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# Removing Revlon

Franklin A. Gevurtz

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*Abstract*

*This Article advocates the abolition of the* Revlon *doctrine—the junior partner in Delaware's corporate takeover jurisprudence, which governs certain contests involving auctions and sales of control.* Revlon *arose in the twilight zone created by the overlap between defenses to hostile tender offers and efforts by directors to avoid or coerce a shareholder vote on corporate mergers and sales (shotgun corporate marriages). The narrow holding of the case stands for the common sense proposition that if directors decide to sell their corporation by choosing between two bids, both of which will pay all of the shareholders cash for all of their shares, the directors should pick the bid that pays the most cash. The problems arose when Delaware courts assumed that the case had something to say about situations in which the directors were not choosing between two all-cash all-shares bids. Specifically, it has been difficult sensibly to decide in which other cases* Revlon *has something relevant to say and to figure out what this something is. These problems in applying* Revlon *are not the typical results one must inevitably expect when courts apply any legal doctrine to the multitude of grey areas that determine a rule's scope and impact. Instead, they reflect a more fundamental difficulty: The doctrine arising from* Revlon *has no sensible underlying policy rationale to guide courts in its application. This is not simply because courts and commentators have not articulated a sensible policy. Rather, this is because there is no sensible policy that one can articulate for* Revlon *beyond the narrow confines of the original decision.*

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## *I. Introduction*

A little over a quarter century ago, the Delaware Supreme Court established the twin pillar edifice governing the conduct of directors in most takeover contests in the United States.[1] The primary pillar is the *Unocal* doctrine[2]—an elegant, if not always elegantly applied, solution to the positional conflict of interest besetting directors opposing a hostile tender offer that would remove them from power.[3] A secondary pillar is the *Revlon* doctrine[4] imposing seemingly more demanding standards in certain situations involving auctions, the break-up of the company, or transfers of control.[5]

In *Unocal*, the court wrote in a situation in which it was obvious that the decision would have far reaching implications in establishing the rules governing directors in the takeover wars raging through corporate America.[6] By contrast, the *Revlon* case involved a more specific situation in which directors took actions to favor one all-cash bid for the company over another all-cash bid.[7] As such, the decision could simply have constituted a relatively minor refinement of the *Unocal* doctrine—or even the business judgment rule—standing for the proposition that once the directors decide to sell their company by choosing between two bids, both of which will cash out all of the shareholders, the only appropriate goal is to get the most cash for the shareholders. It soon became evident, however, that the scope of the *Revlon* decision reached well beyond the narrow confines of the original

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1. *See infra* note 51 (explaining that a majority of public companies incorporate in Delaware).

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

3. *See infra* notes 50–61 and accompanying text (discussing *Unocal*).

4. *See generally* Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1986).

5. *See infra* notes 116–32 and accompanying text (discussing *Revlon*).

6. *See, e.g.*, Ronald J. Gilson, Unocal *Fifteen Years Later (and What We Can Do About It)*, 26 DEL. J. CORP. L. 491, 493–97 (2001) (describing the business environment at the time and the court's decision to intervene in takeover controversies).

7. *See infra* notes 122–28 and accompanying text (describing the facts of *Revlon*).

case to establish a sphere in which a somehow more demanding, if utterly ill-defined, standard seemingly supplants *Unocal*.[8]

The succeeding years have not been kind to the doctrine arising from *Revlon*. The boundaries of the area covered by *Revlon* have shifted over the course of cases in unpredictable and paradoxical ways to produce a result that seems to call for greater judicial scrutiny of directors' decisions in situations posing less danger of directors acting in self-interest, while calling for less judicial scrutiny in situations posing greater danger of directors acting in self-interest.[9] Once entering the area covered by *Revlon*, the actual requirements of the doctrine remain mysterious—even to the courts charged with its application—and create perplexing anomalies when one seeks to reconcile these requirements with the broader doctrines governing directors' conduct in mergers and acquisitions or even more generally.[10] Indeed, so nebulous are the impacts of triggering *Revlon* that it may be mislabeling to refer to *Revlon* as establishing a doctrine at all.

These problems in applying *Revlon* are not the typical results one must inevitably expect when courts apply any legal doctrine to the multitude of grey areas that determine a rule's scope and impact. Instead, they reflect a more fundamental difficulty. In contrast to the *Unocal* doctrine, the doctrine arising from *Revlon* has no sensible underlying policy rationale to guide courts in its application. This is not simply because courts and commentators have not articulated a sensible policy—otherwise this article might seek to fill the void. Rather, this is because there is no sensible policy that one can articulate for *Revlon* beyond the narrow confines of the original decision.

It is, therefore, time to wipe away the mistake arising from applying *Revlon* to cover situations beyond its original foundation of choosing between two all-cash bids and thereby return Delaware takeover jurisprudence to the simpler wisdom of the unadorned *Unocal* test. To reach this conclusion, this Article will

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8. Wags have come to call the cases in which the *Revlon* doctrine applies, "*Revlon*-land." *See, e.g.*, Stephen M. Bainbridge, *The Geography of* Revlon-*Land*, 81 FORDHAM L. REV. 3277, 3280 & n.7 (2013) (describing the use of the term "*Revlon*-land").

9. *See infra* Part III.A (examining jurisprudence governing the situations that trigger the *Revlon* doctrine).

10. *See infra* Part III.B (examining cases that have applied *Revlon*).

proceed as follows: Part II of this Article examines the context out of which *Revlon* arose. Part III of this Article then outlines the problems created by Delaware court opinions seeking both to determine the scope of situations covered by *Revlon*, as well as to determine what impact the doctrine actually has. Finally, Part IV shows how these problems stem from the lack of any sensible reason for having the doctrine.

## *II.* Revlon*'s Origins*

*Revlon*, like *Unocal* before it, arose out of the jagged manner in which corporate law traditionally divides power between directors and shareholders when it comes to mergers and acquisitions. The basic model of corporate governance is republican: Directors have the power to make decisions;[11] shareholders have the power to choose the directors.[12] Sales and combinations of corporations depart from this model. Instead of lodging the power of decision solely with the directors, corporate statutes generally divide the power so as to require mutual consent by the directors and shareholders. Directors act as gatekeepers who must agree to the transaction.[13] Shareholders, however, retain a veto, as they must approve the deal.[14]

Not surprisingly, this dual consent model has produced conflict. Like clashing armies seeking to outflank each other on the battlefield, both shareholders and directors have sought to limit the other's veto power and, at the same time, to preserve their own. The two contexts for this duel involve directors'

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11. *See, e.g.*, DEL. CODE ANN. tit. 8, § 141(a) (2011) ("The business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors . . . ."); MODEL BUS. CORP. ACT § 8.01(b) (1984) ("[T]he business and affairs of the corporation shall be managed by or under the direction, and subject to the oversight, of its board of directors . . . .").

12. *See, e.g.*, DEL. CODE ANN. tit. 8, § 216(3) ("Directors shall be elected by a plurality of the votes of the shares . . . ."); MODEL BUS. CORP. ACT § 7.28(a) ("[D]irectors are elected by a plurality of the votes cast by the shares entitled to vote . . . .").

13. *See infra* notes 20–21 and accompanying text (discussing the directors' role in sales and mergers).

14. *See infra* notes 62–64 and accompanying text (discussing the shareholders' role in sales and mergers).

attempts to preserve their gatekeeping role in the face of hostile tender offers and directors' attempts to limit the shareholders' effective voice in approving the sale or combination of their corporation. *Revlon* arose in the overlap between these two situations: Revlon's directors sought to preserve their gatekeeping role over the sale of Revlon by supporting a "white knight" instead of a hostile bidder acquiring the corporation and did so through tactics that constrained the ability of Revlon's shareholders to decline the bid preferred by Revlon's board.[15] Hence, in order to understand *Revlon* we must examine both defenses to hostile tender offers (including Delaware's response in *Unocal*), as well as efforts by directors to circumvent the requirement of shareholder approval for the sale or combination of their corporation ("shotgun corporate marriages").

### *A. Defenses to Hostile Tender Offers*

#### *1. The Order of Battle*

Acquisitions of corporations over the opposition of the targeted corporation's directors (hostile takeovers) exist by virtue of a discontinuity in corporate law. Broadly speaking, there are three primary ways in which to structure the purchase of a business conducted by a corporation:[16] the individual or company seeking to acquire the target corporation's business can have itself (if the acquirer is a corporation), or a corporation controlled by the acquirer, merge with the target corporation;[17] the acquirer can purchase substantially all of the assets of the target corporation;[18] or the acquirer can purchase most or all of the

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15. *See infra* notes 122–28 and accompanying text (describing the facts of *Revlon*).

16. *See, e.g.*, FRANKLIN A. GEVURTZ, BUSINESS PLANNING 1008–16 (4th ed. 2008) (describing and comparing the three primary methods of conducting an acquisition).

17. In a statutory merger, two corporations become one, with this surviving corporation inheriting all of the assets and debts of both merging companies and with the shareholders of the two merging companies receiving shares in the surviving corporation or other consideration as provided by the merger agreement. *See id.* at 1008, 1028, 1035 (explaining the effect of a statutory merger).

18. The corporation purchasing the assets of another corporation may also

stock owned by the existing shareholders of the target corporation (thereby becoming the majority or sole shareholder of the target corporation).[19]

Corporation statutes, including Delaware's, require the target corporation's board of directors to approve either a merger[20] or a sale of substantially all of the target's assets[21] before submitting the merger or sale to a shareholder vote.[22] This means that the target's board of directors performs a gatekeeping function; without the board's approval there can be no merger or sale of substantially all assets. The board's power, however, turns out to be based upon something of a Maginot Line, for corporate law contains a gap in the board's gatekeeping role. An acquirer

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agree to assume the debts of the selling corporation, thereby ending up at the same place as if the two corporations merged. *See id.* at 1012 (noting that the purchaser often assumes a portion of the target's liabilities). If the corporation selling its assets thereafter dissolves and distributes the stock in the purchaser or other consideration it received in the sale among its shareholders, the shareholders of both corporations end up in the same position as they would if the purchasing and selling corporations had merged. *See id.* ("If the parties undertake these two additional steps, the result of a sales transaction largely parallels a statutory merger . . . .").

19. While the acquirer can operate the target as a subsidiary after acquiring a majority of the target's outstanding stock, if the acquirer desires 100% ownership, or direct access to the target's assets, the acquirer may push through a merger with the target after the acquirer has obtained a majority of the target's outstanding voting stock, thereby ending up with the same end result as if the corporations had merged to start with. *See id.* at 1014 ("The purchaser can then either run the target as a subsidiary, or liquidate it, thereby achieving the same result as a merger."). A party might also seek control over a corporation by persuading other shareholders to elect one and one's allies to the board (a proxy contest in a public corporation). *See* Lucian Ayre Bebchuk, *A Framework for Analyzing Legal Policy Towards Proxy Contests*, 78 CALIF. L. REV. 1071, 1075 (1990) (describing such contests as an alternative to hostile takeovers for replacing management). This may achieve control, but not the economic benefits of ownership, and so is not functionally equivalent to the three primary modes of corporate acquisitions.

20. *See, e.g.*, DEL. CODE ANN. tit. 8, § 251(b) (2011) (requiring the board to adopt a resolution approving the merger); MODEL BUS. CORP. ACT § 11.04(a) (1984) ("The plan of merger or share exchange must be adopted by the board of directors.").

21. *See, e.g.*, DEL. CODE ANN. tit. 8, § 271(a) (stating that directors may sell substantially all assets upon terms the directors decide, subject to approval by the shareholders); MODEL BUS. CORP. ACT § 12.02(b) (same).

22. *See, e.g.*, DEL. CODE ANN. tit. 8, §§ 251(c), 271(a) (requiring that a proposed merger or sale of the company's assets must be approved by a shareholder vote); MODEL BUS. CORP. ACT § 11.04(b), 12.02(a) (same).

can seek to purchase most or all of the target corporation's outstanding shares directly from the target's existing stockholders without any approval from—and, indeed, over the opposition of—the target's board of directors.[23] Normally, such a purchase takes place through a tender offer.[24]

Boards of target companies and their advisors have developed a variety of strategies for reasserting the board's gatekeeping function even when dealing with a tender offer.[25] These strategies—probably the most effective and common of which is the so-called "poison pill"[26]—work by creating various

23. *See, e.g.*, Air Prods. & Chems., Inc. v. Airgas, Inc., 16 A.3d 48, 95 (Del. Ch. 2011) ("[U]nder [Delaware statutory law], board approval and recommendation is required before stockholders have the opportunity to vote on or even consider a merger proposal, while traditionally the board has been given no statutory role in responding to a public tender offer.").

24. The acquirer might seek to buy shares through open market purchases as individual stockholders decide to sell their shares through the stock exchange. Waiting around for stockholders to call their brokers and sell through the stock exchange, however, tends not to be a very efficient way of obtaining a majority of the outstanding shares.

25. *See, e.g.*, STEPHEN M. BAINBRIDGE, MERGERS AND ACQUISITIONS 192–208 (2d ed. 2009) (describing these strategies).

26. Over the years, the poison pill has mutated (like a virus) and now comes in a variety of forms. *See id.* at 196–202 (describing the evolution of the poison pill). Essentially, the poison pill consists of certain rights that attach to various types of securities (such as preferred stock, warrants to purchase preferred stock, or convertible debt instruments). *See id.* at 196 ("Poison pills take a wide variety of forms, but today most are based on the class of security known as a right."). The corporation can issue these securities as an in-kind dividend to its shareholders. *See id.* (noting that the first poison pill was issued to shareholders as a special dividend). In fact, the securities typically possess little rights to control or distribution of income and, except in the hostile takeover context, are largely worthless. *See id.* at 197 (noting that poison pill rights are typically "priced so that exercise of the option would be economically irrational"). Instead, their key feature is the existence of one or more rights that trigger upon an acquirer purchasing a certain percentage of the target corporation's outstanding shares. *See id.* at 196–97 (describing how the exercise of these rights act to make the acquisition of the target corporation less attractive). These rights, which are commonly referred to as "flip-over" and "flip-in" provisions, are the poison in the poison pill. *See id.* at 197, 199 (explaining how flip-over and flip-in provisions operate). In the event an acquirer purchases the triggering percentage of shares in the target, such provisions may allow the holder of the security to purchase the acquirer's common stock at a substantial discount if the acquirer merges with the target, or to purchase stock or other securities of the target at a substantial discount—either of which is very undesirable from the standpoint of an acquirer. *See id.* at 197 (explaining how activation of the poison pill would deter an acquisition). In addition to the poison

barriers that deter a hostile tender offer. Commonly, cooperation by the target's pre-tender offer board can effectively disarm a poison pill or other takeover defense. In this manner, such takeover defenses reinsert the target's board into a gatekeeping role.

### *2. Delaware's Doctrinal Response*

#### *a. Framing the Issues*

In deciding how to respond to defenses against hostile tender offers, the Delaware courts faced two fundamental questions: (1) is the limit on takeover defenses one of directors' authority or of their duty; and (2) if the limit is duty, by what standard does the court review whether directors breached their duty.

The first question frames the issue as one of the relative power of directors and shareholders and asks whether instituting defenses to hostile tender offers exceeds the directors' authority. Prior to *Unocal*, a number of leading academics argued that courts should hold that directors lack authority to institute defenses against hostile tender offers.[27] A simplistic argument for this position would be that the corporation statute empowers the board to manage the corporation[28]—something shareholders in a public corporation cannot do for themselves—not to take actions that simply interfere with the ability of shareholders to sell their own stock. A broader policy oriented argument involves the utility of hostile tender offers. Although the gap in the board's gatekeeping role regarding mergers and acquisitions is the result of an evolutionary accident rather than the product of an

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pill rights, the poison pill security typically is subject to an important redemption provision. This provision empowers the board of the target to redeem the security at a modest price prior to the triggering event. *See id.* at 199–200 (discussing when the board may want to redeem the poison pill security).

27. *See, e.g.*, Frank H. Easterbrook & Daniel R. Fischel, *The Proper Role of a Target's Management in Responding to a Tender Offer*, 94 HARV. L. REV. 1161, 1164 (1981) ("[C]urrent legal rules allowing the target's management to engage in defensive tactics in response to a tender offer decrease shareholders' welfare.").

28. *See supra* note 11 (citing statutes that grant directors the power to manage the corporation).

intelligent design,[29] evolutionary accidents often produce advantages. In this instance, many academics have argued that hostile tender offers play a useful role in ensuring that corporate boards act in the best interest of the corporation and its shareholders by creating a practical mechanism for replacing incompetent or disloyal boards.[30] Given this role for hostile tender

29. The ability of shareholders to freely transfer their stock has been a feature of corporate law ever since the organizers of the Dutch United East India Company invented this as a solution to the liquidity demands of investors who were tired of waiting for the end of multi-year voyages in order to see any money. *See, e.g.*, Ron Harris, *The Formation of the East India Company as a Cooperation-Enhancing Organization* 31–32 (Tel Aviv Univ., Working Paper, Dec. 2005), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=874406 (describing the invention of transferable shares). At the same time, these earliest business corporations were inheriting from merchant guilds and other institutions the norm of governance by an elected board. *See, e.g.*, Franklin A. Gevurtz, *The Political and Historical Origins of the Corporate Board of Directors*, 33 HOFSTRA L. REV. 89, 115–26 (2004) (explaining how corporations adopted the idea of board governance from these institutions). Over time, the franchise changed from one shareholder, one vote to voting in proportion to one's shares. *Id.* at 121. Combining free transferability, an elected board, and voting in proportion to stock creates the basis for a single person to purchase a majority of voting shares and pick the board without having negotiated with the prior board—in other words, to launch a hostile takeover.

30. *See, e.g.*, Henry G. Manne, *Mergers and the Market for Corporate Control*, 73 J. POL. ECON. 110, 112–13 (1965) (explaining how takeovers ensure managerial efficiency). Under this view, the shareholder franchise, by allowing shareholders to vote out incompetent or dishonest directors, exists as mechanism for insuring directors make wealth maximizing decisions. *See, e.g.*, Eugene F. Fama & Michael C. Jensen, *Separation of Ownership and Control*, 26 J.L. & ECON. 301, 309–11 (1983) (noting that an elected board exists to monitor management on behalf of shareholders, who have the best incentives for efficient decisions but are too numerous to monitor management themselves). *But see* Gevurtz, supra note 29, at 170–72 (arguing that a more historically accurate view of the shareholder franchise suggests that its purpose is to bestow democratic legitimacy upon those who come to control organizations with potentially huge economic power). Freely transferable shares, however, can undermine the accountability function of the franchise by encouraging dissatisfied shareholders to sell out rather than engage in electoral contests. *See, e.g.*, JESSE H. CHOPER ET AL., CASES AND MATERIALS ON CORPORATIONS 560 (6th ed. 2004) (describing the causes of rational apathy). The ability of parties to purchase a majority of shares and elect a new board restores the accountability that is otherwise undermined by the apathy induced by freely transferable shares and thus, under this view, returns proper balance to the corporate universe. *See, e.g.*, Ronald J. Gilson, *A Structural Approach to Corporations: The Case Against Defensive Tactics in Tender Offers*, 33 STAN. L. REV. 819, 841–45 (1981) (arguing that a "market for corporate control" is important in keeping management accountable, and that the tender offer is the most effective mechanism by which that market operates).

offers, the argument concludes, directors should not have the authority to block such offers and thereby stand in the way of their removal.[31] Other writers have argued that the superior evolutionary development is the centralization of power in the corporate board—manifested here by the board's statutory gatekeeping role in mergers and asset sales.[32] The argument for this view is that the board has an inherent advantage over scattered shareholders, who face collective action problems, when dealing with a sale of the entire company.[33] Accordingly, this view concludes that directors should have the authority to use defensive tactics in order to claim a gatekeeping role even over tender offers.[34]

Assuming the board possesses the authority to engage in takeover defenses, the question then becomes what sort of standard courts will apply when reviewing whether the directors breached their duty to advance the interests of the corporation and its shareholders in undertaking such defenses in a particular case. Normally, courts apply the business judgment rule when dealing with challenges by disgruntled shareholders to decisions by corporate boards.[35] While disagreement and doubt exists as to what exact standard the business judgment rule entails,[36] there is general agreement that the standard calls for a greater level of deference to directors than to persons in other contexts.[37] Hence, few courts in applying the business judgment rule would hold directors liable for

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31. *See* Gilson*, supra* note 30, at 845–47 (arguing that defensive tactics against tender offers reduces the offers' effectiveness as a means to control management discretion).

32. *See, e.g.*, BAINBRIDGE, *supra* note 25, at 57 (arguing that the board, rather than shareholders, is in the best position to make decisions regarding a merger).

33. *See, e.g.*, Martin Lipton, *Takeover Bids in the Target's Boardroom*, 35 BUS. LAW. 101, 113–14 (1979) (discussing why shareholders will accept tender offers even when not in their interest).

34. *See id.* at 115 ("There is no reason to remove the decision on a takeover from the reasonable business judgment of the directors.").

35. *See,* e.g., Brehm v. Eisner, 746 A.2d 244, 264 (Del. 2000) (applying the business judgment rule).

36. *See* Franklin A. Gevurtz, *The Business Judgment Rule: Meaningless Verbiage or Misguided Notion?*, 67 S. CAL. L. REV. 287, 289–303 (1994) (discussing different interpretations of the rule).

