separate from the board's initial adoption of a purchase price plan. *Id.; see supra* notes 156-59 and accompanying text (discussing limitation of *Moran's* endorsement of Rights Plan). After a board has adopted a purchase rights plan, the directors' consideration of whether to redeem the warrants in the face of a tender offer and request to redeem is similar to a board's consideration of a proposed merger or other form of business combination. *See* Nat'l L.J., May 27, 1985, at 19, col. 1 (purchase rights plans subject takeover offers to directors' prior approval). Thus, if a board rejects a bidder's request to redeem the rights, the directors presumably would have to demonstrate that rejecting the request was the product of an informed decision-making process, and that the directors acted in good faith and in the belief that redeeming the rights was not in the stockholders' best interests. *See Moran,* 500 A.2d at 1357 (directors must comply with fiduciary duties in using purchase rights plan); *supra* notes 105-07 and accompanying text (discussing director's duty to reach informed decision regarding takeover bid); *supra* notes 92-98 and accompanying text (discussing directors' fiduciary duties); *supra* note 33 (same).

161. MacAndrews & Forbes Holdings, Inc. v. Revlon, Inc., 506 A.2d 173 (Del. 1986).

162. *See id.* at 180-81 (adopting note purchase rights plan falls under business judgment rule as defensive mechanism designed to enhance board's negotiating ability and protect corporate entity against legitimate threat).

163. *See infra* notes 200-18 and accompanying text (discussing court's disposition of antitakeover measures in *Revlon).*

164. *Revlon,* 501 A.2d 1239, 1243 (Del. Ch. 1985).

165. *See id.* at 1244 (Revlon board adopted note purchase rights plan).

166. *Id.* at 1243.

matured in one year.[167] The rightsholders could exercise the note purchase rights when a person or group acquired twenty percent of Revlon's outstanding stock, unless the acquiror agreed to purchase Revlon's shares for sixty-five dollars or more.[168] The plan precluded an acquiror from exercising any rights.[169] Under the Revlon Rights Plan, the Revlon board could redeem the rights for ten cents each at the board's option prior to a twenty percent acquisition of Revlon's stock.[170] The function of the note purchase rights was to preclude tender offers of less than sixty-five dollars per share and to facilitate the likelihood of a negotiated tender offer.[171] If an offeror purchased more than twenty percent of Revlon's outstanding stock and refused to pay at least sixty-five dollars per share, the Revlon rights would activate and allow rightsholders to exchange equity for favorably structured debt.[172] If an offeror proceeded to consummate a merger with Revlon, then the surviving entity incurred outstanding debt securities, assuming that Revlon stockholders exercised the Revlon rights upon activation.[173]

Subsequent to Revlon's adoption of the Revlon Rights Plan, Pantry Pride offered to purchase any or all shares of Revlon subject to, among other things, the recission, redemption, or voiding of the Revlon Rights Plan.[174] Revlon reacted by offering Revlon shareholders an exchange of Revlon notes (Exchange Notes).[175] Revlon shareholders responded by tendering ten million shares of Revlon's common stock in exchange for Revlon's notes.[176] Afterward, while Pantry Pride commenced a second tender offer, Revlon pursued Forstman Little & Co. (Fortsman Little) as a white knight

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167. *Id.*

168. *See id.* The acquisition of 20% or more of Revlon common stock in *Revlon* triggered the rights under the Revlon Rights Plan. *Id.* An acquiror of 20% or more of Revlon stock would not trigger the rights, however, if the acquiror promptly purchased Revlon's common stock for at least $65 cash. *Id.*

169. *Id.*

170. *Id.* at 1244.

171. *See id.* The Revlon board intended the Revlon Rights Plan in *Revlon* to prevent tender offers of less than $65 per share and to strengthen the board's bargaining position in relation to potential acquirors. *Id.*

172. *Id.* at 1243. *See supra* text accompanying notes 166-71 (discussing note purchase rights under Revlon Rights Plan).

173. *See Revlon,* 501 A.2d at 1243 (discussing Revlon Rights Plan).

174. *See id.* at 1244. After the Revlon board approved the Revlon Rights Plan, Pantry Pride commenced a tender offer for any and all shares of Revlon common stock at $47.50 per share in *Revlon. Id.* Pantry Pride's tender offer called for the Revlon board to redeem, rescind, or void the note purchase rights. *Id.*

175. *See id.* In response to Pantry Pride's initial tender offer in *Revlon* for any or all shares of Revlon, Revlon self-tendered for its common stock. *Id.* In the exchange proposal, Revlon offered its stockholders notes (Exchange Notes) in principal amounts of $47.50 that bore 11.75% interest and matured in 10 years, as well as one-tenth of a share of $9.00 Cumulative Convertible Exchangeable Preferred stock with a value of $100 per share, for each share of common stock that Revlon shareholders tendered to Revlon. *Id.* In addition, the Exchange Notes contained covenants that severely restricted Revlon's ability to incur debt, sell assets, and pay dividends without the approval of Revlon's independent directors. *Id.*

176. *Id.*

and on October 3, 1985, approved a plan to enter into a leveraged buyout agreement with Forstman Little that would give Revlon shareholders fifty-six dollars per share and allow Revlon management a twenty-five percent equity participation.[177] In addition, Revlon agreed to redeem the purchase rights for Forstman Little or any other offer for Revlon's stock that exceeded fifty-six dollars cash.[178] Pantry Pride immediately raised its offer for Revlon to fifty-six dollars and twenty-five cents per share and indicated that it would counter each Forstman Little offer with a nominal increase.[179] The Revlon board on October 12, 1985, decided to accept an amended Forstman Little merger offer for fifty-seven dollars and twenty-five cents per share of Revlon.[180] The merger agreement provided for the redemption of the Revlon note purchase rights, the recission of the covenants on the Exchange Notes,[181] a "lock-up" option[182] for Forstman Little to purchase two profitable divisions of Revlon,[183] a twenty-five million dollar cancellation fee,[184] and a no-shop provision[185] for Forstman Little.[186] Finally, the agreement precluded any participation by Revlon management in the merger.[187] In return, Forstman Little offered to replace the Exchange Notes with new senior subordinated

177. *Id.* at 1245.

178. *Id.* Under the proposed leveraged buyout agreement in *Revlon* between Revlon and Forstman Little, Forstman Little agreed to assume the $475 million debt that Revlon incurred by issuing the Exchange Notes. *Id. See supra* text accompanying note 176 (discussing Revlon's exchange offer). In addition to requiring that Revlon redeem the poison pill purchase rights, the agreement provided that Revlon would lift certain covenants from the Exchange Notes that would have limited Revlon's ability to incur debt, sell assets, and pay dividends. *Id.* Moreover, Revlon agreed to sell three of its divisions to help finance Forstman Little's leveraged buyout of Revlon. *Id.*

179. *Id.*

180. *Id.* at 1246.

181. *See supra* note 175 (discussing Exchange Notes in *Revlon).*

182. *See generally* Note, *"Lock-up Options: Toward a State Law Standard,"* 96 HARV. L. REV. 1068, 1068-69 (1983). In a lock-up option, a target company typically bestows upon a suitor a favorable option to purchase stock or assets of the target to induce the suitor, rather than an unwanted raider, to take over the target. *Id.* at 1068-69.

183. *Revlon,* 501 A.2d at 1245. The lock-up that Revlon granted to Forstman Little in *Revlon* allowed Forstman Little to purchase the Vision Care and National Health Laboratories divisions of Revlon for $525 million. *Id.* Forstman Little could exercise the lock-up option upon the acquisition of 40% of Revlon's shares by any acquiror. *Id.* The $525 million price for the two divisions of Revlon was $100 to $175 million below the lowest estimate of these divisions by Revlon's investment banker. *See Revlon,* 506 A.2d at 178 (noting that purchase price involved in Revlon's lock-up option was below estimated value).