37. *See, e.g.*, Joy v. North, 692 F.2d 880, 885 (2d Cir. 1982) (comparing the standard of care for corporate directors to that of a negligent automobile driver).

their decision simply because the decision was unreasonable.[38] Delaware courts have equated the standard under the business judgment rule with gross negligence.[39] The principal exception to application of the business judgment rule to a decision by the board occurs when the decision involves a conflict of interest for some or all board members or parties controlling board members.[40] In this event, unless shareholders or directors without a conflict vote to approve the transaction after full disclosure, courts apply a fairness test (called in Delaware the "intrinsic fairness" test).[41] Under this test, proponents of the transaction must prove to a skeptical court that the transaction was fair[42]—essentially that the corporation received as good a deal as it would have if dealing with a stranger.[43] This bifurcated approach reflects a policy that the degree of judicial scrutiny over board decisions should depend upon the extent that one can trust the directors to act for the right motives (even if not always with the best results).[44]

The standard that courts should apply to takeover defenses is not obvious. While some takeover defenses (such as a golden parachute[45] or supporting a management buyout[46] when either

38. *See id.* ("[L]iability is rarely imposed upon corporate directors or officers simply for bad judgment . . . .").

39. *See, e.g.*, Smith v. Van Gorkom, 488 A.2d 858, 873 (Del. 1985), *overruled on other grounds by* Gantler v. Stephens, 965 A.2d 695 (Del. 2009) (noting that the business judgment rule applies a standard of gross negligence).

40. *See, e.g.*, Sinclair Oil Corp. v. Levien, 280 A.2d 717, 721 (Del. 1971) (applying a different standard in the case of alleged self-dealing).

41. *See, e.g.*, DEL. CODE ANN. tit. 8, § 144(a) (2011) (providing the fairness test as an alternative to non-interested director or shareholder approval).

42. *See, e.g.*, *Sinclair*, 280 A.2d at 719–20 ("The standard of intrinsic fairness involves both a high degree of fairness and a shift in the burden of proof.").

43. *See, e.g.*, Fliegler v. Lawrence, 361 A.2d 218, 225 (Del. 1976) (finding that intrinsic fairness test was satisfied because the transaction would have been carried out by another corporation in the subject corporation's position).

44. *See, e.g.*, FRANKLIN A. GEVURTZ, CORPORATION LAW 341–42 (2d ed. 2010) (explaining that the business judgment rule should only apply in instances where directors can be trusted to act in the company's best interest, which is not the case in conflict-of-interest transactions).

45. In a golden parachute, senior executives, some of whom may be on the board, receive compensation from the corporation if terminated following a takeover. *See, e.g.*, BAINBRIDGE, *supra* note 25, at 25 (defining "golden parachute").

46. In a management buyout, an entity owned at least in part by senior

includes members of the board) constitute traditional conflict-of-interest transactions between the corporation and its directors, most takeover defensives, such as a poison pill, do not.[47] On the other hand, a takeover presumably will result in the replacement of the current directors, which is something that most directors have both a financial and a psychological interest to avoid. Hence, in opposing a hostile takeover, directors have what one might call a positional conflict of interest (the interest in retaining their positions even at the shareholders' expense).[48] Still, all sorts of decisions, at least indirectly, impact the directors' retention of control over the corporation.[49] Hence, courts may understandably be reluctant to apply the rigorous scrutiny of fairness review to board decisions simply because the decisions impact the directors' continued control.

#### *b.* Unocal

In *Unocal Corp. v. Mesa Petroleum Co.*,[50] the Delaware Supreme Court answered these two fundamental questions about defenses to hostile tender offers, thereby establishing the law of takeover defenses for most of the largest companies in the United States.[51] *Unocal* arose out of a hostile tender offer made by Mesa Petroleum, a company controlled by corporate raider T. Boone Pickens, for Unocal.[52] The case presented a particularly

executives, some of whom may be on the board, purchases the corporation. *See id.* (defining "management buyout").

47. *See, e.g.*, Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 957–58 (Del. 1985) (rejecting the argument that the directors, in responding to a hostile tender offer by deciding to have their corporation make a competing offer to repurchase its own shares, had a conflict of interest because the directors also owned shares they could sell back to the corporation).

48. *See* Melvin A. Eisenberg, *The Structure of Corporation Law*, 89 COLUM. L. REV. 1461, 1472 (1989) (coining the term).

49. For example, producing good corporate results will decrease the interest of shareholders in replacing the current directors.

50. 493 A.2d 946 (Del. 1985).

51. *See* Lucian A. Bebchuk et al., *Does the Evidence Favor State Competition in Corporate Law?*, 90 CALIF. L. REV. 1775, 1810 (2002) (noting that over half of all public companies that incorporate in the United States incorporate in Delaware).

52. *Unocal*, 493 A.2d at 949 n.1.

sympathetic set of facts for board intervention. Mesa had undertaken a textbook example of a coercive tender offer. Specifically, Mesa offered to buy enough shares in Unocal to give Mesa majority ownership of Unocal, while at the same time informing Unocal's shareholders that once Mesa acquired a majority of Unocal shares, Mesa would use its control to push through a merger in which the remaining Unocal shareholders would receive junk (below investment grade) bonds in exchange for their stock.[53] Under these circumstances, Unocal shareholders who did not find Mesa's price attractive might nevertheless accept its offer for fear of being left in the minority group who only received junk bonds, an example of the "prisoners' dilemma" at work.[54] In response, Unocal's board adopted a resolution stating that Unocal would purchase the minority shares not sold to Mesa at a price considerably higher than Mesa offered.[55] Funding this repurchase would leave Unocal heavily in debt and a much less desirable acquisition for Mesa, who sued to challenge the action.[56]

Looking first at the question of authority, the Delaware Supreme Court in *Unocal* confirmed that directors have the power to engage in defenses to hostile tender offers.[57] By doing so, the court framed Delaware takeover jurisprudence as not about whether directors have usurped power belonging to the shareholders, but rather as about whether directors, in the exercise of their unquestioned power, have breached their fiduciary duty to advance the interests of the corporation and its shareholders. A decade later, the Delaware Supreme Court developed second thoughts about this duty, not power, framework—at least in extreme cases in which directors have deployed defenses that preclude any possibility of a hostile acquisition.[58] The result, for better or for worse, is to create a sort

53. *See id.* at 949–50.

54. *See, e.g.*, Gilson, *supra* note 30, at 859–61 (explaining the prisoners' dilemma in tender offers).

55. *Unocal*, 493 A.2d at 949–51.

56. *Id.* at 950.

57. *See id.* at 953–54 (explaining that the board can engage in tender offer defenses, "provided the directors have not acted out of a sole or primary purpose to entrench themselves in office.").

58. *See* Unitrin, Inc. v. Am. Gen. Corp., 651 A.2d 1361, 1386–88 (Del. 1995)

of schizophrenic quality in Delaware takeover jurisprudence; but this reframing of the issue in takeovers to reintroduce concerns over power, not just duty, post-dates *Revlon* and so has limited impact upon our story.

Having decided that the issue is fiduciary duty, not power, the *Unocal* court then needed to address the standard it would apply in reviewing whether the directors breached their duty through the self-tender. To deal with the positional conflict of interest confronting directors faced with a hostile tender offer, the court in *Unocal* decided to establish an intermediate level of scrutiny between the intrinsic fairness test and the business judgment rule. Specifically, the court set out a two-part test to review directors' decisions to employ takeover defenses.[59] Under the first part of the *Unocal* test, the directors must prove that they possessed reasonable grounds for believing a threat to corporate policy and effectiveness existed.[60] The second part of the test requires that the defensive measure used be reasonable in relation to the threat posed.[61] This sort of reasonableness test

(explaining that defenses which are coercive or preclusive in cramming down upon the shareholders a board sponsored alternative or precluding any hostile tender offer violate *Unocal*'s requirement that defenses be proportionate).

59. *See* Unocal v. Mesa Petroleum Co., 493 A.2d 946, 955–56 (Del. 1985) (establishing the test).

60. *See id.* at 955 ("[D]irectors must show that they had reasonable grounds for believing that a danger to corporate policy and effectiveness existed because of another person's stock ownership.").

61. *See id.* ("If a defensive measure is to come within the ambit of the business judgment rule, it must be reasonable in relation to the threat posed."). The court was on solid ground in finding Mesa's coercive tender offer provided Unocal's directors with reasonable grounds for taking action. The court was sloppier in finding Unocal's self-tender was proportionate to the threat. The problem was that the self-tender was at a significantly higher price than Mesa's tender offer. As a result, the impact went well beyond removing the prisoners' dilemma (which matching Mesa's price would have achieved) and created a reverse incentive to not tender to Mesa and hold out for the higher price from Unocal. Mesa could have responded by matching or exceeding Unocal's price—which would have restored the incentive for Unocal's shareholders to tender to Mesa—but the court never asked whether Unocal's offer was a realistic price that Unocal's directors might have hoped to obtain from Mesa or so out of the ballpark that the directors were simply trying to chase Mesa away. In fact, the directors seem to have set the self-tender price well above the price that Unocal's investment bankers identified as what the shareholders should get from a sale of 100% of the company's stock. *See id.* at 950 ("[Banker] opined that the minimum cash value that could be expected from a sale or orderly liquidation for 100% of Unocal's stock was in excess of $60 per share [compared

as to both ends sought and means used is more demanding than the business judgment rule (absence of gross negligence) but is not as demanding as the intrinsic fairness test (convincing the court that the corporation got a good deal).

### *B. Shotgun Corporate Marriages*

#### *1. Circumventing Shareholder Consent to Mergers and Sales of Corporations*

The three primary modes of corporate acquisition all seemingly require consent of the target company's shareholders. Corporation statutes, including Delaware's, require a vote of approval by a corporation's shareholders for a sale of substantially all of the company's assets[62] and, with limited exceptions, for a merger of the corporation.[63] While corporation statutes, including Delaware's, do not require a formal vote by shareholders to accept a tender offer, shareholders "vote with their feet" insofar as the failure of enough shareholders to sell renders the tender offer unsuccessful.[64] Yet, just as the tender offer allows buyers and shareholders to circumvent the board's gatekeeping role with respect to corporate mergers and sales, techniques exist that allow the board to circumvent the shareholders' veto over mergers and sales.

##### *a. Avoiding Consent Requirements*

Corporate laws contain various gaps in their requirement for shareholder consent to corporate combinations and sales. Directors can exploit these gaps to avoid putting a corporate combination or sale to a shareholder vote.

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to $72 per share offered by Unocal's board].").

62. *See, e.g.*, DEL. CODE ANN. tit. 8, § 271(a) (2011) (requiring that any such sale be authorized by a resolution adopted by shareholder vote); MODEL BUS. CORP. ACT § 12.02(a) (1984) (same).

63. *See, e.g.*, DEL. CODE ANN. tit. 8, § 251(c) (requiring that a proposed merger agreement be submitted to a shareholder vote); MODEL BUS. CORP. ACT § 11.04(b) (same).

64. GEVURTZ, *supra* note 16, at 1015.

To begin with, corporation statutes, including Delaware's, typically do not require a vote by the shareholders of the acquiring corporation either to purchase substantially all of the assets of another corporation or to make a tender offer for another corporation's outstanding shares.[65] At first glance, this seems irrelevant to the requirement of shareholder approval in order to sell the shareholders' corporation. The problem, however, is that the acquiring corporation in a sale of assets or tender offer does not, in fact, need to be the company that is the buyer as one normally thinks of who is buying whom. Specifically, the corporation whose owners end up acquiring a majority of the stock in the company emerging from the transaction—in other words, the party one would normally think of as the purchaser—could actually be the company selling all of its of assets or whose owners sell their stock. This happens if the company purchasing all of another company's assets or purchasing another company's outstanding stock pays by issuing shares sufficient to give the shareholders on the so-called seller's side a majority ownership of the so-called purchasing company.[66] For evident reason this is known as an upside-down transaction.

Triangular transactions also allow planners to avoid requirements for a shareholder vote. In a triangular merger, a subsidiary engages in the merger. In this instance, the shareholder that must approve the merger is the parent company of the merging subsidiary.[67] This means that the decision lies with the parent corporation's board, which will decide how the parent votes the shares it owns in the subsidiary, rather than the shareholders of the parent. This can be true even though the parent might issue sufficient stock in itself to give the other side's

65. *See id.* at 1013, 1014 (noting the lack of shareholder voting rights in these instances).

66. For example, in *Farris v. Glen-Alden Corp.*, 143 A.2d 25 (Pa. 1958), the corporation purchasing all the assets of the so-called selling corporation paid by issuing over three and a half million shares at a time when it had less two and a half million shares outstanding, with the result that, after the corporation which sold its assets dissolved and distributed the shares it received in the sale to its stockholders, the former stockholders of the so-called selling corporation ended up with most of the shares in the so-called buyer. *See id.* at 27 (describing the assets-for-shares exchange).

67. *See, e.g.*, GEVURTZ, *supra* note 16, at 1021 (explaining the mechanics of a triangular merger).

shareholder(s) control over the emerging combination, again depriving the shareholders on what one would normally view to be the seller's side of any vote.[68]

Triangular transactions, asset sales, and tender offers also can deprive at least one side's shareholders of a vote on a so-called merger of equals. The basic scheme of corporate law not only views the target corporation's shareholders as entitled to vote on an acquisition of their company but also views both sides' shareholders as entitled to vote on a marriage between two operating companies in which the combination significantly impacts the shareholders in both companies.[69] Parties, however, can structure such a merger of equals as a triangular merger, sale of assets, or purchase of stock, thereby depriving one side's shareholders of a vote on the transaction.[70]

One caveat to this discussion is that issuing additional shares in upside-down and triangular transactions might demand a shareholder vote. If the certificate of incorporation did not authorize the company to issue the number of shares called for by the deal, shareholders would need to vote to amend the certificate.[71] Stock exchange rules also require listed companies to put large issuances of stock to a shareholder vote.[72] On the

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68. As discussed *infra* in notes 144–52 and the accompanying text, the original structure for the famous Time–Warner merger involved a merger of Warner with a Time subsidiary in which Time would have issued enough shares to the former Warner shareholders to give the former Warner shareholders a majority of Time's outstanding shares after the merger. Nevertheless, the merger provision in Delaware's corporation statute did not require Time's shareholders to approve this proposed merger.

69. *See, e.g.*, DEL. CODE ANN. tit. 8, § 251(c), (f) (2011) (requiring shareholder approval for both corporations in a merger but noting that shareholders do not need to approve a merger that does not significantly change their rights by amending the certificate, exchanging their shares, or issuing a significant amount of additional shares).

70. *See, e.g.*, *Farris*, 143 A.2d at 27 (noting that the sale of assets involved a major change in the rights of shareholders of the purchasing corporation).

71. *See, e.g.*, DEL. CODE ANN. tit. 8, § 242(b)(2) ("The holders of the outstanding shares of a class shall be entitled to vote as a class upon a proposed amendment . . . if the amendment would increase or decrease the aggregate number of shares of such class . . . ."); MODEL BUS. CORP. ACT § 10.03(b) (1984) (requiring that any amendment to the articles of incorporation be approved by the shareholders).

72. *See* N.Y. Stock Exch., *Listed Company Manual* § 312.03(c) (2013), http://nysemanual.nyse.com/LCMTools/PlatformViewer.asp?selectednode=chp%

other hand, if the certificate of incorporation provides for a large number of authorized but not yet issued shares and if a corporation is content to delist its stock, then these requirements for a shareholder vote do not come into play.

*b. Coercing Consent*

In lieu of avoiding a shareholder vote, directors may employ tactics to pressure the shareholders into voting in favor of a board supported sale or combination. To the extent that directors can chase away other bidders for the company through takeover defenses, the directors can push the shareholders to vote in favor of the board supported transaction as the only choice presented. Moreover, to the extent that directors agree to terms that will cause detrimental effects upon the corporation if its shareholders vote the sale or combination down, the directors can discourage shareholders from voting in favor of continuing the status quo.

Various deal protection devices, such as termination fees and lock-up agreements, can pressure shareholders to vote for a board favored combination both by removing other choices and by penalizing the shareholders for voting a deal down.[73] A termination fee paid to the favored merger partner if the shareholders vote down the board proposed merger provides the simplest illustration. A termination fee large enough that its payment would impact negatively the value of the corporation makes the corporation no longer as attractive a target to other bidders. It also penalizes the shareholders by making their corporation less valuable if they vote down the deal. A lock-up under which the board agrees to sell desirable assets of the corporation (the crown jewels) cheaply to the favored bidder in the event the shareholders vote down the board proposed combination has the same two impacts but typically with far greater magnitude. Although they do not decrease the value of

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5F1%5F4%5F11%5F1&manual=%2Flcm%2Fsections%2Flcm%2Dsections%2F (last visited Sept. 21, 2013) (explaining where shareholder approval is necessary for stock distribution) (on file with the Washington and Lee Law Review).

73. *See, e.g.*, Stephen M. Bainbridge, *Exclusive Merger Agreements and Lock-ups in Negotiated Corporate Acquisitions*, 75 MINN. L. REV. 239, 287–88 (1990) (analyzing the impact of asset and stock lock-up agreements).

the target corporation, lock-up agreements under which the board will sell stock cheaply to the favored bidder dilute the value of the remaining shares if the favored combination does not occur. Once again, the impact is to discourage competing bids or a negative vote.[74] The larger the termination fee or lock-up, the greater the impact. Eventually the impact reaches a point at which no other bidder may come forward and rational shareholders would vote for a deal they would otherwise reject simply in order to avoid the penalty.

### *2. Delaware's Doctrinal Response*

The policy issues raised by shotgun corporate marriages are complex—perhaps more so than the issues raised by takeover defenses—and, as a result, the Delaware Supreme Court's response is something of a muddle. While a full exploration of this topic must await another article, an overview of these issues and the Delaware Supreme Court's response is necessary to understand *Revlon* because *Revlon* sits in the middle of this muddle.

#### *a. Framing the Issues*

As with defenses to hostile tender offers, attempts to avoid or coerce shareholder consent force courts to decide whether the issue is authority (have directors exceeded their authority in acting without a vote by shareholders who were not subject to coercion?) or duty (have directors' breached their duty to advance the interests of the shareholders and the corporation?); and, if the issue is duty, by what standard does the court review whether directors breached their duty? Complicating the answers here, however, is the lack of any consensus on what purpose shareholder consent serves, as well as the fact that deal

74. Selling stock cheaply to the favored buyer before the shareholders act on the proposed transaction (as opposed to simply giving the favored buyer the option to purchase stock cheaply if the shareholders reject the deal) also gives the favored buyer a leg-up on gaining favorable shareholder action.

protection devices may have other impacts besides coercing shareholder consent.

The requirement for shareholder consent to mergers and sales of assets is again a product of evolution, in this instance from an era in which corporate laws applied partnership and contract based ideas that called for the consent of all partners or parties to the contract to any alternations of the basic deal.[75] Pressure to remove barriers to corporate mergers and acquisitions led to eliminating the requirement that all shareholders consent and replacing it with supermajority and eventually majority vote requirements[76] but without an evident rethinking of why the law required any shareholder vote at all. Scholars have asserted various rationales for the continuing viability of requiring a shareholder vote to approve mergers and sales of substantially all assets. Melvin Eisenberg argues that it reflects a difference in expertise between directors and shareholders.[77] Directors have an advantage in expertise when it comes to business decisions (e.g., build a plant, discontinue a product line). Shareholders, however, have as much expertise as directors when it comes to broad investment decisions—they buy and sell stock in their company. Frank Easterbrook and Daniel Fischel argue that it reflects the importance of the decision involved. Their notion is that shareholders will not pay much attention to ordinary corporate decisions but will give thoughtful consideration to critical decisions such as whether to merge.[78] By

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75. *See, e.g.*, Lynne L. Dallas, *The Control and Conflict of Interest Voting Systems*, 71 N.C. L. REV. 1, 6–8 (1992) (describing the contractual theory of shareholder consent).

76. *See id.* at 10 (noting that the unanimous consent requirement created an obstacle to corporate expansion and acquisitions). To substitute for unanimous consent, corporate laws established appraisal rights allowing dissenting shareholders to cash out. *See, e.g.*, Bayless Manning, *The Shareholder's Appraisal Remedy: An Essay for Frank Coker*, 72 YALE L.J. 223, 228–29 (1962) (explaining how appraisal rights provided an alternative to the unanimous consent rule).

77. MELVIN EISENBERG, THE STRUCTURE OF THE CORPORATION 14–16 (1976) (creating a distinction between decisions that directors are more qualified to make and those that are more suitable for shareholders).

78. *See* Frank H. Easterbrook & Daniel R. Fischel, *Voting in Corporate Law*, 26 J.L. & ECON. 395, 416 (1983) ("[T]he possibility of large gain or loss in these transactions because of their size is sufficient to overcome the collective action problems . . . that would make voting on ordinary business decisions

contrast, Ronald Gilson and Bernard Black suggest that it is a response to the poor incentives directors may have in a final period situation.[79] Specifically, because directors will presumably lose their positions following a sale of substantially all assets and potentially lose their positions following a merger, directors lose their incentive to avoid actions prejudicial to the shareholders in making these decisions.[80] The requirement of shareholder approval allows the shareholders to protect themselves from damaging board decisions that may result.

The absence of a consensus on the purpose that shareholder consent serves—and therefore whether it should exist—makes it difficult to resolve the power question of when courts should find that directors impermissibly avoided shareholder consent by virtue of the manner in which the directors structured the transaction. Complicating this issue further, courts must ask whether they should leave this issue to the legislature, which created the discontinuity in shareholder approval requirements to begin with.

Deal protection devices, such as lock-ups, raise yet another policy concern. Although they constrain shareholder voice by reducing alternatives and potentially penalizing the corporation if the shareholders vote down the transaction, proponents argue that lock-ups also may be the necessary price to attract either an initial or a topping bid.[81] In other words, prospective buyers may not wish to invest the time and energy bidding on a company without some consolation prize should their deal not go through. Actually, however, it is misleading to suggest that the board must

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meaningless.").

79. *See* RONALD J. GILSON & BERNARD S. BLACK, THE LAW AND FINANCE OF CORPORATE ACQUISITIONS 720–21 (2d ed. 1995) (explaining that directors have less incentive to avoid harmful actions in "final period" transactions because they cannot be penalized in subsequent transactions).