184. *Revlon,* 501 A.2d at 1246. The new leveraged buyout agreement in *Revlon* provided that Revlon place $25 million in escrow and release the money to Forstman Little if the two parties did not complete the agreement or if another entity acquired more than 19.9% of Revlon's stock. *Revlon,* 506 A.2d at 178.

185. *See Revlon,* 506 A.2d at 178 (discussing no-shop provision in *Revlon).* The no-shop provision in Revlon's agreement with Forstman Little precluded Revlon from negotiating with any potential acquirors other than Forstman Little. *Id.*

186. *See id.* at 178-79 (discussing amended leveraged buyout agreement between Revlon and Forstman Little).

187. *Id.*

notes to boost the market value of the original Exchange Notes.[188] The Exchange Notes had decreased in value as a result of Revlon rescinding the covenants in Revlon's initial leveraged buyout agreement with Forstman Little, and had prompted holders of the Exchange Notes to threaten the Revlon board with litigation.[189] Significantly, the Revlon board agreed to redeem the note purchase rights in response to any offer that surpassed fifty-seven dollars cash.[190] Six days later, Pantry Pride increased its offer to fifty-eight dollars cash for any and all shares of Revlon.[191]

After the Revlon board adopted the note purchase rights plan, MacAndrews Forbes Holdings, Inc., an affiliate of Pantry Pride, filed suit in the Delaware Court of Chancery to enjoin Revlon from issuing the rights to Revlon shareholders.[192] Upon Revlon's announcement of the amended leveraged buyout agreement with Forstman Little, Pantry Pride added claims against Revlon and Forstman Little challenging the lock-up option, no-shop provision, and cancellation fee, and continued to contest the validity of the original Revlon Rights Plan.[193] In challenging the Revlon Rights Plan, Pantry Pride requested the Delaware Court of Chancery to declare the Revlon Rights Plan void at the plan's inception.[194] In addition, Pantry Pride sought a ruling that the Revlon board effectively had waived the Revlon Rights Plan by agreeing to redeem the rights for any offer above fifty-seven dollars.[195] The Delaware Court of Chancery upheld the adoption of the Revlon Rights Plan under the business judgment rule.[196] The court disallowed the use of the warrants, however, as a wrongful obstruction to the bidding for Revlon.[197]

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188. *Revlon,* 501 A.2d at 1246.

189. *See id.* (discussing Forstman Little's offer to support par value of original Exchange Notes). After Revlon announced the initial leveraged buyout agreement with Forstman Little in *Revlon,* holders of the Exchange Notes threatened the Revlon board with litigation over the decreased value of the Exchange Notes. *See Revlon,* 506 A.2d at 178 (Wall Street journal reported possible lawsuits by Noteholders).

190. *Revlon,* 501 A.2d at 1246.

191. *Id.*

192. *Id.* at 1242.

193. *See id.* at 1242, 1246 (discussing Pantry Pride's complaint against Revlon's defensive measures).

194. *Id.* at 1246.

195. *Id. See supra* text accompanying note 190 (discussing Revlon's agreement to redeem purchase rights).

196. *See Revlon,* 501 A.2d at 1247 (discussing Revlon's adoption of poison pill in light of Pantry Pride's takeover intimations).

197. *See id.* The Delaware Court of Chancery in *Revlon* found that in adopting the poison pill warrants, the Revlon Board had reached the extent of plenary negotiating authority that *Moran* allowed. *Id. See* Moran v. Household Int'l, Inc., 490 A.2d 1059, 1076 (Del. Ch. 1985) (Household Rights Plan allows board to act as primary negotiator of tender offers). *But see supra* notes 83-84 and accompanying text (discussing Delaware Supreme Court's rejection in *Moran* of argument that Rights Plan accorded board plenary negotiating authority in tender offers). The Court of Chancery in *Revlon* maintained that implementing the note purchase rights effectively would substitute the Revlon board for the marketplace as a judge of tender offers for Revlon shares, and refused to allow the board to use the Revlon Rights Plan to

Similarly, the court enjoined Revlon's lock-up option, no-shop clause, and cancellation fee as a breach of the board's duty of loyalty to Revlon shareholders.[198] The court concluded that instead of attempting to obtain the highest possible price for Revlon stock, the Revlon board effectively terminated the bidding for Revlon by implementing defensive measures in an effort to alleviate the threat of litigation by holders of the Exchange Notes.[199]

In considering the validity of the Revlon Rights Plan, the Delaware Supreme Court in *Revlon* first assessed the applicability of the business judgment rule to the Revlon Board's adoption of the note purchase rights plan.[200] The *Revlon* court found that the Revlon board properly had adopted the Revlon Rights Plan as a defense against the threat of a takeover that the board perceived as detrimental to corporate interests.[201] The court found that the Revlon board's concern over the possibility of Pantry Pride offering an inadequate price for Revlon, financing a takeover with "junk bonds,"[202] and subsequently breaking up the assets of Revlon was sufficient to show that the Revlon board acted reasonably in response to a valid danger to Revlon.[203] The court concluded, therefore, that the Revlon board had satisfied the board's fiduciary duty under *Unocal* to demonstrate the warrants' reasonableness[204] and thus granted the protection of the business judgment rule to Revlon's adoption of the purchase rights.[205]

While the *Revlon* court accorded the protection of the business judgment rule to the Revlon board's adoption of the purchase rights plan, the court found that the Revlon directors had rendered moot the issue of the warrants' propriety by agreeing to redeem the rights for Forstman Little and any other offer above fifty-seven dollars for Revlon stock.[206] The court found that the

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thwart potentially favorable tender offers once the sale of Revlon became imminent. *See Revlon,* 501 A.2d at 1248, 1250-51 (requiring Revlon board to promote bids once directors acknowledged eventual sale of company).

198. *See Revlon,* 501 A.2d at 1250-52 (disallowing use of Revlon's antitakeover defenses against Pantry Pride).

199. *See id.* at 1250 (discussing Revlon board's self-interest in accommodating Forstman Little); *supra* notes 188-89 (Revlon accepted Forstman Little's offer which would raise value of Exchange Notes).

200. *Revlon,* 506 A.2d at 179-80.

201. *See id.* at 180-81 (discussing Revlon board's adoption of rights plan).

202. *See* Lipton & Brownstein, *Takeover Responses and Directors' Responsibilities—An Update,* 40 BUS. LAW. 1403, 1411-12 (1985) (discussing junk bond financing of takeovers). Junk bonds normally are high yield, low credit bonds that a potential acquiror uses as a revenue source in financing a takeover. *Id.* Typically, the acquiror forms a shell acquisition vehicle that issues the bonds. *Id.* After consummating the takeover, the acquiror sells or "busts up" the assets of the target to retire the debt incurred in acquiring the target. *Id.* at 1412. *See supra* note 101 and accompanying text (discussing bootstrap and bust up takeovers).

203. *See Revlon,* 506 A.2d at 180-81 (discussing Revlon board's basis for adopting Revlon Rights Plan).

204. *See supra* notes 95-98 and accompanying text (discussing board's duty to show prudence of takeover defense).

205. *Revlon,* 506 A.2d at 181.

206. *Id. See supra* text accompanying note 190 (Revlon board resolved to redeem rights in connection with Forstman Little's buyout offer).