80. *See id.* ("In the context of an acquisition nothing stops target management from selling out the shareholders in return for side payments from the acquiring company because target management, by definition, will no longer be subject to the constraints of the product, capital and control markets after the acquisition.").

81. *See, e.g.*, Barbara A. Koza, Note, *Corporations—Mergers—"Lock-Up" Enjoined Under Section 14(e) of Securities Exchange Act—*Mobil Corp. v. Marathon Oil Co., 669 F.2d 366 (6th Cir. 1981), 12 SETON HALL L. REV. 881, 892 (1982) (stating that lock-up agreements further the interests of shareholders by ensuring more beneficial "white knight" mergers).

provide substantial consideration just to get a bid. As illustrated by the facts in *Revlon* itself, proposed lock-ups come as part of a package with a bid.[82] Indeed, a board would be crazy (and lose the protection of the business judgment rule[83]) if it were to agree to a lock-up imposing substantial potential cost on the corporation without knowing what the bid is. Hence, the costs incurred by the bidder in preparing the bid are sunk costs and gone if the board rejects the bid (with the lock-up).[84]

In fact, lock-ups, for the most part, only exist because corporate law limits the board's authority to merge or sell the company without shareholder approval. This is not to say that lock-ups are always, or even normally, efforts to coerce shareholder acceptance of the transaction approved by the board. Rather, it is to say that there generally would be no need for a lock-up if the board had the authority to enter a binding contract to merge or sell the corporation without shareholder approval. After all, if the board had such authority, then the bidder could have a binding contract to merge or buy the company, and not just some assets or stock, in order to ensure that the bidder gets something for its efforts.[85] The fact that lock-ups exist because of

82. *See infra* notes 122–28 and accompanying text (discussing the facts of *Revlon*).

83. *See, e.g.*, Smith v. Van Gorkom, 488 A.2d 858, 887–88 (Del. 1985), *overruled on other grounds by* Gantler v. Stephens, 965 A.2d 695 (Del. 2009) (holding directors breached their duty of care in voting without sufficient information for a merger agreement which sold the company).

84. *See, e.g.*, Stephen Fraidin & Jon D. Hanson, *Toward Unlocking Lockups*, 103 YALE. L.J. 1739, 1814 (1994) ("[B]y the time a bidder makes its bid and the target board considers whether to grant a lockup in exchange, most of the costs are already sunk.").

85. In some cases, antitrust or regulatory barriers might prevent completion of a merger or sale, albeit this seems to be a declining risk in the current antitrust era. *See, e.g.*, HERBERT HOVENKAMP, FEDERAL ANTITRUST POLICY: THE LAW OF COMPETITION AND ITS PRACTICE 544, 608 (4th ed. 2011) (noting that today's antitrust enforcers and courts view mergers as less of a competitive threat than they did in the past). Still, it is not clear why the risk of uncompensated costs in events that are beyond the target corporation's control should fall entirely on the target rather than on both sides. Beyond regulatory barriers, there remains the danger that the board might have the corporation breach the contract to merge or sell the company if a better bid comes along. For this reason, a contract might provide liquidated damages, and a cash termination fee might serve the same function. *See, e.g.*, Bainbridge, *supra* note 73, at 245–46 (explaining the use of these provisions). On the other hand, a lock-up option to sell assets or stock is still a contract, and the board might always

the limitation on the board's authority to sell the company without shareholder approval, in turn, raises the question of whether the lock-up, itself, should be viewed as beyond the board's authority. Put in terms of a simple principal/agent model, would a principal, who demands that an agent check back with the principal before entering a contract, wish to give the agent authority to pay the third party something if it turns out that the principal decides that the agent brought back a poor offer? Indeed, is a third party who would demand such a fee not signaling to the principal a lack of confidence in the offer presented to the agent?

One difference, however, with shareholder approval from this simple principal/agent model is the time delay entailed in obtaining a shareholder vote in a public corporation. This might suggest a rationale for lock-ups as the consideration for shareholders obtaining a several month long option contract.[86] If the rationale for lock-ups is to provide an option contract for shareholders, then presumably the lock-up should not be so large as to destroy the value of the option. In other words, if the lock-up is large enough to chase away any higher bidders and pressure shareholders into voting for the transaction simply to avoid triggering the lock-up, then the lock-up gains nothing of value by buying time for the shareholders. Some scholars have attempted to construct tests that would identify lock-ups having such foreclosing impact.[87] Whether these tests, in fact, differentiate good and bad lock-ups and whether adequate information exists in the real world to execute these tests are open questions.[88]

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breach the lock-up contract if a better bid comes along. This would still leave litigation necessary to figure out expectation damages. Hence, asset or stock lock-ups are not equivalent to liquidated damages.

86. *See, e.g.*, Smith v. Pritzker, No. 6342, 1982 WL 8774, at *3 (Del. Ch. July 6, 1982) (describing the lock-up as compensation to the bidder for essentially providing a put option).

87. *See* Bainbridge, *supra* note 73, at 323–32 (proposing bright-line cutoff at 10% of the transaction value); Ian Ayres, *Analyzing Stock Lock-Ups: Do Target Treasury Sales Foreclose or Facilitate Takeover Auctions?*, 90 COLUM. L. REV. 682, 704–09 (1990) (suggesting an approach that compares whether the bidder would profit more from a takeover or from tendering treasury shares to another bidder).

88. *See* Fraidin & Hanson, *supra* note 84, at 1768–69, 1774–84 (calling Ayres and Bainbridge's proposals into question).

Turning from power to duty, courts must once again decide what standard they will employ in reviewing a particular board decision to see if the board breached its duty to advance the interest of the corporation and the shareholders. This turns out to be even more complicated in shotgun corporate marriages than when dealing with tender offer defenses. For one thing, it is less clear how circumventing shareholder consent fits within the traditional rubric under which the degree of judicial scrutiny depends upon whether one can trust directors to act for proper motives. In the context of takeover defenses, the concern raised by the directors' positional conflict of interest fits nicely into this rubric—even if the positional conflict may call for greater nuance than the traditional bifurcated approach of extreme deference or extreme scrutiny. By contrast, the existence of self-interest is less apparent if all that is going on is that the directors are determined to have their way and not allow the shareholders to block a merger or sale which the directors view to be in the best interests of the company or the shareholders.

As the events in *Revlon* itself illustrate, however, this conclusion becomes confused because of the overlap between takeover defenses and shotgun corporate marriages. The takeover defenses discussed earlier deter and stall hostile tender offers but might not be able to prevent the acquisition of a widely held corporation over the board's objection no matter how determined and patient the acquirer.[89] Hence, the only way to prevent the acquisition of a highly attractive target corporation by an undesired (from the standpoint of the target's board) suitor might be to find another buyer (a so-called white knight).[90] Of course, it is not enough simply to locate a white knight; the target's board must both entice the white knight to enter the fray and ensure the white knight prevails in the contest. Agreeing to lock-ups or other deal protection devices for the white knight potentially

89. For example, to deal with a poison pill, an acquirer may launch a proxy contest coupled with a hostile tender offer conditioned on the board's redeeming the pill. The idea is to persuade the existing shareholders to vote in directors friendly to the acquirer. These new directors will redeem the pill before the acquirer purchases the number of shares otherwise triggering the poison. *See, e.g.*, CHOPER, ET AL., *supra* note 30, at 990 (describing this strategy).

90. *See id.* at 993 (explaining that if the target's management fails in its efforts to defend against a hostile bid, its second best strategy may be an acquisition by a less threatening bidder—a so-called white knight).

accomplishes both goals. Yet, corporate combinations occur all the time without the prompting of a hostile tender offer.[91] In this situation, a significant threat to obtaining shareholder approval is a better offer from another bidder.[92] Hence, tactics, including lock-ups and other deal protection devices, that deter competing offers are a major means for assuring shareholder approval of board favored combinations.[93] The end result is to create a twilight zone in which a board may take the same actions either to push through a corporate combination in order to defeat an undesired tender offer or to deter competing tender offers in order to push through a desired corporate combination. Put in more colorful language, shotgun corporate marriages can be a defense to a hostile tender offer, while defenses to a hostile tender offer can be the shotgun used to force the shareholders to accept a board desired corporate marriage.

When the board seeks to avoid or coerce shareholder consent in favor of a white knight brought in as a response to a hostile tender offer, the positional conflict of interest created by the pending hostile tender offer seems evident enough—albeit, as discussed later,[94] the positional conflict actually may be less in the white knight situation than with takeover defenses that would leave the target independent. The same positional conflict may exist even if the board searches for a white knight when the board views the corporation as likely in the near future to attract a hostile bid, albeit prior to facing the threat from an identifiable hostile bidder. On the other hand, suppose a board seeks a combination or sale in the situation in which the board did not feel there was any particular danger of a hostile tender offer if the board did not act. In such a situation, where is the positional conflict? True, the board may employ deal protection devices to prevent competing bids, which action sounds like it fits in the tender offer defense world. Yet, in this instance, the motive for deterring such offers is not to maintain the current directors' positions but rather to get the board's way on the transaction.

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91. *See id.* at 992 (noting that most corporate acquisitions are friendly).

92. *See, e.g.*, Bainbridge, *supra* note 73, at 240–42 (naming potential obstacles to consummating friendly mergers).

93. *See id.* at 250 (describing how lock-ups deter competing bids).

94. *See infra* notes 343–46 and accompanying text (comparing the conflicts of interest in a white knight situation and a typical takeover defense).

Does the mere desire to have one's way regarding a specific business decision constitute a conflict of interest? If so, the implications reach far beyond shotgun corporate marriages.[95]

Beyond the question of self-interest, perhaps there is some other justification for heightened judicial scrutiny when directors avoid or coerce shareholder consent to a corporate merger or sale. The argument would be that the traditional rubric, under which the degree of judicial scrutiny depends upon the presence or absence of director self-interest, is not exclusive. Instead, heightened scrutiny also may be necessary to provide a functional substitute for shareholder consent that directors avoided or coerced.

In fact, one might find support for this functional substitute argument in the structure of statutory provisions, such as Section 144 of Delaware's General Corporation Law,[96] which deals with director conflict-of-interest transactions. Such provisions allow either a vote by shareholders or a judicial finding of fairness to cure the conflict.[97] Hence, heightened judicial scrutiny and shareholder consent act as functional substitutes in addressing director self-dealing. On the other hand, with director conflict-of-interest transactions, the law looks for a party one can trust to review the transaction because we cannot trust the directors. Both the court and disinterested shareholders constitute someone we can trust.[98] Unless one accepts Professor Gilson's final period incentives argument,[99] however, the issue is not one of trust when dealing with directors avoiding or coercing shareholder approval of mergers and sales. If the issue is not trust, then heightened judicial scrutiny may not serve as a functional substitute for shareholder consent. For example, if the purpose of shareholder

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95. *Cf. In re* Walt Disney Co. Derivative Litig., 907 A.2d 693, 763 (Del. Ch. 2005) (describing Eisner's manipulation of the process in order to get his way on hiring Ovitz).

96. DEL. CODE ANN. tit. 8, § 144 (2011).

97. *See id.* § 144(a)(2)–(3) (allowing the conflicted transaction to occur if the conflict is disclosed to shareholders who then approve the deal or if the transaction is "fair" to the company).

98. *See, e.g.*, GEVURTZ, *supra* note 44, at 344 (noting that shareholders or the court can be trusted more to provide a fair review of conflict-of-interest transactions than interested directors).

99. *See supra* note 79 and accompanying text (elaborating on the final period argument).

consent is to allow the owners control over investment or major decisions for what is, after all, their company, heightened judicial scrutiny does not provide a functional substitute any more than it would if directors simply cancelled the annual election of directors and ask the court to review whether the current board has done a good job.

*b. The Current Approach*

The Delaware Supreme Court has not shown the same concern found in some other states about actions taken by boards to avoid putting corporate combinations or sales to a shareholder vote. Courts in some jurisdictions have attempted to prevent use of upside-down and triangular transactions to avoid triggering shareholder rights (such as voting or appraisal rights) that normally attach to a merger.[100] These courts have done so by labeling such a transaction a de facto merger, which, in turn, requires the same approval process and calls for the same shareholder rights as a normal merger.[101] By contrast, the Delaware Supreme Court in *Hariton v. Arco Electronics, Inc.*[102] rejected any recognition of the de facto merger doctrine when it comes to shareholder rights in Delaware.[103] Instead, the court held that statutory provisions involving mergers and asset sales were "of equal dignity," and if directors employ one to achieve the same objective without extending the same rights to shareholders as provided by the other it is not up to the court to interfere.[104]

Delaware court decisions regarding lock-ups and other deal protection devices are more complicated. Interestingly, the Delaware Supreme Court has only obliquely addressed the issue of whether the statutory requirement that shareholders approve

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100. *See, e.g.*, Pratt v. Ballman-Cummings Furniture Co., 495 S.W.2d 509, 510–11 (Ark. 1973) (recognizing that a corporate combination, though not a merger in fact, may still have the same legal effect as a merger and therefore should be treated as such).

101. *See id.* at 510 (noting that a de facto merger confers the same rights on shareholders as a true merger).

102. 188 A.2d 123 (Del. 1963).

103. *See id.* at 125 (applying the sale-of-assets statute, even though the sale achieved the same result as a merger).

104. *Id.*

a merger or sale of assets also limits the board's authority to agree to lock-ups or other deal protection devices without shareholder approval. Courts outside of Delaware have disagreed on this question.[105] While never expressly entering this fray, the fact that the Delaware Supreme Court has repeatedly reviewed whether directors breached their fiduciary duty in agreeing to individual lock-ups and deal protection devices[106] suggests that this overall authority issue does not bother the court.

Turning to fiduciary duty and lock-ups brings us to *Revlon*. Prompted in part by *Revlon* but extending to situations not governed by *Revlon*,[107] the Delaware Supreme Court has conflated the white knight situation with the situation in which directors avoid or coerce shareholder consent in order to push through a merger or sale favored by the board prior to any threat of a hostile tender offer.[108] Hence, lock-ups and deal protection devices seem to trigger *Unocal* even when they do not trigger *Revlon*.[109] Unfortunately, the Delaware Supreme Court has made a muddle of the rationale for and the implications of triggering *Unocal* in these situations.

In *Omnicare, Inc. v. NCS Healthcare, Inc.*,[110] the Delaware Supreme Court sought to explain the basis for invoking *Unocal* when the directors were not seeking to thwart a hostile tender

105. *Compare* ConAgra, Inc. v. Cargill, Inc., 382 N.W.2d 576, 588 (Neb. 1986) (stating that the corporation was not bound by an agreement to submit a merger to a shareholder vote because there was no binding merger agreement before shareholders approved), *with* Jewel Cos., Inc. v. Pay Less Drug Stores Nw., Inc., 741 F.2d 1555, 1560 (9th Cir. 1984) (stating that the board may bind the corporation not to enter into competing contracts until the shareholders have an opportunity to vote on the proposed merger).

106. *See, e.g.*, Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 183 (Del. 1986) ("[A] lock-up is not *per se* illegal under Delaware law.").

107. *See, e.g.*, Paramount Commc'ns, Inc. v. Time Inc., 571 A.2d 1140, 1150 (Del. 1989) (treating the denial of a shareholder vote on a deal agreed to by the board before any threat of a hostile tender offer as if it was a takeover defense, in a case in which *Revlon* did not apply).

108. *See, e.g.*, Paramount Commc'ns Inc. v. QVC Network Inc., 637 A.2d 34, 46 (Del. 1994) (applying enhanced scrutiny to lock-ups in a deal agreed to before the threat of a hostile tender offer).

109. *See e.g.*, Omnicare, Inc. v. NCS Healthcare, Inc., 818 A.2d 914, 930–31 (Del. 2003) (applying *Unocal* to deal protection terms in a merger agreement not entered in response to a hostile tender offer and not covered by *Revlon*).

110. 818 A.2d 914 (Del. 2003).

offer. The court spoke of the "conflicts of interest [that] arise when a board acts to prevent the shareholders from effectively exercising their right to vote contrary to the will of the board."[111] In other words, the court appears to be treating the mere desire of the board to have its way on a corporate decision requiring mutual consent of the board and the shareholders as a conflict of interest requiring heightened scrutiny without regard to whether the directors have any other self-interest at stake. This concern with preserving an effective shareholder franchise in approving mergers finds further reflection in the substance of *Unocal* as later refined by the Delaware Supreme Court. Specifically, as later interpreted, *Unocal* bans "coercive" or "preclusive" defenses.[112] This would seem to provide a basis for invalidating lock-ups that coerce shareholders into voting for a board-favored deal. Yet, it remains unclear how much the Delaware Supreme Court really will protect shareholder voice in corporate mergers. Specifically, although the Delaware Supreme Court has stated that devices which lead shareholders to vote for a transaction on the basis of something other than its merits are coercive,[113] the court defanged this in the deal protection context by holding that termination fees and lock-ups are part of the transaction and so the influence of such terms on the shareholder vote does not lead the shareholders to vote based upon something other than the merits of the deal.[114] Further, it is doubtful that the *Omnicare* Court would have invalidated the agreement in that case had the directors left themselves an escape clause to take a better deal if one came along before the shareholders voted.[115] This suggests

111. *Id.* at 930.

112. Unitrin, Inc. v. Am. Gen. Corp., 651 A.2d 1361, 1386–88 (Del. 1995).

113. Williams v. Geier, 671 A.2d 1368, 1382–83 (Del. 1996) ("Wrongful coercion may exist where the board or some other party takes actions which have the effect of causing the stockholders to vote in favor of the proposed transaction for some reason other than the merits of that transaction.").

114. Brazen v. Bell Atl. Corp., 695 A.2d 43, 50 (Del. 1997) (finding that termination fee provisions "were an integral part of the merits of the transaction").

115. *See Omnicare*, 818 A.2d at 936–39 (finding that the deal in question did not allow directors to uphold their fiduciary duties to minority stockholders). Such a "fiduciary out" provision would not only have complied with the portion of the court's opinion explicitly commanding such a term but it also arguably would have eliminated the basis for the court's treating the deal as coercive insofar as the merger was preordained to take place (because the board

that concerns over shareholder consent may evaporate if the court does not think that the directors got an undeniably bad deal. This focus on patently inferior deals brings us to *Revlon*.

## *C.* Revlon

*Revlon* arose out of an effort by a company, Pantry Pride, to acquire Revlon. Pantry Pride was a small, highly leveraged company that planned to acquire Revlon by using money raised through the sale of junk bonds—a debt it would repay by selling off Revlon's divisions.[116] After rejecting Pantry Pride's offer to purchase Revlon, Revlon's board adopted a poison pill plan.[117] When this turned out to be inadequate to deter Pantry Pride from launching a cash tender offer for all Revlon shares, Revlon's board responded by having Revlon make a tender offer to repurchase a substantial fraction of its own outstanding shares in exchange for a combination of convertible preferred stock and, of considerable significance to the events that followed, promissory notes issued by Revlon.[118] Revlon's offer was hugely oversubscribed and Revlon purchased on a pro-rata basis from the tendering shareholders the number of shares it offered to buy.[119] While this turned the vast majority of Revlon's shareholders into also its creditors, the transaction did not stop Pantry Pride's unwanted advances. After Pantry Pride responded with a higher price tender offer, Revlon's board authorized its management to seek other buyers for the company.[120] Management's efforts produced a bid from the private equity firm Forstmann Little.[121]

The ultimate Forstmann bid, like the Pantry Pride bid, involved paying cash for all outstanding Revlon stock financed by

promised to put it to a shareholder vote while the controlling shareholders promised to vote for it). *Id.*

116. Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 180–81 (Del. 1986).

117. *Id.* at 177.

118. *Id.*

119. *See id.* (stating that Revlon stockholders tendered 87% of the total outstanding shares of Revlon (approximately 33 million shares) and the company repurchased the 10 million shares it offered to buy on a pro rata basis).

120. *Id.*

121. *Id.* at 177–78.

debt to be repaid through the sale of Revlon's divisions.[122] Forstmann's price was slightly higher than the outstanding Pantry Pride offer;[123] albeit, Pantry Pride had announced its intention to top any competing bid by at least a small margin.[124] Pantry Pride never got the opportunity to do so because Revlon's board agreed to Forstmann's offer.[125] Critically in terms of cutting off any further offer by Pantry Pride, the agreement with Forstmann contained a lock-up provision requiring Revlon, if anyone other than Forstmann acquired 40% of Revlon's stock, to sell a pair of divisions to Forstmann at a price far below the value Revlon's investment banker attributed to them.[126] Revlon's board gave three reasons for entering the agreement with Forstmann: the higher price (ignoring, of course, Pantry Pride's announced intention to top any bid); firmer financing (which the court found not to be the case[127]); and, critically, that Forstmann had agreed to actions to protect the value of the notes Revlon had issued in the stock buy-back (many holders of which were threatening to sue the board when the noteholders heard that the board would support a leveraged buy-out of Revlon).[128]

Blocked by the lock-up, Pantry Pride sued. Applying *Unocal*, the Delaware Supreme Court upheld Revlon's initial defensive steps, including adoption of the poison pill.[129] The court's approach changed, however, when it reached the challenges to the Forstmann agreement with its lock-up provision. Here, the court announced a new rule for the situation in which the break-

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122. *Id.* at 178.

123. The exact amount of the disparity was uncertain because, while the Forstmann price was a dollar per share higher than Pantry Pride's existing offer, it would not be paid to the shareholders as soon as the Pantry Pride offer, thereby offsetting some of the advantage when one factors in the time value of money. *Id.* at 178 n.6.

124. *Id.* at 178.

125. *Id.* at 178–79.

126. *Id.* at 178. The agreement with Forstmann also contained a termination fee and a no-shop provision. *Id.*

127. *See id.* at 184 ("[A]ny distinctions between the rival bidders' methods of financing the proposal were nominal at best . . . .").

128. *See id.* at 178–79 (describing the Revlon board's reasons for accepting Forstmann's bid).

129. *See id.* at 180–81 (noting that the board acted appropriately in the face of an inadequate hostile bid).

up of the company is inevitable and the board authorizes efforts to sell the company:

> The duty of the board had thus changed from the preservation of Revlon as a corporate entity to the maximization of the company's value at a sale for the stockholders' benefit. This significantly altered the board's responsibilities under the *Unocal* standards. It no longer faced threats to corporate policy and effectiveness, or to the stockholders' interests, from a grossly inadequate bid. The whole question of defensive measures became moot. The directors' role changed from defenders of the corporate bastion to auctioneers charged with getting the best price for the stockholders at a sale of the company.[130]

From this language grew the notion that *Revlon* created a new regime in takeover contests in which the directors abandoned their role as defenders against a corporate takeover and now must auction the company to get the highest price for the shareholders.[131] Finding that Revlon's directors had breached their duty in this regard by cutting off the auction not to get the highest price but to favor the bid protecting the noteholders, the Delaware Supreme Court upheld the injunction against carrying out the Forstmann agreement.[132]

### *III. Problems in Applying the* Revlon *Gloss*

The subsequent history of *Revlon* might stand for the proposition that "bad facts make bad law." More appropriately, it stands for the proposition that sometimes courts should quit while they are ahead. The decision in *Revlon* itself was reasonable. The problems arose when Delaware courts assumed that the case had something to say about situations in which the directors were not choosing between two all-cash all-shares bids.

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130. *Id.* at 182.

131. *See* Bainbridge, *supra* note 8, at 3280 (treating this passage as establishing a situation ("*Revlon*-land") in which *Unocal* is supplanted by a narrower obligation).

132. *See* Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 185 (Del. 1986) (concluding that Revlon's directors "allowed considerations other than the maximization of shareholder profit to affect their judgment, and followed a course that ended the auction for Revlon . . . to the ultimate detriment of its shareholders.").

Specifically, it has been difficult to decide sensibly about which other cases *Revlon* has something relevant to say and to figure out what this something is.

### *A. What Triggers* Revlon*?*

A quarter century of efforts by Delaware courts to decide when *Revlon* applies reminds one a bit of the NFL's experience with replacement referees: Decisions often seem unpredictable and paradoxical.

#### *1. The Early Formulations*

*Revlon* was less than entirely clear on what exactly triggers its impact. The court referred to the increase in the hostile bidder's offers from which "it became apparent to all that the breakup of the company was inevitable."[133] The court then stated that the "board's authorization permitting management to negotiate a merger or buyout with a third party was a recognition that the company was for sale."[134] Putting the two sentences together, did the court mean that the rule it announced in *Revlon* only became applicable if the board capitulates to seeking a sale, or is it sufficient that an objective observer would conclude that an acquisition was inevitable despite the board's opposition? Moreover, does any decision to sell the company trigger the rule that *Revlon* announces or only a sale in which the buyer intends to break-up the company? Also, what is a sale? For example, does this include transactions such as a recapitalization of the company through corporate share issuances and repurchases that leaves a management group with a controlling block of shares?

The Delaware Supreme Court seemed to take a narrow and formalistic approach to answering such questions in *Ivanhoe Partners v. Newmont Mining Corp.*[135] *Ivanhoe* involved an idiosyncratic situation in which the challenged board action consisted of declaring a dividend that financed open market

133. *Id.* at 182.
134. *Id.*
135. 535 A.2d 1334 (Del. 1987).

purchases by the company's largest shareholder of more stock in the company.[136] These purchases left this shareholder still owning slightly less than half the outstanding stock and the shareholder agreed to limit its exercise of control.[137] Yet, between this party's holdings and the shares held by management there were not enough other shares left outstanding for anyone else to purchase control.[138] Hence, the end result left the management free from the threat of a hostile bidder and entrenched in control. Finding that the board did not sell the company—after all, the shareholder, aided in its purchases by the board, did not buy the whole company or even acquire control over the company, and the group who ended up in control did not buy anything—the Delaware Supreme Court held *Revlon* did not apply.[139]

In *Mills Acquisition Co. v. Macmillan, Inc.*,[140] however, the Delaware Supreme Court suggested a more expansive view. Actually, the facts in *MacMillan* did not force the court to reach situations much beyond *Revlon* itself. The company was faced with two competing all-cash or largely all-cash bids, and the board concluded that it would be in the best interest of the shareholders to sell the company and initiate a formal auction.[141] Nevertheless, the court sought to minimize the significance of its *Ivanhoe* decision as involving a unique situation in which the impact of strengthening management's position was a secondary effect.[142] Moreover, the court stated that *Revlon* applied whether the "sale" takes the form of an active auction, a management buy-out, or a restructuring in which a party acquires control through some combination of purchasing newly issued shares from the corporation and the corporation repurchasing shares from other stockholders.[143]

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136. *Id.* at 1339–40.

137. *Id.* at 1340.

138. *Id.*

139. *See id.* at 1345 (emphasizing that the board sought to keep the company independent and that there was no bidding or sale).

140. 559 A.2d 1261 (Del. 1989).

141. *Id.* at 1274–75.

142. *See id.* at 1285 n.35 (stating that the primary purpose of the board's actions in *Ivanhoe* was to "guide the corporation through the minefield of dangers directly posed by one bidder, and potentially by another").

143. *Id.* at 1285.

### *2. The Paradox of Paramount's Paramours*

This is where things stood when the Delaware Supreme Court dealt with a pivotal pair of cases involving efforts by the movie company, Paramount, to merge with companies operating cable television networks. The result is a paradox worthy of an episode in Paramount's "Star Trek" series.

In the first case, *Paramount Communications, Inc. v. Time*,[144] Paramount played the role of spurned suitor to Time—who not only published magazines but also operated the HBO network.[145] The prologue to this battle was that Time's board had entered into a merger agreement with another movie company, Warner.[146] The original merger agreement called for the stockholders in Warner to obtain stock in the combined Time–Warner entity.[147] This stock deal, however, required a vote of the Time shareholders.[148] Before such a vote could take place, Paramount beamed in with a generous tender offer to the Time shareholders.[149] This, in turn, caused Time's board to restructure the transaction with Warner as a cash tender offer to the Warner shareholders with a follow-up merger in which the remaining Warner shareholders received cash and some securities.[150] This change meant that Time's shareholders did not get to vote on the deal.[151] Paramount and some other Time shareholders sued. Some of the plaintiffs argued that the decision of Time's board to merge with Warner—whose pre-merger shareholders under the original plan would end up with a larger stake in the combined Time–Warner entity than would the pre-merger Time shareholders[152]—put Time up for sale and thereby triggered

144. 571 A.2d 1140 (Del. 1989).

145. *Id.* at 1143.

146. *Id.* at 1146.

147. *Id.* at 1145.

148. *See id.* at 1146 (noting that this requirement was imposed by the rules of the New York Stock Exchange but not by the Delaware statute).

149. *See id.* at 1147 (stating that Paramount offered to purchase Time's shares for $175 per share, nearly $50 more than their trading price at the time).

150. *Id.* at 1148.

151. *See id.* at 1149 (noting Paramount's argument that the revised agreement was preclusive in part because Time's shareholders could not vote on the merger).

152. Under the original Time–Warner merger agreement, the former

*Revlon*.[153] Both the Delaware Chancery and Supreme Court rejected this argument.[154] To the Chancery Court the critical factor was that the board's choice under either plan contemplated no shift in control over Time because control over Time would remain in whatever transitory alliance among numerous unaffiliated shareholders created a majority vote in a given election.[155] While stating that the Chancery Court's observation was correct, the Delaware Supreme Court preferred to place its reliance on the fact that the transaction favored by Time's board did not involve the dissolution or breakup of Time, either after the board initiated an active bidding process (as in *MacMillan*) or after the board abandoned a defensive posture and sought to sell the company (as in *Revlon*).[156]

The notion that sales only trigger *Revlon* when they involve the break-up or dissolution of the company and follow an auction or occur as a defensive response to another bid did not last a second case involving Paramount. In *Paramount Communications Inc. v. QVC Network Inc.*,[157] it was Paramount's board that played the role that Time's board had earlier. It

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Warner shareholders would have ended up owning 62% of the combined company. *Id.* at 1146.

153. *See id.* at 1149 (describing the arguments of the shareholder plaintiffs).

154. *Id.* at 1142.

155. *See id.* at 1150 (describing the Chancery Court's position that no change in control had taken place because the majority of shares were still held by the market, rather than any individual shareholder). The lack of any change in control over Time was certainly true as the deal ended up because the former Warner shareholders received mostly cash and some securities rather than Time stock. *Id.* at 1149. Even as the Time–Warner merger was originally structured, however, the Chancery Court viewed control over Time to be unchanged, despite the receipt by the former Warner shareholders of a majority of the voting stock in Time. *See* Paramount Commc'ns Inc. v. Time Inc., Nos. 10866, 10670 & 10935, 1989 WL 79880, at *739 (Del. Ch. July 14, 1989) ("It is irrelevant . . . that 62% of Time–Warner stock would have been held by former Warner shareholders). Essentially, the Chancery Court conceived of the former Warner shareholders as indistinguishable from the original Time shareholders—in both cases, the shareholders were simply numerous unaffiliated investors in a fluid market. *See id.* ("[W]here, as here, the shares of both constituent corporations are widely held, corporate control can be expected to remain unaffected by a stock for stock merger.").

156. *See* Paramount Commc'ns, Inc. v. Time Inc., 571 A.2d 1140, 1150–51 (Del. 1989) (stating that these are the two scenarios that trigger *Revlon*).

157. 637 A.2d 34 (Del. 1994).

entered into a merger agreement with a cable network company (Viacom Inc., who operated Showtime) and then faced a competitive bid from another cable network company (QVC, who operated the home shopping network).[158] The original Paramount–Viacom merger agreement contained some aggressive deal protection provisions, including a no-shop provision that limited Paramount's ability to talk with competing bidders, a $100 million termination fee for Viacom if the deal did not go through, and, most significantly, an option for Viacom to buy almost 20% of Paramount's stock cheaply if the deal did not go through.[159] Paramount's board refused to consider QVC's offer. Instead, while Paramount's board renegotiated the merger agreement with Viacom in response to QVC's offer in order to change what Paramount's shareholders received in the Viacom deal, Paramount's board made no effort to change the deal protection devices.[160] Viewing these devices to be a serious barrier, QVC sued.[161]

Because the Viacom deal did not involve the breakup or dissolution of Paramount either after a board initiated auction or in a defensive sale in response to QVC's bid, Paramount's board assumed that *Revlon* did not apply.[162] The Delaware Supreme Court, however, pulled a surprise on Paramount's board. The court focused on the fact that the deal Paramount's board made with Viacom would leave Viacom's controlling shareholder (Sumner Redstone) in control of the combined entity.[163] By contrast, the court explained, the transaction in *Time* had left control in whatever fluid aggregation of unaffiliated shareholders might come together to cast a majority vote in any given

158. *Id.* at 37–40.

159. *Id.* at 39.

160. *Id.* at 40–41.

161. *Id.* at 40.

162. *See id.* at 46 (noting the defendants' position that a breakup is necessary to trigger *Revlon*).

163. *See id.* at 43, 46 (emphasizing that *Revlon* applies in a situation where there is a change in corporate control, in this case due to the presence of a controlling shareholder). Redstone owned an overwhelming majority of the voting stock in Viacom, and the shareholders of Paramount would only receive a limited amount of voting (as opposed to non-voting) stock in Viacom. *Id.* at 38–40.

election[164]—in other words, the Delaware Supreme Court belatedly decided to rely on the rationale of the Chancery Court in *Time*.

In the end, the outcome in *Time* and *QVC* create something of a paradox—the paradox of Paramount's paramours if you will—as far as the application of *Revlon*. In *QVC*, the shift in control over Paramount to a stranger under the proposed Paramount–Viacom merger[165] triggered what all assumed was the more intensive scrutiny under *Revlon* as opposed to *Unocal*. By contrast, in *Time*, the court applied the presumably lesser scrutiny of *Unocal* to Time's marriage to Warner—even though this marriage left Time's board and management in charge of the combined entity.[166] As a result, the rule appears to be that the greater the conflict of interest by the target's board (as far as retaining the current directors' and managers' power), the less the court's scrutiny of the board's action.

### *3. Subsequent Confusion*

Cases after *QVC* demonstrate the problems Delaware courts continue to encounter in deciding what triggers *Revlon*. As discussed earlier,[167] *Revlon* left open the question of whether objective circumstances or board decisions trigger the doctrine. Actually, this question can manifest itself in a couple of different ways. The more common argument would be that even though the board had not yet decided to seek a sale implicating *Revlon*, the situation was such that a sale was inevitable (in common parlance, the company is "in play"). In *Lyondell Chemical Co. v.*

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164. *See id.* at 46–48 (explaining that *Time* did not implicate *Revlon* because control remained dispersed in the market).

165. While Paramount's CEO apparently was to be the CEO of the combined Paramount–Viacom company, the existence of a controlling shareholder of the combined company presumably would place the CEO into a subordinate role. *Id.* at 38.

166. Indeed, a critical component of the Time–Warner deal was the retention of "Time culture" for the company by assuring that senior Time executives would end up in charge. *See* Paramount Commc'ns, Inc. v. Time Inc., 571 A.2d 1140, 1146 (Del. 1989) (noting that several of Time's directors advocated paying a premium to keep the company's culture intact).

167. *Supra* notes 133–34 and accompanying text.

*Ryan*,[168] the Delaware Supreme Court held that the triggering event is the board's decision.[169] Flipping the situation around, suppose the board decides to seek a buyer who will break up or dissolve the company (a *Revlon* transaction), but, in the end, the board only enters a transaction that leaves control in the market. In *Arnold v. Society for Savings Bancorp, Inc.*,[170] the Delaware Supreme Court held that a stock-for-stock merger that left control in the market did not trigger *Revlon* even though the directors had unsuccessfully sought a bust-up transaction prior to agreeing to the stock merger.[171]

A more controversial question is whether triggering *Revlon* depends upon the nature of the consideration received by the shareholders.[172] To the simple minded,[173] the most obvious fact about the situation in *Revlon* is that it involved a choice between two all-cash all-shares bids.[174] As discussed later,[175] a straightforward explanation for the result in *Revlon* is that when directors decide to sell to one of two bidders, both of whom will pay all of the shareholders cash for all of their shares, the only legitimate goal is to get the most cash. Strangely, however, *Revlon*,[176] *MacMillan*,[177] and later descriptions of those cases by the Delaware Supreme Court[178] do not focus on this fact. Instead,

168. 970 A.2d 235 (Del. 2009).

169. *See id.* at 242 ("The duty to seek the best available price applies only when a company embarks on a transaction—on its own initiative or in response to an unsolicited offer—that will result in a change of control.").

170. 650 A.2d 1270 (Del. 1994).

171. *See id.* at 1274, 1289–90 (emphasizing that the board did not initiate a bidding process, and that subjective intent is not relevant to the *Revlon* inquiry).

172. *See, e.g.*, Bainbridge, *supra* note 8, at 3323–37 (criticizing Delaware Chancery Court decisions suggesting that cash sales trigger *Revlon*).

173. Me.

174. This was also largely true in *Macmillan*, in which one bid introduced a small amount of subordinated debt. *See* Mills Acquisition Co. v. Macmillan Inc., 559 A.2d 1261, 1275 (Del. 1989) (stating that less than 10% of one of the bids consisted of subordinated securities, with the rest made up of cash).

175. *See infra* notes 278–79 and accompanying text (providing a simple explanation for the result in *Revlon*).

176. *See supra* notes 133–34 and accompanying text (discussing *Revlon*'s triggering language).

177. *See* 559 A.2d at 1285 (describing the circumstances in which *Revlon* is triggered).

178. *See, e.g.*, Paramount Commc'ns, Inc. v. Time Inc., 571 A.2d 1140, 1150

they talk about transactions involving the break-up or dissolution of the corporation, either in response a hostile bid or resulting from a board initiated auction. In other words, the traditional description of what triggered the *Revlon* decision itself and its application in *MacMillan* focuses on context and process (a decision to sell in response to a hostile bid or to auction the company) and the outcome for the corporation (dissolution or break-up) but not the outcome with respect to the shareholders of the corporation (whether they are cashed out).[179] Given how common cash sales of corporations are,[180] the implications of this question as to the scope of *Revlon* is evident.

The original emphasis on the outcome for the corporation (dissolution or break-up) is embedded in the metaphor the court employed in *Revlon*. In *Revlon*, the court spoke of the board's decision to abandon the role of defender of the corporate bastion.[181] Before this point, *Unocal* had allowed the board to respond to "a danger to corporate policy and effectiveness."[182] If the board, however, decided to abandon the defense of the corporation and allow its dissolution or break-up, justifications based upon threats to corporate policy and effectiveness were presumably inapplicable, and so the idea of triggering the new rule based upon what would happen to the corporation seemed to follow.

At first glance, the two cases involving Paramount reinforce the notion that the nature of the consideration does not matter. If the nature of the consideration was important, then both the Delaware Chancery and Supreme Court in *Time* could have disposed of the plaintiffs' argument that *Revlon* applied by pointing out that neither version of the Time–Warner merger

(Del. 1989) (characterizing the aspects of *Revlon* and *MacMillan* that triggered the *Revlon* doctrine).

179. Perhaps the notion that all of the shareholders will be cashed out is implicit in the criteria that the transaction involve the dissolution or break-up of the corporation; but there are other ways in which to cash out all of the shareholders besides dissolution or break-up. *See, e.g.*, GEVURTZ, *supra* note 16, at 1138–39 (describing mechanisms for freezing out minority shareholders following an acquisition of control).

180. *See, e.g.*, *id.* at 935–36 (discussing advantages of cash versus stock as consideration in the purchase and sale of a corporation).

181. *See supra* note 130 and accompanying text (discussing *Revlon*'s rule).

182. Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 955 (Del. 1985).

cashed out Time's shareholders (the original iteration being a stock-for-stock deal and the final iteration cashing out the Warner, rather than the Time, shareholders).[183] Moreover, *QVC* applied *Revlon* despite the competing offers containing considerable fractions of equity.[184] Even so, *QVC* introduced an important conceptual shift that suggests the nature of the consideration might matter. Specifically, in holding that a change in control can trigger *Revlon*, *QVC* focused on the impact of the transaction upon the shareholders—who would find themselves in the more dangerous position of minority shareholders in a corporation with a controlling shareholder and who would lose the ability to share in the proceeds of selling control[185]—rather than the impact of the transaction upon the corporation. If the impact upon the shareholders is the trigger, then the dramatic impact of being cashed out seems relevant.

Subsequent Delaware Supreme Court opinions are inconclusive. In *Lyondell*, the Delaware Supreme Court dealt with a case in which the Chancery Court held that Lyondell's directors breached their duties under *Revlon* in approving a cash-out merger with a privately held company.[186] Although rejecting the Chancery Court's notion that *Revlon* began to apply the moment Lyondell was "in play" as opposed to when the directors decided to start negotiating the sale, the Delaware Supreme Court nevertheless implicitly accepted the conclusion that the cash-out merger constituted a change in control triggering *Revlon*.[187] On the other hand, was this a change in control because cashing out all the existing Lyondell shareholders removed their role in the corporation? Or was it a change in control because the buyer was a privately held company and so

183. *See supra* notes 144–51 accompanying text (explaining the transaction at issue in *Time*).

184. *See infra* notes 210–11 and accompanying text (noting the mix of cash and stock in the Viacom and QVC bids).

185. *See infra* note 311 and accompanying text (discussing the shareholders' loss of control).

186. *See* Lyondell Chem. Co. v. Ryan, 970 A.2d 235, 237 (Del. 2009) (describing the Chancery Court's ruling).

187. *See id.* at 242–43 (stating that *Revlon* duties did not kick in until the board began to negotiate the merger).

control had passed from unaffiliated dispersed shareholders in the market? The Delaware Supreme Court never actually said.

In *Lyondell*, the Delaware Supreme Court cited its post-*QVC* opinion in *Santa Fe Pacific Corp. Shareholder Litigation*[188] for the proposition that a change in control triggers *Revlon*.[189] In *Santa Fe*, the court held that *Revlon* did not apply to a merger with a company lacking a controlling shareholder when 33% of the shareholders received cash in the transaction and the rest received stock.[190] What, if anything, this tells us about an entirely (or even predominately) cash-out deal, however, is in the eye of the beholder.[191]

Lacking unequivocal direction from the Delaware Supreme Court, the Delaware Chancery Court has issued several opinions stating that cash-out mergers may trigger *Revlon* if the cash constitutes a primary proportion of the consideration, even if the merger occurs with a company that lacks a controlling shareholder such that unaffiliated shareholders in the market still ultimately control the combined firms.[192] The basic rationale is that "there is no long run" for the cashed-out shareholders to justify forgoing maximum immediate value in favor of the sort of considerations listed in *Unocal*.[193] So far, none of these decisions actually has found that the directors breached their fiduciary duty under *Revlon*; albeit a recent decision explicitly applied *Revlon* to a half cash-out/half stock-for-stock merger with a company lacking a controlling shareholder.[194]

188. 669 A.2d 59 (1995).

189. *Lyondell*, 970 A.2d at 242.

190. *Santa Fe*, 669 A.2d at 64–65, 71.

191. *Compare In re* NYMEX S'holder Litig., C.A. Nos. 3621-VCN, 3835-VCN, 2009 WL 3206051, at *5 (Del. Ch. Sept. 30, 2009) (characterizing *Santa Fe* as establishing a floor of 33% below which cash would be insufficient to trigger Revlon), *with* Bainbridge, *supra* note 8, at 57–58 (characterizing *Santa Fe* as establishing that sales to public companies do not trigger *Revlon*).