Revlon Rights Plan presented no real obstacle to the bidding for Revlon because the offers of Forstman Little and Pantry Pride eventually exceeded fifty-seven dollars.[207] The *Revlon* court maintained, however, that the Revlon board improperly used the lock-up option, no-shop clause, and cancellation fee to foreclose further bidding by Pantry Pride.[208] The court observed that Revlon's sale became imminent after Pantry Pride had increased its tender offer for Revlon from fifty to fifty-three dollars per share and after the Revlon board had authorized Revlon management to negotiate a merger.[209] The court found that once the Revlon board realized that Revlon's breakup was inevitable, the directors' duty changed from protecting Revlon's corporate enterprise to auctioning the company at the maximum price per share for stockholders.[210] The *Revlon* court maintained that price should have been the Revlon board's fundamental consideration in responding to the competing tender offers of Forstman Little and Panty Pride.[211] The court observed that while not per se illegal, the concessionary lock-up option, no-shop clause, and cancellation fee effectively had terminated the bidding process for Revlon.[212] The *Revlon* court found that by precluding Revlon shareholders form realizing the maximum possible profit from the imminent sale of Revlon, the Revlon board breached its fundamental duty of care to the stockholders and, therefore, could not benefit from the protection of the business judgment rule.[213]

In addition to finding that the Revlon board failed to procure the best possible sale price for Revlon shareholders, the *Revlon* court held that the Revlon board granted the lock-up option to Forstman Little at least partially on the basis of Forstman Little's promise to reinforce the market value of Revlon's Exchange Notes.[214] In light of the noteholders' prior threats to bring suit against the Revlon board, the court maintained that the directors wrongfully permitted a selfish consideration to influence the board's decision to allow the lock-up option.[215] The *Revlon* court thus maintained that the board's decision, which the directors made at the expense of shareholders, constituted a breach of the board's duty of loyalty to Revlon equity owners.[216]

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207. *Revlon,* 506 A.2d at 181.

208. *See infra* notes 209-18 and accompanying text (discussing *Revlon* court's disposition of lock-up option, no-shop clause, and cancellation fee).

209. *Revlon,* 506 A.2d at 182.

210. *Id.*

211. *Id.*

212. *See id.* at 183 (discussing effect of Revlon's antitakeover measures on bidding for Revlon).

213. *Id.* at 185. *See supra* note 33 (discussing duty of care and business judgment rule).

214. *Revlon,* 506 A.2d at 182.

215. *Id.*

216. *Id.* In ascertaining whether the lock-up option in *Revlon* deserved the judicial deference of the business judgment rule, the *Revlon* court analyzed the board's action under the directors' duties of care and loyalty. *See id.* at 184 (defensive measures breached duty of care); *id.* at 182 (lock-up agreement breached duty of loyalty). More traditional business judgment rule analysis has separated the duty of care from the duty of loyalty. *See supra* note 33 (discussing directors'

Recognizing that no rationally related benefit from the board's action accrued to Revlon's principal constituency, the Revlon shareholders, the court refuted Revlon's argument that protecting the interests of the noteholders was a legitimate concern of the Revlon board.[217] The *Revlon* court reasoned that the adverse effect of the lock-up option on shareholders outweighed the importance of protecting another corporate constituency, the Revlon noteholders.[218]

Although the Delaware Supreme Court deemed moot the issue of the poison pill warrants under *Revlon's* particular facts, *Revlon* remains significant to corporate directors who are considering adopting a poison pill.[219] In determining the validity of the lock-up option, no-shop clause, and cancellation fee in *Revlon,* the Delaware Supreme Court addressed for the first time under Delaware law a board's adoption of these defensive measures in response to an impending struggle for corporate control.[220] Presumably the *Revlon* court would have applied the court's analysis of directors' responsibilities to the Revlon Rights Plan had the Revlon board not agreed to redeem the rights for all pertinent bidders in *Revlon.*[221] While the *Revlon* court accorded the protection of the business judgment rule to the Revlon board's adoption of the note purchase rights plan, *Revlon* may have undermined the general efficacy of a poison pill rights defense by disallowing Revlon to implement the lock-up option, no-shop clause, and cancellation fee after Forstman Little and Pantry Pride had intensified the bidding for Revlon.[222] While the mere presence of poison pill warrants in a corporation's financial structure may benefit a company that wishes to prevent unsolicited takeovers,[223] a board's adoption of a rights plan presumably connotes that board's desire to allow the plan to take effect against a hostile acquiror should the board deem this necessary. *Revlon,* however, suggests that a board's refusal to redeem poison pill warrants may result in a breach of the board's fiduciary duties to shareholders if two or more bidders actively are pursuing the