192. *See, e.g.*, *In re* Smurfit-Stone Container Corp. S'holder Litig., C.A. No. 6164-VCP, 2011 WL 2028076, at *15 (Del. Ch. May 24, 2011) (emphasizing the importance of cash consideration); *In re NYMEX S'holder Litig.*, 2009 WL 3206051, at *5 (noting that when cash is the exclusive consideration, *Revlon* is triggered); *In re* Lukens Inc. S'holders Litig., 757 A.2d 720, 732 n.25 (Del. Ch. 1999) (discussing the amount of cash consideration that would be sufficient to trigger *Revlon*).

193. *In re Lukens Inc. S'holders Litig.*, 757 A.2d at 732 n.25.

194. *In re Smurfit-Stone Container Corp. S'holder Litig.*, 2011 WL 2028076,

### *B. What Does* Revlon *Do?*

Not only has it been uncertain what triggers *Revlon*, it has also been uncertain what *Revlon* actually does. Specifically, *Revlon* and later cases applying the doctrine suggest three possible impacts: (i) limiting the goals directors can pursue in the situation; (ii) supplanting general standards governing the directors' conduct and the courts' review of this conduct with more specific rules for the process directors are to follow; and (iii) imposing a heightened standard of judicial scrutiny over directors' actions. Unfortunately, Delaware courts have been neither clear nor consistent in articulating or applying these possible impacts to the doctrine. In part, this is because the Delaware Supreme Court has treated these three impacts like the three shells in the carnival game in which pea always seems magically to appear under a different shell than the player guessed. In part, this is because the logical extension of these impacts either creates inconsistencies with other principles of Delaware corporate law or else suggests that "there is no there there" when it comes to the impact of *Revlon*.

#### *1. Limitation of Permissible Goals*

The Delaware Supreme Court's opinion in *Revlon* focused much of its attention upon the Revlon board's motive for favoring Forstmann's bid over Pantry Pride's. Specifically, the court stated that Revlon's board breached its duty because the board acted principally to protect Revlon noteholders rather than to obtain the best price for Revlon's shareholders.[195] Hence, one aspect of the *Revlon* doctrine seems to be a specification of permissible goals for directors to pursue once they enter into the sphere governed by *Revlon*. Yet, it is not clear what this motivational aspect of *Revlon* requires or how it fits with the motivational

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at *15 (finding *Revlon* applicable when half of the stockholders' investment was liquidated).

195. *See* Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 184 (Del. 1986) ("The principal object, contrary to the board's duty of care, appears to have been protection of the noteholders over the shareholders' interests.").

limitations imposed upon directors' conduct outside of *Revlon*. In order to understand why this is so, one must work through the several layers folded within the court's conclusion.

The bottom layer involves why Revlon's directors cared about the interests of the noteholders. The court believed this was because the noteholders threatened to sue the directors.[196] Hence, at first glance, the situation would appear to involve nothing more than a simple duty of loyalty violation in which the directors put their self-interest in avoiding personal liability ahead of their duty to the shareholders. On further reflection, however, this is not so simple. Treating fear of personal liability as a conflict of interest might suggest that directors or other corporate officials have a duty to disregard their other legal obligations if doing so will advance shareholder interests—hardly a savory proposition.[197] In the end, however, the court avoided the need to consider such implications by concluding that the directors had no duty to the noteholders (and therefore the directors' self-interest flowed from only their incorrect perception of a risk of personal liability).[198]

Putting aside self-interest, the next question regarding legitimate goals was whether the directors could sacrifice shareholder interests for the interests of the noteholders. Here, the court entered into the long debate about shareholder primacy

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196. *See id.* (noting the benefit to the directors, who avoided personal liability).

197. *See, e.g.*, DEL. CODE ANN. tit. 8, § 102(b)(7) (2011) (stating that the certificate of incorporation cannot waive liability for a knowing violation of law); GEVURTZ, *supra* note 44, at 326 ("[I]t is unheard of for a court to suggest that a director or officer could possibly breach his or her duty to the corporation by refusing to have the corporation engage in illegal activity.").

198. *See Revlon*, 506 A.2d at 182–83 (noting that the noteholders' rights were limited to their contract and that the board owed them no further duty). Actually, because directors and other officials can only act based upon their perception of legal duties, which can always be wrong, one might legitimately worry that a rule placing the risk of such erroneous determinations on directors and officers will deter non-erroneous efforts to comply with legal limits on what directors can do in search of profits for the shareholders. *See, e.g.*, Bohatch v. Butler & Binion, 977 S.W.2d 543, 561 (Tex. 1998) (Spector, J. dissenting) (arguing that allowing expulsion of a law firm partner, who reported her ultimately erroneous suspicions of overbilling by a fellow partner, will deter other lawyers from complying with their ethical obligations to report suspected overbilling in the future).

versus stakeholder models[199] in one of the rare decisions in which this actually mattered. Confronted with the language in its earlier *Unocal* decision stating that directors may take into account the interests of other corporate constituencies in reacting to a hostile tender offer,[200] the court in *Revlon* explained that this is only true if there are rationally related benefits accruing to the shareholders.[201] This, the court concluded, meant that concern for non-shareholder interests was no longer appropriate once the directors decided to auction rather than protect the company.[202] As explained later in this article,[203] this analysis invokes a highly traditional, although often highly artificial, reconciliation of stakeholder interests with shareholder primacy long found in corporate-law decisions in the United States.

In specifying that self-interest and the interest of other constituencies when not tied to the benefit of the shareholders were inappropriate goals, the court in *Revlon* reached a result no different than it could have reached by simply applying the business judgment rule. On top of these two layers, however, *Revlon* set out a command identifying the goal toward which the directors must work. Specifically, the court stated that once the situation changed from defending against a takeover to selling the company, the central theme guiding the directors should have been obtaining the highest price for the shareholders.[204] Like a shimmering mirage on the desert surface, this command promises much and delivers frustration.

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199. *See infra* note 282 and accompanying text (explaining the shareholder primacy debate).

200. *See* Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 955 (Del. 1985) (stating that the board can take into account the "impact on 'constituencies' other than shareholders").

201. *See* Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 182 (Del. 1986) (stating that the board can only consider other constituencies if there are rationally related benefits to the stakeholders).

202. *See id.* (stating that the board could no longer protect the noteholders and claim there were rationally related benefits to the shareholders from doing so).

203. *See infra* notes 282–94 and accompanying text (analyzing *Revlon* in the context of the shareholder primacy debate).

204. *See Revlon*, 506 A.2d at 182 (emphasizing that the board's only permissible objective is to obtain the best price for shareholders).

In part, this may have been because the command makes more sense in its original context. In the *Revlon* opinion, the command to obtain the best price for the shareholders largely appears in juxtaposition to the impermissible goals of advancing the interests of the noteholders and avoiding personal liability for the directors.[205] Hence, it may simply have meant that the directors' obligation was to put the shareholders' interest ahead of the interests of other constituencies and of the directors' themselves. Moreover, the factual context for this statement in *Revlon* involved a situation in which there were two competing all-cash bids with essentially the same method of financing.[206] Having decided to accept one of these bids, what other goal could the directors legitimately pursue besides getting the best price?

Still, the Delaware courts have not been content to leave this aspect of *Revlon* to its original context. Instead, they have grabbed at the shiny object and attempted to apply this command to contexts in which the choice facing the directors was not simply between accepting one of two all-cash bids equivalent in their impact on the shareholders except for the price. Like a law professor's hypotheticals that start close to the original case and then become increasingly different, this started with a minor variant on two all-cash bids. In *MacMillan*, the contest was between one all-cash bid and a blended bid with mostly cash and a small amount of subordinated debt securities.[207] With nary a pause to remark on the difference, the Delaware Supreme Court responded by changing the wording of its *Revlon* command from a duty to obtain the "highest price" to a duty to get the "highest value reasonably attainable for the shareholders"[208] or, at another point of the opinion, to obtain the "highest price reasonably available to the company, provided it was offered by a

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205. *See id.* ("[S]uch concern for non-stockholder interests is inappropriate when an auction among active bidders is in progress, and the object no longer is to protect or maintain the corporate enterprise but to sell it to the highest bidder.").

206. *See id.* at 184 (finding any difference between the bids nominal at best in terms of financing).

207. Mills Acquisition Co. v. MacMillan, Inc., 559 A.2d 1261, 1274–75 (Del. 1989).

208. *Id.* at 1288.

reputable and responsible bidder."[209] Of course, the presence of subordinated debt complicates the comparison of the two bids, especially insofar as it may continue to link the fate of the selling shareholders to the future fortunes of the company if those fortunes turn sufficiently negative to impact the company's ability to service the debt. Still, the presence of a small amount of subordinated debt might not seem to leave the situation that much changed from *Revlon*.

As law students soon discover, once one begins down the road of applying the rule despite a seemingly minor difference, the trap is sprung and before long one faces much more significant differences. In this instance, the significant differences arrived in *QVC*. There, both bids involved a mix of cash and continuing equity in the combined company. QVC's bid involved a cash tender offer for 51% of Paramount's outstanding stock, with the remaining 49% receiving QVC common stock in a follow-on merger.[210] The initial merger agreement with Viacom gave Paramount shareholders a small amount of cash and a mix of voting and non-voting Viacom stock, while Viacom's later merger agreement matched QVC's proposal for a cash tender offer for 51% of Paramount's stock and then a mix of voting, non-voting and convertible preferred shares in Viacom for the other 49%.[211] In response, the Delaware Supreme Court invoked the "best value reasonably attainable for the shareholders" formulation

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209. *Id.* at 1282. The court elaborated on this caveat in a footnote:

> In assessing the bid and the bidder's responsibility, a board may consider, among various proper factors, the adequacy and terms of the offer; its fairness and feasibility; the proposed or actual financing for the offer, and the consequences of that financing; questions of illegality; the impact of both the bid and the potential acquisition on other constituencies, provided that it bears some reasonable relationship to general shareholder interests; the risk of nonconsumation; the basic stockholder interests at stake; the bidder's identity, prior background and other business venture experiences; and the bidder's business plans for the corporation and their effects on stockholder interests.

*Id.* at 1282 n.29.

210. Paramount Commc'ns, Inc. v. QVC Network Inc., 637 A.2d 34, 40–41 (Del. 1993).

211. *Id.* at 39–41.

from *MacMillan* instead of the best price formulation from *Revlon* as the goal directors must pursue.[212]

Yet, how does this best value reasonably attainable for the shareholders objective differ from the continuing obligation that directors owe to the shareholders in any decision directors make regarding a corporate merger or acquisition, or, indeed, in any context? Put in terms of a concrete example, how did the permissible objective for the Paramount's directors in agreeing to the Viacom merger rather than going with QVC differ from the permissible objective for Time's directors in agreeing to the Warner merger rather than going with Paramount in the *Time* case, where, as discussed earlier,[213] the court did not apply *Revlon*? The court's answer is a Rorschach test.

For those predisposed to find that *Revlon* narrows the acceptable goal for directors, the court in *QVC* stated that the directors should try to quantify the value of any non-cash consideration if feasible.[214] The court further explained in a footnote that the board should focus on the value of the non-cash consideration as of the date the shareholders will receive it and that such value normally will be determined with the assistance of experts using generally accepted methods of valuation.[215] By contrast, the court in *Time* explained that whereas *Revlon* triggers a duty to maximize "immediate shareholder value," review under *Unocal* was not intended to lead to a simple "mathematical exercise" of comparing the discounted value of Time–Warner shares at some point in the future versus the value of Paramount's offer.[216]The problem, of course, is that the value of the two bids in *QVC* depended in substantial measure upon the future performance of the equity in each packet, which, in turn, depended both on the performance of the combined entity (Paramount and Viacom or Paramount and QVC) and the

212. *Id.* at 43.

213. *See supra* note 156 and accompanying text (discussing the *Time* court's view of *Revlon*'s applicability).

214. *See QVC*, 637 A.2d at 44 ("Where stock or other non-cash consideration is involved, the board should try to quantify its value, if feasible, to achieve an objective comparison of the alternatives.").

215. *See id.* at 44 n.14 (discussing the valuation of non-cash consideration).

216. Paramount Commc'ns, Inc. v. Time Inc., 571 A.2d 1140, 1153 (Del. 1989).

interest in the combined entity represented by the shares received by Paramount's stockholders.[217] But these two variables were at the heart of the decision facing the directors in *Time*. Specifically, the impact of the originally agreed Time–Warner merger on Time's pre-merger stockholders depended upon whether the future earnings of the combined entity outweighed the dilution of the stockholders' interest resulting from issuing Time shares to the Warner stockholders.[218] Once Paramount arrived on the scene with a competitive bid, there was the additional question as to whether the value Time's shareholders gained in the Warner merger exceeded what Paramount offered. How is the determination of the value called for under *QVC* and *Revlon* supposed to differ from the more open-ended goals analysis allowed under *Time*? Is the court saying that because *Revlon* did not apply, Time's directors were free to ignore whether the increased earnings from the Time–Warner combination would at least eventually offset the dilution suffered by Time's pre-merger shareholders or whether Paramount's offer provided better value for Time's stockholders than the Warner combination no matter how and when measured?

Maybe the court is saying that without *Revlon* directors are entitled to use their own informed judgment on whether a combination or other decision enhances shareholder value, but once *Revlon* applies directors must look to the market valuations of exchanged securities.[219] Yet other language in *QVC* casts doubt on this interpretation. Specifically, the court in *QVC* elevated to text its footnote in *MacMillan* in which it discussed the latitude open to directors in weighing bids under *Revlon*.[220] So, the court

217. *See, e.g.*, GEVURTZ, *supra* note 16, at 918–36 (discussing valuation in the context of selling a corporation, including the impact when sellers receive shares in the purchasing corporation).

218. *See id.* at 935 (discussing the impact on the purchasing corporation's shareholders of issuing shares to purchase another corporation).

219. *See* Bernard Black & Reinier Kraakman, *Delaware's Takeover Law: The Uncertain Search for Hidden Value*, 96 NW. U. L. REV. 521, 523–24 (2002) (explaining *Revlon* as a situation in which courts focus on "visible" (market) value to measure a transaction's merits, instead of allowing directors to act based upon their potential knowledge of the corporation's "hidden" value that market price does not reflect).

220. Paramount Commc'ns, Inc. v. QVC Network Inc., 637 A.2d 34, 44 (Del. 1994).

explained, directors are entitled under *Revlon* to take into account an offer's fairness and feasibility as well as the bidder's business plans for the corporation and their effects on stockholder interest.[221] To reinforce the point, the court also stated that the directors are not limited to considering only the amount of cash involved—which would seem rather obvious when the bid includes significant non-cash consideration—and, of seemingly greater importance, are not required to ignore totally the board's view of the future value of a strategic alliance.[222]

Perhaps the answer is not found in what the court said but in what it actually did. In finding that Paramount's directors breached their duty, the court pointed to the one billion dollar advantage of the QVC bid over the Viacom bid when measured by the current market value of the securities involved and stated that Paramount's directors could not justify giving up this much advantage based upon their vision of future strategy.[223] While the court based this conclusion in part upon the board's loss of credibility as a result of the board's poor process, the court explained that the primary reason for discounting valuation based upon future strategy was because the current board would not be in control of Paramount after the merger in order to carry out its strategic vision.[224] So, is the court saying that market valuation trumps under *Revlon* and that a change in control precludes consideration of the added value of a strategic combination beyond that recognized in market prices, or is the court saying that directors must justify disregarding huge disparities in market valuations of competing bids and that a new management's continued willingness to implement the outgoing board's strategic plan following a change in control is too uncertain a reed upon which to justify such a huge disparity? We

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221. *See id.* (discussing the evaluation of bids) (citing *Mills Acquisition Co. v. MacMillan, Inc.*, 559 A.2d 1261, 1282 n.29 (Del. 1989)).

222. *See id.* at 44 ("In determining which alternative provides the best value for the stockholders, a board of directors is not limited to considering only the amount of cash involved, and is not required to ignore totally its view of the future value of a strategic alliance.").

223. *See id.* at 50 (explaining how the value of QVC's bid outweighed any strategic benefits from accepting Viacom's bid).

224. *See id.* (noting the change in control would remove the board's authority to implement its strategic vision).

shall return to this question when we consider whether *Revlon* imposes a higher level of judicial scrutiny over directors' decisions than imposed by *Unocal*.

In the meantime, this language in *QVC* starts to shift our attention from goals to process. Specifically, another way of viewing the language about valuing non-cash consideration with the aid of experts using accepted methods of valuation is that the overall goal for directors remains the same—get the best value for the shareholders—but now the process directors should use in working toward this goal has narrowed. This brings us to the second possible impact of *Revlon*.

### *2. Substitution of Process Rules for General Standards of Conduct and Review*

Early in their legal studies, many law students in the United States read a pair of Supreme Court opinions that deal with accidents at railroad crossings.[225] In the first case, Justice Holmes announced a rule that an automobile driver who approaches a railroad track at which the driver cannot see if there is an oncoming train must stop the car and get out and look, and that the failure to do so amounts to negligence precluding recovery.[226] In the second case, Justice Cardozo confronted a situation in which the existence of four parallel tracks at the crossing would have rendered an effort to follow this "stop, get out and look rule" impractical.[227] Justice Cardozo's solution is to explain that there is no "stop, get out and look rule"; rather, the only rule is that the driver must act reasonably under the circumstances and the driver in the prior case had not done so under the particular facts

225. *See, e.g.*, MARC A. FRANKLIN, ROBERT L. RABIN & MICHAEL D. GREEN, TORT LAW AND ALTERNATIVES: CASES AND MATERIALS 60–64 (8th ed. 2011) (including these cases as part of a fundamental study of tort law).

226. *See* Baltimore & Ohio R.R. Co. v. Goodman, 275 U.S. 66, 69–70 (1927) ("In such circumstances it seems to us that if a driver cannot be sure otherwise whether a train is dangerously near he must stop and get out of his vehicle . . . .").

227. *See* Pokora v. Wabash Ry. Co., 292 U.S. 98, 101 (1934) ("This does not mean, however, that if vision was cut off by obstacles, there was negligence in going on . . . .").

of that case.[228] The purpose of reading these cases is not to learn about railroad crossing accidents. Rather, in addition to raising the roles of judges and juries, these opinions expose students to a fundamental tension between governing conduct with specific rules or with general standards.[229] When setting forth the impact of *Revlon*, the Delaware Supreme Court has tried to have it both ways.[230] The result has been confusion.

This confusion came to something of a head a few years ago in *Lyondell*. The situation in *Lyondell* reminds one a little of the famous *Smith v. Van Gorkom* decision,[231] albeit in *Lyondell* the board seemed to have carefully analyzed the deal, including receiving the opinion of an investment banking firm (who described the offer as "an absolute home run").[232] Even though the shareholders approved the deal by a 99% vote,[233] some shareholders still brought a class action alleging that the directors breached their duty.[234] Despite these circumstances, the plaintiff was able to avoid summary judgment in the Chancery Court based upon the argument that *Revlon* applied; that *Revlon* required the directors to conduct an auction prior to, or a market test after, accepting the cash-out deal unless the directors could establish they had impeccable knowledge of the market; and that

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228. *See id.* at 102–06 (acknowledging that the rule should not apply in all instances where such conduct would not be expected of a reasonable man under the circumstances).

229. *See generally* Louis Kaplow, *Rules Versus Standards: An Economic Analysis*, 42 DUKE L.J. 557 (1992).

230. Delaware courts frequently have tried to gain the advantage of specific guidelines within general standards by providing directors "safe harbor" suggestions for processes that will clearly comply with fiduciary duties. *See, e.g.*, Malone v. Brincat, 722 A.2d 5, 10 (Del. 1998) ("This Court has endeavored to provide the directors with clear signal beacons and brightly lined-channel markers as they navigate with due care, good faith, and loyalty on behalf of a Delaware corporation and its shareholders."); Broz v. Cellular Info. Sys., Inc., 673 A.2d 148, 157 (Del. 1996) (acknowledging that safe harbors "remove[] the specter of a *post hoc* judicial determination that the director or officer has improperly usurped a corporate opportunity"). This is different, however, from mandating specific processes.

231. *See* 488 A.2d 858 (Del. 1985) (holding directors breached their duty of care in voting to sell the corporation in a two hour meeting based upon a twenty minute oral presentation and without asking many questions).

232. Lyondell Chem. Co. v. Ryan, 970 A.2d 235, 238–39 (Del. 2009).

233. *Id.* at 239.

234. *Id.*

there was a triable issue of fact regarding whether the directors had such impeccable knowledge.[235] The Delaware Supreme Court would have none of this. Instead, the Delaware Supreme Court explained that *Revlon* does not mandate an auction or any special procedure; it mandates a goal of obtaining the highest price.[236]

So, how did the Chancery Court in *Lyondell* manage to get this wrong? Telling the story in flashbacks, one sees a pattern of confusing signals from the Delaware Supreme Court. This starts, not surprisingly, in *Revlon* itself. The problem resulted from the fact that recognizing a duty to get the highest price did not immediately resolve the *Revlon* case. At the time Revlon's board acted, the Forstmann bid favored by the board was slightly higher than the Pantry Pride bid, which the board disfavored.[237] The court in *Revlon* held that this slight advantage did not justify granting Forstmann lock-up and no-shop agreements that deterred a further bid by Pantry Pride.[238] The simple explanation was that the board cut off further bidding not because the board felt that it had extracted as high a price as it could but rather to ensure that the bid protecting the noteholders (and the directors themselves from lawsuits) prevailed,[239] which, as discussed above,[240] is not a permissible goal. Unfortunately, the Supreme Court did not stop there. Instead, it also threw in language suggesting that directors breach their duty by playing favorites when auctioning the company and that market forces must be allowed to operate freely to obtain the best price available for the shareholders.[241] From this nugget grew the notion that *Revlon*

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235. *See id.* at 241, 243 (discussing the Chancery Court's basis for denying summary judgment).

236. *See id.* at 242 (noting that there is no specific way the directors must acquire the highest price).

237. *See supra* note 123 and accompanying text (comparing the Forstmann and Pantry Pride bids).

238. *See* Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 184 (Del. 1986) (noting that these provisions were impermissible when they did not work to secure the highest bid).

239. *See id.* ("The principal benefit went to the directors, who avoided personal liability to a class of creditors to whom the board owed no further duty under the circumstances.").

240. *See supra* notes 196–202 and accompanying text (elaborating on the court's implementation of the shareholder primacy theory).

241. *See Revlon*, 506 A.2d at 184 ("Market forces must be allowed to operate freely to bring the target's shareholders the best price available for their

imposes process rules directors must follow.[242] Subsequent decisions by the Delaware Supreme Court have vacillated between taming and inflaming this notion (sometimes both in the same opinion).

Having seemingly condemned playing favorites in auctioning the company, the Delaware Supreme Court felt compelled to explain in *MacMillan* that directors have no independent duty to conduct fair auctions for the sake of fair auctions.[243] Rather, the directors can favor one bidder.[244] The directors' duty in a *Revlon* situation is simply to get the best price for the shareholders, and the directors must justify any favoritism based upon achieving this goal.[245] So what then is the point of the language in *Revlon* about not playing favorites and allowing market forces to work? Fair auctions provide a means both for obtaining the highest price and for verifying that the price is, in fact, the highest.[246] This, however, raises the question of whether directors can use other tools to obtain and verify the highest price in selling the company, and, if so, what are the other tools.

The Delaware Supreme Court discussed this question at some length in *Barkan v. Amstead Industries*.[247] This discussion began with the reassurance that *Revlon* does not command a heated bidding contest (an auction) before any sale of control.[248] The court then broke down situations that might arise into two possibilities.[249] The first was multiple bidders competing for control. Here, the court returned to the admonition that fairness

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equity.").

242. *See, e.g.*, Bainbridge, *supra* note 8, at 3315 (indicating that the courts have drawn lines as to what action is permissible under *Revlon*).

243. *See* Mills Acquisition Co. v. MacMillan, Inc., 559 A.2d 1261, 1286–87 (Del. 1989) (noting that directors need not follow some standard formula when initiating an auction).

244. *See id.* (recognizing that favoring one bidder is allowed, so long as it is for the benefit of the stockholders).

245. *See id.* (noting that there must be a rational basis for any favoritism involved).

246. *See generally* Preston McAfee & John McMillan, *Auctions and Bidding*, 25 J. ECON. LIT. 669 (1987).

247. 567 A.2d 1279 (Del. 1989).

248. *Id.* at 1286.

249. *See id.* at 1286–87 (discussing instances of multiple bidders and single bidders).

to the shareholders precludes using defensive mechanisms to favor one bidder over another,[250] leading one to wonder what happened to *MacMillan*'s statement that favoritism was allowable if justified by getting the best deal for the shareholders. Of significance to *Lyondell*, the court also discussed the situation in which there was only one bidder. In this circumstance, the court stated that unless the directors have reliable grounds for determining if the one bid is adequate, they must canvass the market to determine if higher bids might be available.[251] Moreover, in commenting on what might constitute reliable information sufficient to forgo canvassing the market, the court cautioned that the advice of an investment banker is often a poor substitute for a market test to determine the adequacy of a single bid.[252] Given this discussion, it is not surprising that the Chancery Court in *Lyondell* thought that directors in a *Revlon* situation without competing bidders must test the market unless they can establish their impeccable knowledge of the market.[253] Indeed, one suspects the Chancery Court judge may have felt betrayed by the Delaware Supreme Court's "now you tell me" explanation that *Revlon* does not impose any specific process obligations—at least until the Delaware Supreme Court says something different again in another opinion.

### *3. Heightened Scrutiny*

The final impact of *Revlon* is a notion of heightened scrutiny. What this heightened scrutiny entails is not entirely clear. In part, this is because the concept of heightened scrutiny gets mixed together with statements of acceptable goals and a specification of required process. In part, this is because it is

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250. *Id.*

251. *See id.* at 1287 ("When the board is considering a single offer and has no reliable grounds upon which to judge its adequacy, this concern for fairness demands a canvas of the market to determine if higher bids may be elicited.") (citing *In re* Fort Howard Corp. S'holders Litig., CIV A. No. 9991, 1988 WL 83147 (Del. Ch. Aug. 8, 1988)).

252. *Id.*

253. *See* Lyondell Chem. Co. v. Ryan, 970 A.2d 235, 241 (Del. 2009) (noting the Chancery Court's emphasis on the fact that directors failed to conduct "even a limited market check").

uncertain how this heightened scrutiny meshes with the *Unocal* standard and with the standards applicable to reviewing director decisions generally.

As discussed earlier,[254] judicial scrutiny of directors' decisions generally falls within the deferential standard of the business judgment rule unless there is a conflict of interest without disinterested approval, in which case the intrusive intrinsic fairness test becomes applicable. *Unocal* establishes an intermediate standard for takeover defenses under which directors seemingly must prove the reasonableness of their actions both in terms of objectives and means.[255] Where does *Revlon* fit into this? Specifically, when it comes to the degree of scrutiny, does *Revlon* do anything more than *Unocal*? There are two possibilities for doing more than *Unocal*: *Revlon* might establish a new intermediate standard which is more demanding than *Unocal*, albeit less demanding than the intrinsic fairness test; or *Revlon* might extend *Unocal*'s reasonableness standard to situations previously covered by the business judgment rule standard.

In *MacMillan*, the Delaware Supreme Court equated the degree of scrutiny under *Unocal* and *Revlon*. Specifically, the court explained that if there is favoritism for one bidder over another in auctioning the company, then the court must examine under *Unocal*'s reasonableness standard whether the directors perceived that the favoritism would advance shareholder interests and whether the favoritism was reasonable in relation to the advantage the directors sought to achieve.[256] By contrast, the two Delaware Supreme Court decisions dealing with Paramount's paramours (*Time* and *QVC*) provide more confusing signals. Recall that the Delaware Supreme Court in these two cases confronted arguments by the parties about whether *Revlon*

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254. *See supra* notes 35–43 and accompanying text (comparing decisions evaluated under the business judgment rule and conflict-of-interest transactions).

255. *See supra* notes 59–61 and accompanying text (discussing the *Unocal* standard).

256. *See* Mills Acquisition Co. v. MacMillan, Inc., 559 A.2d 1261, 1286–88 (Del. 1989) (discussing the process to determine if disparate treatment was appropriate).

or just *Unocal* applied.[257] If *Revlon* does not establish a more demanding standard than *Unocal*, the Supreme Court might have disposed of the whole issue by saying it did not matter. Instead, the Delaware Supreme Court in *QVC* couched its distinguishing *Time* and exploring whether *Revlon* applied in terms of whether the court will employ "enhanced scrutiny" of the board's decision,[258] which seems to suggest that *Revlon* requires some higher level of scrutiny than *Unocal*.

Perhaps the enhanced scrutiny the court spoke of in *QVC* referred to ensuring directors complied with some greater process required under *Revlon* but not *Unocal* or with a narrowing of acceptable goals under *Revlon* as opposed to under *Unocal*. Indeed, as discussed earlier, there is language in *Time* and *QVC* suggesting a narrowing of the acceptable goal for the board under *Revlon*.[259] Still, one can read this language not as narrowing the permissible goal for directors but as increasing the scrutiny applied by the court. So, to return to the passage in *QVC* in which the court points to the $1 billion greater market value of the QVC bid over the Viacom offer followed by the statement that this disparity could not be justified by the Paramount directors' vision of future strategy,[260] this might mean that directors must focus their attention on the getting the most value for the shareholders as measured by market prices. On the other hand, this could reflect a greater level of scrutiny under which the court is willing to examine market prices and other factors to decide for itself whether the shareholders got the best value rather than deferring to the directors' balancing of market valuations versus the directors' internal assessments.[261] The Delaware Supreme

257. *See supra* notes 153, 163–164 and accompanying text (discussing the arguments in *Time* and *QVC* over whether *Revlon* or just *Unocal* applied).

258. *See* Paramount Commc'ns, Inc. v. QVC Network Inc., 637 A.2d 34, 44–46 (Del. 1994) (noting the enhanced scrutiny that applies when *Revlon* duties are applicable).

259. *See supra* notes 214–16 and accompanying text (examining the court's recommendations for evaluating non-cash consideration).

260. *QVC*, 637 A.2d at 50 (stating that the disparity in market value between the two offers outweighed any benefits provided by a strategic alliance).

261. To pursue this thought further, the court's statement that a change in control renders a valuation based upon future strategy insufficient to justify a huge disparity in market valuation could be read to suggest that directors cannot consider future strategy very much or it could be read to reflect a court

Court's decision in *Arnold* suggests, in fact, that this is about scrutiny rather than goals or process. Specifically, the court, in a footnote, scolded the plaintiff's attorney for referring to "*Revlon* duties" in order "inappropriately" to describe the "enhanced scrutiny courts apply to certain types of transactions."[262]

Beyond the question of whether *Revlon* creates a higher level of scrutiny than *Unocal*, there is also the question of whether *Revlon* extends an intermediate level of scrutiny to situations not covered by *Unocal* and, hence, otherwise subject to evaluation under the deferential approach of the business judgment rule. *Lyondell* provides an illustration of this issue. As mentioned above,[263] *Lyondell* involved the sort of cash-out merger negotiated with a solitary bidder reminiscent of *Van Gorkom*.[264] In *Van Gorkom*, the plaintiff had to establish the directors were grossly negligent in order to prevail under the business judgment rule.[265] This would appear to suggest that the business judgment rule/gross negligence standard would also apply to *Lyondell*.[266] Moreover, in response to the *Van Gorkom* decision, the Delaware legislature amended Delaware's corporation statute to authorize certificates of incorporation to waive liability of directors for monetary damages except in certain cases, including actions not in good faith.[267] Lyondell's certificate of incorporation contained such a waiver.[268] This, in turn, suggests that good faith established the appropriate standard for reviewing the plaintiff's

much more willing to exercise its own judgment about the value to accord a future strategy when it is uncertain whether the strategy will be implemented following a change in control.

262. Arnold v. Soc'y for Sav. Bancorp, Inc., 650 A.2d 1270, 1289 n.40 (Del. 1994).

263. *Supra* notes 231–32 and accompanying text.

264. *See* Lyondell Chem. Co. v. Ryan, 970 A.2d 235, 238–39 (Del. 2009) (discussing the terms of the merger).

265. *See supra* note 39 (discussing the standard of care applied under the business judgment rule).

266. Because *Van Gorkom* predates *Revlon*, however, it is possible that the Delaware Supreme Court would have applied *Revlon* to *Van Gorkom* had the order of the decisions been reversed.

267. *See* DEL. CODE ANN. tit. 8, § 102(b)(7) (2011) (allowing a provision that limits or eliminates directors' liability for a breach of fiduciary duty, but not allowing such a waiver for acts not in good faith).

268. Lyondell Chem. Co. v. Ryan, 970 A.2d 235, 239 (Del. 2009).

claim in *Lyondell*. Yet, the court in *Lyondell* assumed that accepting a cash-out offer, at least from a privately controlled buyer, constituted the sale of control under *QVC* and hence fell under *Revlon*.[269] This suggests more rigorous scrutiny of the board's action than either the business judgment rule or good faith standards. The Chancery Court in *Lyondell* tried to reconcile all this by holding that the conscious failure to comply with *Revlon*'s process requirements—conduct an auction, conduct a market test, or establish the directors' impeccable knowledge of the market—established a lack of good faith.[270] In reversing the Chancery Court's decision, the Delaware Supreme Court explained that *Revlon* did not command any particular process.[271] This, however, still leaves the question of what is the degree of scrutiny that the court should apply. The Delaware Supreme Court in *Lyondell* found it necessary for the plaintiff to establish a lack of good faith.[272] Yet, all this may show is that certificates of incorporation can waive monetary damages from *Revlon* claims so long as the directors acted in good faith. Such waivers, however, do not apply to actions pursuing an injunction.[273] Hence, the question continues as to whether, in cases seeking injunctive relief, *Revlon* mandates heightened judicial scrutiny of the garden variety sale of the corporation for cash outside of any takeover contest that courts for decades had reviewed under the business judgment rule.

Beyond this, *Lyondell*'s application of the good faith standard to some *Revlon* situations exposes a more fundamental problem: Specifically, what is the justification for ever applying heightened scrutiny in *Revlon* situations? As stated earlier,[274] heightened

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269. *See id.* at 242–43 (determining that *Revlon* duties did not kick in until the board began to evaluate and negotiate the merger).

270. *See id.* at 242 (explaining how the trial court conflated the board's inaction with bad faith).

271. *See id.* at 242 (rejecting a process requirement).

272. *See id.* at 243 (requiring a finding of failure to act in good faith to find for the plaintiffs).

273. *See* DEL. CODE ANN. tit. 8, § 102(b)(7) (2011) (permitting waiver of claims for monetary damages). In fact, most cases involving *Revlon* seek injunctive relief. Bainbridge, *supra* note 8, at 3319–20.

274. *See supra* notes 40–44 and accompanying text (discussing the higher level of scrutiny in conflict-of-interest scenarios compared to that applied under the business judgment rule).

judicial scrutiny traditionally stems from concerns over conflict of interest. As discussed later,[275] concerns with conflict of interest in a final period situation is one rationale asserted on behalf of the *Revlon* doctrine. Yet, the presence of a conflict of interest means we are dealing with a duty of loyalty, rather than a duty of care, claim.[276] Duty of loyalty claims, like claims for acts not in good faith, are not subject to waiver under Section 102(b)(7) of Delaware's corporation statute.[277] Hence, by abandoning strict scrutiny of *Revlon* claims seeking monetary damages in favor of a good faith standard whenever faced with a Section 102(b)(7) waiver, the *Lyondell* opinion not only limits the practical impact of *Revlon*, but also may substantially undercut the underlying rationale behind the doctrine. This provides a segue into asking whether there is any sensible rationale behind the doctrine.

## *IV. The Futile Search for a Sensible Underlying Rationale*

Normally, courts can look to a doctrine's underlying rationale to help resolve the issues regarding the doctrine's scope and impact, which the Delaware courts have encountered in applying *Revlon*. With *Revlon*, however, the failure of the Delaware courts to resolve such issues satisfactorily is symptomatic of the fact that there really is no sensible underlying rationale for the doctrine.

### *A. Disparate Cases, Disparate Rationales*

There are three cases in which the Delaware Supreme Court actually held that directors, under *Revlon*, breached their fiduciary duty. The result in the first two, and perhaps all three, is reasonable. The attempt to tie the cases altogether into one

275. *See infra* notes 356–61 and accompanying text (explaining the incentives problem in a final periods scenario).

276. *See, e.g.*, GEVURTZ, *supra* note 44, at 340 (describing conflict-of-interest transactions as presenting the danger that directors "will favor themselves at the expense of the corporation," bringing the duty of loyalty into play).

277. *See* DEL. CODE ANN. tit. 8, § 102(b)(7) (2011) (stating that the certificate of incorporation cannot eliminate or limit a director's liability for a breach of the duty of loyalty).

coherent doctrine, however, has simply created unhelpful complexity and, in turn, confusion.

### *1.* Revlon

*Revlon* is really about whether directors must maximize shareholder value, as opposed to protecting stakeholder interests, in the rare case in which the court could not dodge the issue. As discussed above, Revlon's board faced a choice between two all-cash bids with essentially the same impact upon the shareholders except for the price.[278] Hence, even the deference called for under the business judgment rule (let alone the more demanding *Unocal* standard) should not protect the directors if, without explanation, they simply chose the lower price bid.[279] The facts in *Revlon* are a little more complicated because the directors took the slightly higher price bid and cut off further bidding through a lock-up agreement.[280] Critically, however, the court found that the directors had ended the auction not because the directors felt that they had extracted the highest price but rather because the bid, which thereby prevailed, protected the holders of certain notes (debt) issued by Revlon.[281] Hence, the question was whether Revlon's directors could sacrifice the highest price for the shareholders in order to protect certain Revlon creditors.

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278. *See* Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 176–78 (Del. 1986) (discussing the terms of the deals offered in the merger transaction).

279. Notice in this regard the critical role played by the fact that the situation involved two all-cash bids with equivalent impact upon the shareholders except for the price. If there had been only one bid, then instead of an easy comparison of price, there would be the much more difficult comparison of the one bid against the future earnings prospects of the company or the uncertain prospects for some future higher offer. Similarly, if either or both of the two bids involved significant non-cash consideration or otherwise differed in their impact upon the shareholders in ways less measurable than a cash price, then again there would be a much more difficult comparison. In either of these more difficult cases, there exist the sorts of judgmental factors that normally make it vastly more difficult to say that directors breached their duty.

280. *Revlon*, 506 A.2d at 179.

281. *See id.* at 184 ("The principal object, contrary to the board's duty of care, appears to have been protection of the noteholders over the shareholders' interests.").

Over the years, academics have spent considerable ink arguing over whether the directors' duty is to maximize the welfare of the shareholders (often called the shareholder primacy norm) or whether the directors can sacrifice shareholder profits to advance the interests of other stakeholders in the corporation such as employees, creditors and the like.[282] For the most part, this debate has been more of interest to academics than important to the actual operation of the law. While courts pay lip service to the notion that directors must maximize shareholder welfare, application of the business judgment rule leaves the balancing of interests between shareholders and other corporate stakeholders within the largely unchecked discretion of the board of directors.

The leading case, *Dodge v. Ford Motor Co.*,[283] illustrates the point.[284] Though the court's opinion in *Dodge* contains oft-quoted language to the effect that the directors breach their duty if they act to change the end objective of the corporation from profiting the shareholders to seeking to benefit others,[285] the court actually

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282. *See generally* Martin Gelter, *Taming or Protecting the Modern Corporation? Shareholder-Stakeholder Debates in a Comparative Light*, 7 N.Y.U. J. L. & BUS. 641 (2011); Kent Greenfield, *The Impact of "Going Private" on Corporate Stakeholders*, 3 BROOK. J. CORP. FIN. & COM. L. 72 (2008); Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 247 (1999); E. Merrick Dodd, *For Whom Are Corporate Managers Trustees*?, 45 HARV. L. REV. 1145 (1932); A.A. Berle, Jr., Note, *For Whom Corporate Managers Are Trustees: A Note*, 45 HARV. L. REV. 1365 (1932); Milton Friedman, *The Social Responsibility of Business Is to Increase its Profit*, N.Y. TIMES SUNDAY MAGAZINE, Sept. 13, 1970, at 17.

283. 170 N.W. 668 (Mich. 1919).

284. The Dodge brothers were minority shareholders in Ford Motor Co. *Id.* at 669. Henry Ford owned a majority of the outstanding stock and dominated the board. *Id.* at 671. Ford Motor Co. at this time was unbelievably successful. *See id.* at 670 (describing the company's increasing profits). The Dodge brothers sued after Henry Ford announced that the corporation would not pay any more special dividends, but, instead, would retain the extra earnings for expansion. *Id.* at 671.

285. Statements by Henry Ford, both in and out of court, suggest that his reason for expanding the business was not to maximize profits, but, rather, stemmed from his desire to implement his economic and social views. *Id.* at 671. Specifically, Henry Ford expressed the view that the company should lower the price of its cars and expand its production, not to increase profits, but in order to enable more Americans to own a car and to provide employment for more persons. *Id.* at 672. The court took a different view of the permissible goals of a business corporation. Such a corporation (as opposed to an entity organized as a nonprofit corporation) exists, the court explained, "primarily for the profit of the

allowed Henry Ford to forgo obedience to maximizing shareholder profits on the off chance that the shareholders might end up better off anyway.[286] The practical upshot of cases like *Dodge* is that, by and large, courts have not scrutinized business decisions to see whether directors sacrificed profit maximization to advance the interests of employees, creditors, customers and the community.[287] Instead, the courts almost invariably accept some rationale as to how the business decisions were in the long range interest of the shareholders.[288] The statement in *Unocal* that directors can consider the interests of other constituencies, such as employees, creditors and even the community generally, in reacting to a takeover attempt[289] is consistent with this approach.

*Revlon* presented an extreme situation in which the court felt it could no longer say that advancing the interests of other corporate constituencies (in this case, the noteholders) might somehow benefit the shareholders in the long run.[290] Normally,

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stockholders." *Id.* at 684.

286. *See id.* (refusing to interfere with the proposed expansion). The court in *Dodge* ordered the payment of a special dividend; but this was only because Ford Motor Co. had plenty of money both to expand and to pay the dividend. *See id.* at 685 (noting that company's excess of cash). Critically, however, the court refused to block the corporation's expansion plans, despite what the court had to say concerning Henry Ford's express motivations for those plans. *See id.* at 684 (acknowledging the court's limited ability to determine whether the proposed expansion was a good business decision). The court felt that the expansion plans might serve a business purpose and refused to substitute the court's judgment for the business expertise of the directors. *Id.*

287. *See, e.g.*, Einer Elhauge, *Sacrificing Corporate Profits in the Public Interest*, 80 N.Y.U. L. REV. 733, 775 (2005) (noting that courts have not been overly wary of those methods).

288. *See, e.g.*, Shlensky v. Wrigley, 237 N.E.2d 776, 780 (Ill. App. 1968) (finding that defendants, directors of the Chicago Cubs, acted in the interest of shareholders in refusing to allow night games at Wrigley Field because any benefits to the surrounding neighborhood would be reflected in increased attendance and increased value of the corporation's real estate); A.P. Smith Mfg. Co. v. Barlow, 98 A.2d 581, 590 (N.J. 1953) (finding that defendant corporation's charitable donations provided shareholders with long-term benefit).

289. *See* Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 955–56 (Del. 1985) ("Examples of such concerns [affecting the reasonableness of the board's decision] may include . . . the impact on 'constituencies' other than shareholders . . . .").