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duties of care and loyalty). The validity of the lock-up option in *Revlon* primarily appears to turn on the issue of good faith. *See Revlon,* 506 A.2d at 182 (preferential consideration of noteholders prevented board from satisfying good faith element of business judgment rule). The *Revlon* court found that by considering the threat of noteholder litigation in the decision to grant the lock-up option to Forstman Little, the Revlon board breached the board's duty of loyalty and negated the good faith presumption of the business judgment rule. *Id.*

217. *Revlon,* 506 A.2d at 182. *See also Unocal,* 493 A.2d at 955 (noting that directors may consider the impact of takeover bid on constituencies other than shareholders).

218. *See Revlon,* 506 A.2d at 182 (concern for nonshareholder interest inappropriate when board's duty is to sell company at highest possible price).

219. *See infra* notes 222-27 and accompanying text (discussing relevance of *Revlon* to directors' use of poison pill).

220. *Revlon,* 506 A.2d at 176.

221. *See Revlon,* 501 A.2d at 1247, 1251 (disallowing use of Revlon Rights Plan).

222. *See infra* notes 223-26 and accompanying text (discussing *Revlon's* limitations on use of poison pill warrants).

223. *See supra* note 9 and accompanying text (possessing rights plan may induce hostile raiders to negotiate with target prior to takeover bid).

company.[224] Concerning the validity of poison pill purchase rights, *Revlon* appears to stand for the proposition that once the bidding process for a target company has reached the point when the sale of the company is imminent, courts should not permit a board to implement a purchase rights plan that in a discriminatory manner retards market forces and undermines the ability of the target's shareholders to receive the highest possible price for the target's stock.[225] Although the purchase rights plan in *Revlon* did not inhibit the bidding for Revlon, any concessionary redemption of the rights by the Revlon board in favor of Forstman Little and to the exclusion of Pantry Pride would have assisted in eroding the protection of the business judgment rule regarding the Revlon board's response to the competing tender offers.[226]

Revlon's implied limitation on the use of poison pill warrants is consistent with the validation of the Household Rights Plan in *Moran.*[227] Both the *Revlon* and *Moran* courts endorsed the adoption of similar defensive rights plans.[228] The Household board in *Moran,* however, unlike the board in *Revlon,* was not facing a situation in which active bidding for the company had begun when the board adopted the Rights Plan.[229] Yet the *Moran* court specifically stated that judicial approval of a board's adoption of a purchase rights plan would not absolve directors of their fiduciary duties in considering a specific takeover bid and request to redeem the warrants.[230] *Revlon* thus appears to manifest the *Moran* court's admonition by impliedly prohibiting a board from implementing an auction-ending purchase rights plan.[231]

In light of *Moran* and Revlon, the prospective adoption of a poison pill rights plan appears safe for boards of directors.[232] Presumably, courts will

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224. *See Revlon,* 506 A.2d at 184 (disallowing Revlon's lock-up option, no-shop agreement, and cancellation fee); *supra* notes 208-18 and accompanying text (discussing *Revlon's* preclusion of antitakeover measures).

225. *See Revlon,* 506 A.2d at 182 (inevitability of company's sale renders moot issue of defensive measures because board's duty becomes that of auctioneer).

226. *See id.* at 184 (refusing to defer to Revlon board's decision to implement defensive mechanisms).

227. *See infra* notes 228-31 and accompanying text (reconciling treatment of rights plans in *Moran* and *Revlon).*

228. *See Revlon,* 506 A.2d at 180-81 (according protection of business judgment rule to adoption of Revlon Rights Plan); *supra* notes 200-05 (discussing *Revlon* court's upholding of Revlon board's decision to adopt rights plan under business judgment rule); *Moran* 500 A.2d at 1357 (endorsing Household board's adoption of poison pill warrants under business judgment rule); *supra* notes 99-101 (discussing Household board's compliance with requirements of business judgment rule).