290. *See* Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 175 (Del. 1986) (finding that consideration for other constituencies must at least rationally benefit the shareholders).

directors might argue that showing solicitude for the interest of corporate creditors beyond the requirements the debt contract can be in the long run interest of shareholders by encouraging creditors to loan money to the company on favorable terms in the future. There was simply no basis for such an argument in *Revlon*. Significantly, there are two reasons for this, making it uncertain whether the court relied on one, the other, or both. The more obvious reason is that the directors were choosing between two all-cash all-shares bids essentially equivalent in their financing.[291] Under these circumstances, it is difficult to see how the shareholders could somehow be better off in the long run by taking a lower priced bid on the ground that it better protected corporate creditors. After all, having been completely cashed out in the deal, there seems little way for the shareholders to benefit from whatever happens to the company, including its enhanced ability to borrow money, thereafter. The alternate reason involved the bidders' plans for the corporation. Specifically, they planned to break-up Revlon and sell off its pieces.[292] Breaking up the corporation renders its good relations with creditors irrelevant. Because the court could not come up with an argument under these facts that what is good for stakeholders is also good for shareholders, the Delaware Supreme Court held that the directors could not consider the interest of the noteholders.[293] Once the court reached this conclusion, the case was done and the rest of the opinion unnecessary.[294]

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291. *See id.* at 177–79 (discussing the terms of the various bids).

292. *See id.* at 178 (discussing the plan for the disposition of Revlon's assets).

293. *See id.* at 182 (stating that the board could not consider the interests of the noteholders when, because of the sale and breakup, there was no rational benefit to the shareholders from considering the noteholders).

294. One wrinkle, however, lies in the fact that the bid protecting the noteholders was slightly higher at the time the board effectively ended the competition than the competing bid. A second wrinkle lies in the possibility that the directors may have mistakenly thought themselves under some legal obligation to the noteholders. Under these circumstances, a court which displayed as much willingness to wink at actual motives as occurred in *Dodge* might have found that Revlon's directors acted consistently with shareholder interests or otherwise in accord with their duty despite their actual motive or mistake of law. The heightened scrutiny entailed by *Unocal* may explain this. In other words, while *Unocal* allows directors to consider the interests of other stakeholders in responding to a hostile tender offer, the heightened scrutiny

Implicit in this analysis is a defining assumption about the measure of shareholder welfare. Specifically, underlying the decision in *Revlon* is the view that one measures the shareholders' interest solely in terms of the ownership in this one corporation without regard to other investments shareholders might have in their portfolios or other interests they might have as members of society. Otherwise, it could be possible to rationalize sacrificing the highest price for the Revlon stock in favor of protecting the noteholders as still being in the shareholders' interest. Specifically, given the notes' origin as consideration received pro-rata by Revlon's shareholders who oversubscribed Revlon's self-tender,[295] it is quite possible that many Revlon stockholders still held some of these notes. More broadly, perhaps other corporations in which the Revlon shareholders own stock could obtain loans on better terms in the future if the Delaware court held that directors can accept lower price bids for the company when those bids better protect corporate creditors.[296]

A recent article by Stephen Bainbridge[297] seems to take a different view of the appropriate measure of shareholder interest under *Revlon*. Professor Bainbridge criticizes the Delaware Chancery Court decisions discussed above which stated that

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under *Unocal* could mean that the court will not uncritically accept any rationale that advancing the interest of the stakeholders in opposing a tender offer is also in the interest of the shareholders (as it would under the business judgment rule) but, instead, will consider for itself whether this supposition is reasonable under the circumstances.

Of course, one might agree or disagree with *Revlon*'s prohibition on directors from sacrificing the interests of the shareholders for other stakeholders when there is no rational argument as to how this might be in the long-range interest of the shareholders, but such debate is far beyond the scope of this Article.

295. *See supra* note 119 and accompanying text (describing the initial distribution of the notes).

296. Indeed, this could apply well beyond the facts in *Revlon*. Lynn Stout and Margaret Blair's team production theory would support an argument that shareholders with diversified portfolios of corporate stocks could prefer to take actions sacrificing maximum value in mergers and sales in order to protect the interests of workers, as this would promote firm-specific investments of human capital in other ventures in which the shareholders own, or might in the future own, stock. *See* Blair & Stout, *supra* note 282, at 275 (arguing that it is in the shareholders' interest to promote workers' investment in working for the firm).

297. *See generally* Bainbridge, *supra* note 8.

cash-out bids trigger *Revlon*.[298] He argues instead that only deals which pass control to private parties come within *QVC's* sale of control trigger.[299] His rationale is that a sale of control to a publicly held buyer still enables the target company's stockholders to share in any benefits of the deal not reflected in the price they received, because diversified investors are as likely to hold shares in the buyer as they are in the target.[300]

Accepting this sort of portfolio-based approach to determining shareholder interest would radically rewrite corporate law in ways reaching far beyond *Revlon*. As just discussed, it would eviscerate what little teeth *Revlon* gives to the shareholder primacy norm. More radically, this portfolio theory of shareholder interest would transform commonplace corporate decisions into a breach of the directors' duties. Specifically, if one assumes that shareholders have diversified portfolios in which they invest in competing corporations, then advertising and other actions aimed at building market share at the expense of a company's publicly held competitors do not advance shareholder interests. As a result, such actions constitute waste (actions serving no legitimate purpose).[301]

### *2.* MacMillan

*MacMillan* presents a different issue than *Revlon*. MacMillan's board accepted a bid for a management buyout (MBO) over a competing bid.[302] The participants in the MBO included MacMillan's CEO and COO (chief operating officer), the CEO also being the chairman of MacMillan's board.[303] This means that the board's acceptance of this bid, including the agreement to a lock-up provision that effectively cut off further

298. *See generally id.*

299. *See id.* at 3337–38 (discussing the "roadmap" for when *Revlon* applies).

300. *See id.* at 3310–11, 3335 (noting that fully diversified shareholders should be indifferent to the allocation of gains between the two entities).

301. *See, e.g.*, Michelson v. Duncan, 407 A.2d 211, 217 (Del. 1979) (stating that expenditures without consideration or serving no corporate purpose equal waste).

302. Mills Acquisition Co. v. MacMillan, Inc., 559 A.2d 1261, 1273 (Del. 1989).

303. *Id.* at 1265.

bidding, presented a classic conflict-of-interest transaction. The court found that the CEO and COO failed to inform the other directors of material facts about the transaction. Specifically, they did not inform the board that they had tipped the individuals in charge of the MBO's bid about the relative status of the two bids.[304] This tip had undermined the effectiveness of the final phase of the blind auction to obtain the highest price possible.[305] The failure to disclose this conduct meant that MacMillan's disinterested directors acted in the mistaken belief that a fair auction had extracted the best price the company could get.[306] As a result, the transaction was neither approved by disinterested directors after full disclosure nor fair.[307] Though the board later affirmed its action after learning of the tip, this seems simply to have reinforced the court's view that the disinterested directors lacked any independence of the CEO and COO.[308] Hence, the court was correct to enjoin the transaction based upon a straightforward breach of the duty of loyalty and the court's discussion of *Revlon* was superfluous.

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304. *See id.* at 1277 (explaining information withheld during a board meeting held to evaluate the two bids).

305. Confronted with two bids close in price, the financial analysts carrying out the auction on behalf of MacMillan decided to conduct an additional round of bidding without telling either bidder which bidder was ahead. *Id.* at 1275 . They did tell MacMillan's CEO and COO the amount of the two bids, and the CEO and COO, in turn, passed on the relative status of the bids to the representative bidding for the MBO. *Id.* Knowing it was already ahead, the MBO bidder only slightly raised its bid. *See id.* at 1277 (stating that the MBO bidder increased its bid by only $.05 per share). Mistakenly thinking that it was already ahead and that the last round was simply an attempt to get it to bid against itself, the other bidder did not raise its bid. *Id.* at 1275–77. Of course, it is possible that the MBO bidder might have acted similarly to the other bidder had it remained ignorant of the relative status of the two bids. Still, there is no way of knowing whether ignorance would, instead, have prompted a more aggressive final bid by the MBO bidder. Because the burden of proof is on the directors' when dealing with a conflict-of-interest transaction, the Delaware Supreme Court was correct to hold that this unknowable doomed the agreement.

306. *See id.* at 1277 (describing how the board was misled into believing that the bidding process was fair).

307. *See id.* at 1282–84 (noting the materiality of the nondisclosure of the "tipping" to the other bidder).

308. *See id.* at 1280 ("The board was torpid, if not supine, in its efforts to establish a truly independent auction, free of [the CEO's] interference and access to confidential data.").

### *3.* QVC

*QVC* presents neither the issue of shareholder primacy versus protecting other corporate stakeholders at the heart of the situation in *Revlon* or the conflict of interest with a management buyout found in *MacMillan*. The Delaware Supreme Court was highly critical of the care exercised by Paramount's board,[309] which suggests that it might not actually have been necessary to go beyond *Unocal* or even the business judgment rule to condemn the board's actions. If so, then the court's result was correct and, as with *MacMillan*, the court simply made its opinion unnecessarily complex by introducing the discussion of heightened scrutiny under *Revlon*.

In any event, by holding that shifting control to a single person triggered heightened scrutiny under *Revlon*,[310] the *QVC* opinion not only substantially increased the reach of *Revlon*, but also suggested a different sort of rationale for the doctrine. Specifically, as its rationale for this trigger, the court expressed concern with the loss of effective voting power for the unaffiliated shareholders once a single individual owns a majority of a corporation's outstanding voting stock and explained that the transaction, in essence, involved the sale of a valuable asset belonging to the public shareholders (the ability to obtain a premium price for selling control over the corporation).[311] This rationale, however, simply demonstrates that the decision is an important one to the shareholders, both in terms of potential upside (the premium they receive for selling control) and downside (the dangers they face as minority shareholders once a single individual obtains control). Yet, many decisions directors make are highly important to the shareholders. Why should this alter the court's approach to the decision?

Perhaps the argument is one of judicial economy: in other words, if a reason for courts deferring to corporate boards is to avoid the burden of constantly reviewing board decisions, a rule

309. *See* Paramount Commc'ns, Inc. v. QVC Network Inc., 637 A.2d 34, 49 (Del. 1994) ("[T]he Paramount Board clearly gave insufficient attention to the potential consequences of the defensive measures demanded by Viacom.").

310. *See id.* at 36 (finding the board's actions to be subject to the *Revlon* standard).

311. *Id.* at 42–43.

that says courts will focus their attention on particularly important board decisions might logically follow. A problem with this argument is that courts[312] and commentators[313] generally do not point to judicial economy as a rationale behind judicial deference to board decisions. Alternately, elementary notions of reasonable conduct might suggest that the more important a decision, the more time and attention directors should give to it. While sensible enough, this observation hardly seems to call for a special doctrine as opposed to a common sense application of the business judgment rule. One suspects that courts can figure out without any special doctrine that while a twenty-minute oral presentation is normally more than enough before, say, the board recommends that shareholders vote against an advisory proposal placed by a shareholder on the corporation's proxy statement, it probably provides insufficient information upon which to vote for selling the entire company. Finally, as discussed earlier,[314] one argument for requiring shareholder approval of mergers and the like is that shareholders will pay more attention to more important decisions. This shareholder time management argument, however, has nothing to do with justifying greater judicial scrutiny.

A further problem, however, with this whole rationale for applying heightened scrutiny is that the importance of board decisions involves infinite shades of grey in which it is difficult to cull out some decisions as particularly critical. So, for example, did the decision in *QVC* really have that much greater impact on Paramount's shareholders than the decision in *Time* had on Time's shareholders? The Delaware Supreme Court seems to think so based upon a notion of reversibility. Specifically, the court in *Time* argued that the Time–Warner merger did not preclude Paramount's acquisition because Paramount could simply purchase Time–Warner.[315] By contrast, transfer of control

312. *See, e.g.*, Joy v. North, 692 F.2d 880, 885–86 (2d Cir. 1982) (discussing rationales for the business judgment rule).

313. *See* Gevurtz, *supra* note 36, at 304–21 (discussing rationales for the business judgment rule).

314. *Supra* note 78 and accompanying text.

315. *See* Paramount Commc'ns, Inc. v. Time, 571 A.2d 1140, 1150, 1155 (Del. 1989) (noting that nothing in the agreement precluded Paramount from purchasing the combined entity)

over Paramount to Mr. Redstone would preempt any later ability of Paramount's shareholders to obtain a premium for selling control and permanently place them in a precarious position of minority shareholders in a controlled corporation.[316]

Yet, this argument overstates the difference between the two situations, which, in the end, all comes down to making or losing money. So, to return to the situation in *Time*, both the Warner and Paramount mergers seem motivated by some synergy from combining cable networks with movie studios.[317] Assume, however, that combining two movie studios with one cable network would at best be redundant and potentially counterproductive—which seems to be the thinking behind Paramount's conduct. Assume further that Paramount's deal was better for the Time shareholders than the Warner deal, either because there was greater synergy or because Paramount was offering them a larger share of the synergistic gains. Under these assumptions, if Paramount acquires the combined Time–Warner company, much of the gain that the Time stockholders would have obtained for themselves in an acquisition of Time by Paramount is now shared with the former Warner stockholders. After all, the Warner stockholders received a price reflecting synergistic gains of the Time–Warner combination, which gains, if they do nothing for Paramount, will not result in Paramount paying a higher price for the Time–Warner combination.[318] Hence, the Time–Warner merger involved significant irreversible consequences for Time's shareholders; otherwise, of course, there would have been no lawsuit by the Time shareholders other than Paramount.[319] More broadly, the constant stream of corporate

316. Paramount Commc'ns Inc. v. QVC Network Inc., 637 A.2d 34, 42–43 (Del. 1994).

317. *See Time*, 571 A.2d at 1143 (discussing the motivations for the Time–Warner merger).

318. In other words, under the assumption that combining two movie companies with one cable network would be redundant or counterproductive, Paramount will simply pay what it would have for Time separately plus what Warner would be worth spun off, leaving the Time shareholders uncompensated for the extra amount Time paid for the Warner shares based upon the synergistic value of a Time–Warner combination.

319. In the end, Paramount walked away and married another cable network company and years later the Time shareholders could only look back wistfully at the premium Paramount offered to pay. *See, e.g.*, Thomas L. Hazen, *The Corporate Persona, Contract (and Market) Failure, and Moral Values*, 69

bankruptcies testifies to the fact that directors make, or allow management to make, irreversibly bad decisions of huge importance to the shareholders all the time.[320]

### *B. Other Rationales for the* Revlon *Doctrine*

Looking at the broader context instead of specific cases, there are essentially two rationales one might assert on behalf of the *Revlon* doctrine. The first involves the division of power between directors and shareholders; specifically, *Revlon* substitutes judicial review for the functions otherwise provided by shareholder consent in situations in which the directors circumvent the duel consent model for sales or combinations of corporations by avoiding or coercing shareholder consent. The other rationale follows the more traditional fiduciary duty concern about situations in which directors face incentives that might motivate them to slight corporate and shareholder interests and argues that the incentives arising in a final period bring *Revlon* situations within this concern. These rationales overlap under the argument discussed earlier that the reason for requiring shareholder approval of mergers and the like is to deal with a final period incentives problem.[321] While both of these rationales have some superficial appeal, neither provides a satisfactory explanation for the *Revlon* doctrine.

#### *1. Substituting for Shareholder Consent*

One rationale for the *Revlon* doctrine follows from viewing *Revlon* in the context of the mutual consent model the law imposes upon sales and combinations of corporations. As

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N.C. L. REV. 273, 291 n.105 (1991) (pointing out the failure of the Time–Warner stock price to match the premium offered by Paramount even several years after the merger).

320. *See, e.g.*, *In re* Citigroup Inc. S'holder Derivative Litig., 964 A.2d 106, 139–40 (Del. Ch. 2009) (invoking the business judgment rule in dealing with a claim that the board allowed managers to lose billions of dollars in CDO business, which led to government bailout of Citigroup).

321. *See supra* note 79 and accompanying text (explaining the final period incentives problem).

discussed above, this model calls upon directors to propose and shareholders to approve such transactions.[322] *Revlon* and later cases applying the doctrine typically involve shotgun corporate marriages in which directors seek to bypass or coerce shareholder acceptance of a deal favored by the board.[323] Perhaps the purpose of *Revlon* is to employ judicial review as a substitute for shareholder consent in the case of such shotgun corporate marriages. Specifically, the various impacts of *Revlon* might carry out the function(s) otherwise performed by shareholder consent.

Assessing this rationale begins by asking what function shareholder consent to sales and combinations of corporations serves. Unfortunately, as discussed earlier, there is lack of consensus on why the law requires shareholders to approve mergers and asset sales.[324] Still, a simple, if not simplistic, answer is that shareholder consent helps to ensure that these transactions are in the interest of the shareholders,[325] both in the sense that the directors have not sacrificed the interests of the shareholders for the interests of others and in the sense that the directors succeeded in obtaining a good deal. Matched against this objective, one might see how the three arguable impacts embedded in the *Revlon* doctrine could serve as functional substitutes for shareholder consent.

The narrowing of acceptable goals could serve as a substitute for shareholder consent if we assume that shareholders, in voting on the sale of their company, would not sacrifice maximum price for themselves in order to advance the interests of other corporate stakeholders, and if we also assume that shareholders, in voting on the sale of their company, will focus on immediate market values. Of course, it is possible that shareholders might be sufficiently altruistic—or sufficiently aware of the impact which

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322. *See supra* notes 20–21, 62–64 and accompanying text (discussing the roles of directors and shareholders).

323. *Revlon*, *MacMillan*, and *QVC* all involved challenges to significant lock-ups for the favored bidders. *See supra* notes 126, 159, 303 and accompanying text (noting protective devices used in those cases).

324. *Supra* notes 77–79 and accompanying text.

325. *See, e.g.*, John H. Matheson & Brent A. Olson, *Shareholder Rights and Legislative Wrongs: Toward Balanced Takeover Legislation,* 59 GEO. WASH. L. REV. 1425, 1505 (1991) ("The shareholders are in the best position to weigh the competing alternatives; given substantial, if not perfect, information from both sides, the shareholders' vote must be afforded great weight.").

the treatment of creditors, employees and the like might have on other companies in their stock portfolios[326]—that they would agree to transactions in which they did not receive top dollar at the expense of other constituencies. Alternately, it is possible that shareholders might be sufficiently heterogeneous in their valuations of potential combinations such that they would not rely on market valuations in choosing between bids.[327] In either case, *Revlon* would go beyond being a functional substitute for shareholder consent to the extent it limits the permissible goal for a corporate sale to the highest price for the shareholders.

Heightened judicial scrutiny of the wisdom of the directors' decision, potentially coupled with mandated processes directors must follow to establish that they obtained the best deal for the shareholders, might serve as a functional substitute for a shareholder vote in ensuring that the directors made a good deal. In this instance, judicial review places the court in the position of a super-shareholder whose judgment serves as a surrogate for an un-coerced shareholder vote.[328]

Of course, all this assumes that shareholder consent plays an important role in protecting shareholder interests. If instead shareholder approval is simply an unnecessary vestige hanging on from traditions transported into corporate law from partnership and contract law,[329] then it is unnecessary to create a functional substitute through judicial review. Alternately, if shareholder consent is seen as a value for its own sake, perhaps in the sense of providing democratic legitimacy to fundamental constitutional changes, then judicial review is not a functional substitute.

So far, the notion that *Revlon* provides a functional substitute for shareholder consent looks quite plausible. Things

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326. *See supra* note 296 and accompanying text (noting a possible reason why shareholders might consider the interests of other stakeholders).

327. *See, e.g.*, Lynn A. Stout, *Are Takeover Premiums Really Premiums? Market Price, Fair Value, and Corporate Law*, 99 YALE L.J. 1235, 1244–52 (1990) (arguing that because of heterogeneous expectations, shareholders often value their stock differently than the market price).

328. *See* Brehm v. Eisner, 746 A.2d 244, 266 (Del. 2000) (establishing liability merely because the court disagrees with what the directors did would inappropriately turn the court into a super-director).

329. *See supra* note 75 and accompanying text (noting the historic, contractual basis for requiring shareholder consent).

start to break down, however, when one compares the boundaries of the *Revlon* doctrine to the situations in which directors have circumvented requirements for shareholder consent to sales and combinations of corporations.

*Time* is all about directors circumventing the requirement for shareholder consent. The Time–Warner combination avoided a requirement under Delaware law for a vote by Time's shareholders by structuring the deal as a triangular merger of Warner with a Time subsidiary rather than a merger into Time itself.[330] Hence, the shareholder on the Time side who voted on the merger was Time, acting through a decision of its board, not its shareholders.[331] Under the original structure of the deal, however, stock exchange rules demanded a vote by Time shareholders because of the quantity of stock that Time would issue to the Warner shareholders in the merger.[332] Time's board triggered the lawsuit by changing the consideration given to the Warner shareholders from Time stock to cash and securities.[333] The motive for this was to remove the requirement under the stock exchange rules that Time's shareholders get to vote on the deal.[334] Yet, the Delaware courts held that depriving Time's shareholders of a vote did not trigger *Revlon*.[335] This is hardly consistent with the notion that the purpose of *Revlon* is to substitute heightened judicial scrutiny for shareholder consent.[336]

330. Paramount Commc'ns, Inc. v. Time, 571 A.2d 1140, 1145–46 (Del. 1989).

331. *Id.* at 1146.

332. *Id.*

333. *Id.* at 1148.

334. *See supra* note 151 and accompanying text (explaining that the deal no longer required approval by Time's shareholders).

335. *See Time*, 571 A.2d at 1151 (finding that the actions of Time's directors did not trigger *Revlon* duties).

336. One might argue that Delaware courts do not need to provide substitute protection for a shareholder vote when the requirement for a vote would not have come from Delaware law. Yet, the fact remains that Time's directors also used deal structure—a triangular merger—to avoid Delaware's requirement for a vote by Time's shareholders. While the original motivation for a triangular merger was not to preclude a vote by Time's shareholders, Time's directors presumably could have restructured the Warner transaction into a triangular merger if it had not started as such when, in response to Paramount's bid, they sought to preclude a vote by Time's shareholders on the Time–Warner combination.