229. *Moran,* 500 A.2d at 1357.

230. *Id. See supra* notes 156-60 and accompanying text (discussing *Moran* court's limited endorsement of Household Rights Plan).

231. *See supra* notes 219-26 and accompanying text (discussing *Revlon* court's restrictions on use of rights plan).

232. *See supra* notes 93-111 and accompanying text (discussing *Moran* court's protection of Household Rights Plan under business judgment rule); *supra* notes 200-05 (discussing *Revlon* court's endorsement of Revlon Rights Plan under business judgment rule).

accord the presumptions of good faith, honesty, and well-founded decisions[233] under the business judgment rule to a board's decision to adopt a preplanned defensive stock purchase rights plan, provided that a board can show initially that the defensive mechanism was a reasonable means to counter a viable threat to the corporation, as long as the sale of the company is not inevitable.[234] A general concern about the coercive nature of the present takeover market appears to constitute sufficient reasonable grounds to adopt the prospective takeover defense as required by Delaware courts.[235] As long as a board acts on an informed basis,[236] therefore, the business judgment rule should protect the board's decision to adopt a purchase rights plan.[237]

While *Moran* and *Revlon* appear to endorse the adoption of poison pill warrants, the cases highlight the importance of the manner in which a board uses a takeover defense, including a purchase rights plan.[238] The Delaware Supreme Court appears to have legitimized implementing poison pill warrants to preserve a target's corporate entity, at least until bidding for the target reaches a level at which the target's sale is imminent.[239] By deterring heated bidding from potential acquirors, a poison pill may enable a board to avoid reaching a point of imminent breakup.[240] If the pill cannot dissuade resolute competition for the target, however, *Revlon* clearly demands that the board view its primary role as that of an auctioneer, and attempt to secure the highest possible dollar amount per share for the company's shareholders.[241] Additionally, directors must take care not to allow selfish considerations to enter into a decision concerning an antitakeover measure in the heat of a tender offer, especially since *Revlon* indicated that courts should not accord the protection of the business judgment rule to decisions tainted with director self-interest.[242] After *Moran* and *Revlon,* therefore, Delaware courts will judge a board's implementation of a purchase rights plan in the context of each specific takeover offer and each request to redeem or rescind the

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233. *See* Aronson v. Lewis, 473 A.2d 805, 817 (Del. 1984) (discussing presumptions that business judgment rule accords to directors); *supra* note 33 (discussing judicial application of business judgment rule).

234. *See supra* notes 92-98, 200-05 and accompanying text (discussing directors' compliance with burdens of persuasion in *Moran* and *Revlon).*

235. *See supra* notes 99-101, 202-03 and accompanying text (discussing directors' bases for adopting poison pill plans in *Moran* and *Revlon).*

236. *See supra* notes 105-08 (discussing board's duty to render informed decisions).

237. *See supra* notes 92-111, 200-05 and accompanying text (discussing judicial validation of rights plans under business judgment rule in *Moran* and *Revlon).*

238. *See supra* notes 156-60, 219-26 and accompanying text (delineating standards for use of defensive measures against impending takeover threat).

239. *See Revlon,* 506 A.2d at 182 (discussing altered duty of directors once company reaches brink of auction).

240. *See supra* notes 9, 24 and accompanying text (discussing deterrent effect of purchase rights plan on potential acquirors).

241. *See supra* notes 208-18, 222-26 and accompanying text (discussing directors' duty in response to inevitable sale of company).

242. *See supra* notes 214-18 (discussing *Revlon's* incorporation of director self-interest into business judgment rule analysis).

rights.[243] Accordingly, the valid existence of poison pill warrants in a target corporation's arsenal of takeover defenses will not allow the corporation's board to use the poison pill with impunity to thwart the bidding process for the target's stock.

J. CURTIS HENDERSON

243. *See supra* notes 156-60, 219-26 and accompanying text (discussing significance of *Moran* and *Revlon* on directors' duties to stockholders in implementing poison pill rights plan in response to hostile tender offer).