Perhaps the notion is that *Revlon* should serve as a substitute for shareholder consent when directors may have coerced such consent by deal protection devices but not when directors have avoided the requirement for such consent altogether by the structure of the deal. If so, one must work hard to justify such a distinction. Moreover, the boundaries of *Revlon* are not co-terminus with situations in which there are deal protection devices with potentially coercive impact. Specifically, *Revlon* does not reach transactions having deal protection devices unless the transactions involve the break-up or dissolution of the target after an auction or in response to a hostile bid or else involve the sale of control as defined in *QVC*. Hence, the Delaware Supreme Court refused to apply *Revlon* in *Santa Fe Pacific* despite the fact that the merger agreement with the favored bidder included deal protection devices.[337]

Maybe this simply goes to show that the boundaries of *Revlon* need redesign. Specifically, under this analysis, the boundaries of *Revlon* should match the situations in which boards have avoided or coerced shareholder consent. Yet, this may simply worsen the problems the Delaware courts face in determining the borders of *Revlon*. A pragmatic argument in favor of the Delaware Supreme Court's rejection in *Hariton* of attempting through the de facto merger doctrine to create equivalent shareholder rights despite differences in deal structure is the inevitably difficult line drawing problems this would entail.[338] Determining the impact of deal protection devices on shareholder choice also can be challenging.[339] Ultimately, the only way to resolve this line drawing problem is to have a coherent theory for when shareholders should possess the right to an uncoerced vote on a transaction and when deal protection devices sufficiently constrain the shareholder vote so as to fatally undermine the vote's efficacy. If, however, there is such a

337. *In re* Santa Fe Pacific Corp. S'holder Litig., 669 A.2d 59, 64, 71 (Del. 1995). *See also supra* note 109 (citing a case in which the Delaware Supreme Court reviewed deal protection provisions under *Unocal* because the transaction did not come within *Revlon*).

338. *See, e.g.*, Manning, *supra* note 76, at 240–44 (discussing the difficulty of determining when investors should get the appraisal remedy).

339. *See supra* notes 81–88 and accompanying text (evaluating the effects of lock-ups).

coherent theory, the question will become why we need *Revlon*. Specifically, the substitute for shareholder consent rationale proposes a presumably second best solution without asking why one is settling for second best. Instead of establishing judicial review as a substitute for uncoerced shareholder consent, maybe the answer is to preserve uncoerced shareholder consent. If there is a coherent theory to provide guidelines for when the law should require shareholder consent then it would become relatively straightforward for the legislature or the courts to adopt rules preserving the requirement for shareholder consent despite differences in deal structure that do not, under the theory, justify avoiding such consent.[340] Similarly, if there is a point at which one can say that a deal protection device fatally interferes with the efficacy of a shareholder vote critical to protecting the shareholders' interest, a simple solution may be to ban such a deal protection device.[341]

### *2. The Final Period Incentives Rationale*

The alternate rationale for the *Revlon* doctrine returns to traditional fiduciary duty analysis. As discussed earlier, this analysis starts with courts granting deference to board decisions under the business judgment rule.[342] The justification for any greater level of scrutiny normally comes from concerns with conflicts of interest that might cause the directors to sacrifice corporate or shareholder interests to advance the interests of the directors themselves or of those with significant affiliations to the directors.[343] Fitting *Revlon* into this justification means finding some conflict of interest on the part of directors in situations covered by the doctrine.

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340. *See, e.g.*, CAL. CORP. CODE §§ 1200 et. seq. (2000) (creating parallel shareholder rights in a merger, asset sale, or stock purchase whenever the transaction equals a "reorganization").

341. *See supra* note 87 and accompanying text (discussing proposals to ban lock-ups that meet certain criteria).

342. *Supra* notes 35–39 and accompanying text.

343. *See supra* notes 40–44 and accompanying text (explaining the enhanced level of scrutiny applied in conflict-of-interest transactions).

*Revlon* itself involved favoritism for a white knight brought in to defeat a hostile tender offer.[344] As such, the court seemingly faced the positional conflict of interest present in takeover defenses. Still, this does not call for a new rule with increased scrutiny because the *Unocal* doctrine already provides added scrutiny of takeover defenses.

Actually, the white knight situation would generally seem to call for less, rather than more, scrutiny than otherwise applied under *Unocal*. This is because the white knight situation typically presents less positional conflict of interest than a situation in which the target corporation remains independent. After all, the positional conflict of interest arises from the normal desire of those in power to retain their power. A sale to a white knight presumably will lessen the power of the target's directors. The greatest reduction in the power of the target's directors, and accordingly the weakest positional conflict, occurs in a sale leading to the dissolution or bust-up of the target that would not leave a corporation for the target's directors to direct. Yet, this is the transaction that occurred in *Revlon*.[345] Even if the target corporation continues, and even if the white knight keeps the target's pre-acquisition directors on the target's board, they now answer to a single shareholder instead of enjoying the freedom made possible when stock is widely scattered among the rationally apathetic.[346] In fact, the worst positional conflict in the white knight situation occurs if the transaction entails a so-called merger of equals between public companies in which the target's directors end up on the board of a corporation without a controlling shareholder and so have lost little power at all. Yet, this is the situation least likely covered by *Revlon*.[347]

Perhaps the target's executives will continue to manage the company or a significant operational component after the white knight purchases control. Even so, this would still seem to present less of a conflict of interest than a decision to remain

344. Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 184 (Del. 1986).

345. *See id.* at 178 (describing the bust-up transaction proposed in *Revlon*).

346. *See, e.g.*, GEVURTZ, *supra* note 44, at 232 (discussing rational apathy of shareholders in a public corporation).

347. *See supra* notes 163–66 and accompanying text (comparing *Time* and *QVC*).

independent. This is because *Revlon* involves a challenge to a decision by the board and not by the executives.[348] Of course, some executives may also be directors. More broadly, a realistic assessment of board dynamics commonly shows the influence possessed by executives, and especially the CEO, over outside directors.[349] Still, belief in the ability of nominally disinterested directors to protect the corporation from executive conflicts reigns as a central tenet of corporate law. This is evidenced by section 144 of Delaware's corporation law, which allows the vote of disinterested directors to cure conflicts of interest by directors or officers.[350] Indeed, the most dramatic conflict-of-interest transaction involving corporate executives, the setting of their compensation, generally falls within the business judgment rule by virtue of disinterested director approval.[351] In any event, even if one viewed the target's board to be the supine tool of the target's executives or such executives are on the board, and even if some of those executives maintain executive positions after the white knight takes over, this would still not change the basic calculation that the positional conflict of interest is weaker with a white knight than with takeover defenses that would keep the target independent. After all, despite keeping their executive positions, the target's executives have gone from a situation in which, by hypothesis, they were on or able to control the board ostensibly supervising them, to a situation in which the presumably more independently minded managers of the white knight now have ultimate control.

Of course, if corporate directors or executives take a significant financial stake in the white knight purchaser (as in an

348. *See supra* notes 126–28, 157–60, 303–04 and accompanying text (discussing the challenged board decisions in *Revlon*, *QVC*, and *MacMillan*).

349. *See, e.g.*, Jeffrey N. Gordon, *What Enron Means for the Management and Control of the Modern Business Corporation: Some Initial Reflections*, 69 U. CHI. L. REV. 1233, 1241–42 (2002) (stating that Enron's board was "a splendid board on paper" and its failure "reveal[s] a certain weakness with the board as a governance mechanism"); Rita Komik, *Greenmail: A Study of Board Performance in Corporate Governance*, 32 ADMIN. SCI. Q. 163, 166–67 (1987) (describing a modern board as a "co-opted appendage institution").

350. DEL. CODE ANN. tit. 8, § 144(a)(1) (2011).

351. *See, e.g.*, Michelson v. Duncan, 407 A.2d 211, 225 (Del. 1979) (applying the business judgment rule to executive compensation because of disinterested director approval).

MBO), then the conflict of interest in the transaction rises above being simply a positional conflict of interest of directors seeking to keep their control. Now, however, we are back to the protections already accorded the corporation from conflict-of-interest transactions with firms in which their directors or officers have a material financial interest. As discussed above when addressing *MacMillan*,[352] these protections can deal with managerial overreach in MBO transactions without the need to invoke *Revlon*.

Even so, many scholars attempt to justify *Revlon* as necessary to deal with side deals the target firm's management might make with a bidder under which the target's directors will favor the bidder in exchange for future employment or the like.[353] The simple answer, however, is to recognize the conflict of interest such side deals can create and invoke the higher scrutiny required of conflict-of-interest transactions.[354] By contrast, attempting to address the problem of side deals by invoking the *Revlon* doctrine is both under-inclusive insofar as *Revlon* does not apply to the host of corporate sales in which there could be a side deal and over-inclusive insofar as *Revlon* subjects sales in which there is no side deal to heightened scrutiny.[355]

The question thus becomes whether there is some conflict of interest inherent in *Revlon* situations that is not otherwise addressed either by normal duty of loyalty analysis or by *Unocal*. Academic commentary,[356] joined by some Chancery Court opinions,[357] asserts that the final period incentives problem

352. *Supra* notes 303–08 and accompanying text.

353. *See* Bainbridge, *supra* note 8, at 35 (explaining concerns about side deals).

354. *See, e.g.*, Smith v. Good Music Station, Inc., 129 A.2d 242, 246–47 (Del. Ch. 1957) (stating that simultaneous negotiation of sale of business and employment contracts for board members triggers heightened judicial scrutiny).

355. Federal securities law reporting requirements would seem to limit the concern that such side deals will remain secret. *See, e.g.*, Fraidin & Hanson, *supra* note 84, at 1786 (noting that substantial disclosure requirements during an acquisition make it unlikely that board members could receive side payments in secret).

356. *See, e.g.*, Sean J. Griffith, *Deal Protection Provisions in the Last Period of Play*, 71 FORDHAM L. REV. 1899, 1947 (2003) (describing the final period incentives problem as a "structural dilemma in corporate law").

357. *See, e.g.*, Reis v. Hazelett Strip-Casting Corp., 28 A.3d 442, 458–59 (Del. Ch. 2011) (explaining why final stage transactions warrant enhanced scrutiny).

presents such a conflict of interest. The final period incentives rationale begins with the observation that directors and executives face a variety of constraints on engaging in poor behavior (disloyal or careless conduct) or, put more positively, have a variety of incentives for doing a good job. For example, poor performance by directors and executives might hurt the corporation in product markets and markets for capital, which, in turn, can impact compensation and job security of corporate managers, while good corporate performance in product and capital markets can yield increased compensation and job security.[358] Good reputation resulting from good performance might also impact executives and directors as they compete for advancement in labor markets both internal and external to the corporation, while poor performance will have the opposite effect.[359] Dissatisfaction by those holding the ultimate power to dismiss executives (more senior executives and directors) or directors (the shareholders) impacts job security, creating an incentive to keep more senior executives, directors, and shareholders happy.[360]

Many of these constraints and incentives lose their force if directors or executives learn that the corporation will cease operations or that new owners plan to terminate existing directors or executives. So, if directors and executives learn that the corporation will terminate operations, their concern with maintaining the corporation's competitive position in product and capital markets ceases to be a motivating factor. Alternately, if directors and executives learn that new owners plan their removal—even though continuing corporate operations—the directors and executives will no longer worry about maintaining job security or seeking advancement within this corporation. This, in turn, creates the argument that sales leading to the bust-

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358. *See, e.g.*, David M. Phillips, *Principles of Corporate Governance: A Critique of Part IV*, 52 GEO. WASH. L. REV. 653, 681–82 (1984) (discussing the effect the success in a product market can have on corporate performance).

359. *See, e.g.*, Michael P. Dooley & E. Norman Veasey, *The Role of the Board in Derivative Litigation: Delaware Law and the Current ALI Proposals Compared,* 44 BUS. LAW. 503, 526 (1989) (arguing that market forces discipline executives).

360. *But see, e.g.*, Eisenberg, *supra* note 48, at 1496 (arguing the impact is weak at the most senior level).

up or dissolution of the corporation or to a change in control over the corporation (*Revlon* situations) produce a final period between the time it becomes obvious that corporate operations will terminate or directors and executives will lose their positions and the actual termination or removal.[361] During this time, directors and executives have less incentive toward good performance.

This final period rationale is different in a fundamental way from the conflict-of-interest concerns that traditionally lead to increased scrutiny of board decisions. With conflicts of interest, directors face incentives that affirmatively encourage them to act in ways contrary to the corporation's or the shareholders' interests. So, in a transaction between a director and the corporation in which he or she is a director, the director has an incentive to give him or herself a better deal than the corporation receives. Less extreme, but still similar, the normal human desire to retain power, not to mention whatever compensation or perquisites go with the position, give directors an incentive to oppose hostile tender offers that might be in the corporation's or shareholders' interest. By contrast, the final period argument, in itself, does not posit any incentive that affirmatively encourages directors to sacrifice corporate or shareholder interests. Rather, the argument is that the directors will not have as much incentive as they normally do to make the right decision for the corporation and its shareholders. In other words, the concern is not with bad incentives but with less good incentives.

This distinction, in turn, suggests the need for great caution before applying heightened scrutiny merely because the situation involves a final period problem. Corporate law already faces a difficult challenge when dealing with conflicts of interest in which directors have affirmative incentives to sacrifice corporate or shareholder welfare in favor of personal ends. This is because the bipolar approach—great deference under the business judgment rule versus intense scrutiny under the fairness test—fits awkwardly when matched against the reality that directors commonly face a host of subtle conflicts of various degrees that may affirmatively encourage them to sacrifice corporate or

361. *See, e.g.*, Griffith, *supra* note 356, at 1945–47 (arguing that during this period, directors and executives are less likely to identify the old company as "theirs," and therefore may be less likely to act in the old company's interest).

shareholder interests.[362] On rare occasions, *Unocal* being one, courts have responded to this reality by creating intermediate levels of review.[363] By and large, however, courts have eschewed such an approach. The reason is simple: such an approach would create an extraordinarily difficult level of complexity in application.[364]

This complexity would increase exponentially if, in addition to applying new levels of scrutiny when presented with all the sort of conflicts that affirmatively entice directors to disregard corporate or shareholder interests, courts also applied different levels of scrutiny to situations in which there are reduced incentives encouraging directors to advance corporate and shareholder interests. This is because there are a host of situations beyond the final period problem associated with the sale of a corporation in which directors may have reduced incentives toward optimal performance.

To begin with, the final period situation involving the sale of a corporation is not the only final period situation, and, indeed, may not even be the most important final period situation. The inevitability of aging presents each director and executive with his or her own final period situation. The impact of Van Gorkom's impending retirement on the events in the *Van Gorkom* case provides an example of this.[365] By contrast, directors or executives in mid-career may have plenty of incentive to do a good job in order to preserve their reputation and position in the

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362. *See, e.g.*, *In re* RJR Nabisco S'holders Litig., CIV. A. No. 10389, 1989 WL 7036, at *1159 (Del. Ch. Jan. 31, 1989) ("Greed is not the only human emotion that can pull one from the path of propriety; so might hatred, lust, envy, revenge, or, as is here alleged, shame or pride. Indeed any human emotion may cause a director to place his own interests, preferences or appetites before the welfare of the corporation.").

363. *See supra* notes 59–61 and accompanying text (explaining the *Unocal* test).

364. *See, e.g.*, Johnson v. Trueblood, 629 F.2d 287, 292–93 (3d Cir. 1980) (stating that the business judgment rule is based on the recognition that all director decisions involve some personal interest but it would be impractical to take this into account).

365. Van Gorkom's approaching retirement seems to have motivated him to seek a quick sale—which would provide him a healthy nest egg—rather than worrying about getting the top dollar. *See, e.g.*, Griffith, *supra* note 356, at 1955–56 (noting that Van Gorkom's retirement could have played a role in his actions).

managerial labor market even if they will never face another election by the target's shareholders or review by seniors within the target corporation.[366] Beyond this, compensation schemes and stock ownership create different degrees of incentive toward good performance.[367] Does this mean courts should apply a higher degree of scrutiny to a board decision if the directors do not own much stock in their corporation or do not receive compensation dependent upon corporate performance and so may have limited financial incentives for making good decisions? How about directors of nonprofit corporations who may not receive any compensation?[368] Should their decisions be subjected to stricter scrutiny because of less financial incentive to do a good job? As suggested by this last example, outside directors on a corporate board can have complex motives for being directors[369] and, in turn, for performance. An outside director who is highly accomplished in his or her primary position might have far less incentive for good performance than a director for which this board position creates greater impacts on career prospects and satisfaction. Should courts apply higher scrutiny to boards with larger numbers of more accomplished directors?

Perhaps one might attempt to distinguish these other reduced incentive situations from the final period problem arising with the sale of the company by arguing that the problem here is a combination of less good incentives with more bad incentives. Specifically, when selling the corporation, the combination of a final period situation with the former owners and an anticipated relationship with the new owner(s) can give managers an

366. *See generally* Dooley & Veasey, *supra* note 359.

367. *See, e.g.*, Daniel R. Fischel & Michael Bradley, *The Role of Liability Rules and the Derivative Suit in Corporate Law: A Theoretical and Empirical Analysis* 71 CORNELL L. REV. 261, 276 (1986) (noting that compensation schemes that include stock compensation can align managerial interests with those of the investors).

368. *See, e.g.*, Thomas L. Hazen & Lisa L. Hazen, *Punctilios and Nonprofit Corporate Governance - A Comprehensive Look at Nonprofit Directors' Fiduciary Duties*, 14 U. PA. J. BUS. L. 347, 364 (2012) (pointing out that directors of nonprofit corporations are often not paid).

369. *See, e.g.*, Susan S. Boran, et al., *Why They Still Do It: Directors Motivations for Joining a Board*, POINT OF VIEW 3 (Dec. 2010), http://content.spencerstuart.com/sswebsite/pdf/lib/wtsd_pov10.pdf (considering why directors join boards).

incentive to favor prematurely the interest of the expected new owner(s) over the interest of the departing owners in negotiating the sale. Indeed, this might suggest a different sort of rationale for the distinction drawn in *Time* and *QVC* between sales leaving control in the market and sales to controlling individuals. One might argue that so long as control remains in the market, managers have an incentive to avoid developing a reputation for being willing to sell out the set of public investors to which they had a duty at the time because the public investors after the transaction will not trust such managers not to do the same to them in the future. On the other hand, the same thinking could be true even when the new controlling owner is an individual. Managers might think twice before beginning their relationship with their new boss with actions that will give their new boss grounds to suspect their future trustworthiness.[370] Moreover, while this shifting loyalties rationale might explain *Revlon* in sale of control situations, it does not fit break-up or dissolution of the corporation situations in which managers will not retain their positions. In any event, this seems to bring us back to the previous discussion of white knights and side deals and how existing doctrines can address this without *Revlon*.

Beyond all this, the final period argument is entirely upside down. To the extent that it often focuses on executives rather than directors, it is, as pointed out above,[371] looking at the wrong people: *Revlon* involves challenges to decisions by the board. Focusing on the board, what exactly is the constraint on the board's conduct that the final period removes? The answer is that the directors will no longer face the need to go before the target's shareholders for reelection; in political parlance, they are lame ducks. Of course, given how infrequently directors of publicly traded companies are deposed in an election,[372] one must question how much of a constraint actually arises from the need to keep the shareholder electorate happy. The more realistic threat for a

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370. *See, e.g.*, Fraidin & Hanson, *supra* note 84, at 1811 (noting that the buyer may perceive target management as a liability if it acts disloyally to the former shareholders).

371. *Supra* notes 96–99 and accompanying text.

372. *See, e.g.*, Lucian A. Bebchuk, *The Myth of the Shareholder Franchise*, 93 VA. L. REV. 675, 682–83 (2007) (reporting the small number of contested proxy solicitations).

poorly performing board typically lies in removal through a hostile tender offer.[373] This suggests that the final period problem is something of a mirror to the positional conflict of interest that directors face in responding to a hostile tender offer.

Yet, the incentive problem in a final period situation is only a pale reflection of the incentive at work in the hostile takeover situation. In the final period situation, the directors lose the incentive for good performance that arose before the final period from the abstract concern that at some future time a sufficiently poor level of corporate performance might lead to a threat to their continued control. By contrast, when facing a hostile tender offer, the directors confront the immediate and real prospect of being dethroned. One does not need an exhaustive search into the literature on psychology to recognize that people will react much more to the immediate and concrete than to the abstract and future.[374] What this means is that efforts to remain independent in the face of an impending hostile takeover always present a greater danger of directors acting contrary to shareholder interests than the final period problem creates by rendering irrelevant concerns of more distant threat to one's position.[375] Hence, the notion that the final period situation justifies greater scrutiny under the *Revlon* doctrine than the threat of a hostile takeover calls for under *Unocal* is wrong.

373. *See, e.g.*, Manne, *supra* note 30, at 115–17 (suggesting that tender offers are more likely than proxy contests to remove directors).

374. *See, e.g.*, Ahmad R. Hariri et al., *Preference for Immediate Over Delayed Rewards Is Associated with Magnitude of Ventral Striatal Activity*, 26 J. NEUROSCIENCE 13213, 13123 (Dec. 20, 2006) ("People naturally favor . . . rewards received sooner rather than later . . . .").

375. Admittedly, a final period situation presents an immediate and concrete reality just like a takeover threat. Unlike the takeover situation, however, the incentive problem in the final period situation does not gain its strength from the need to address a new concrete threat. Rather, the problem stems from the removal of incentives that existed before the final period situation. Hence, the impact cannot be any stronger than the incentives for good behavior that existed before the final period: the incentives that involved an abstract and distant threat.

## *VI. Conclusion*

In the end, the *Revlon* doctrine has been an expensive distraction, consuming countless billable hours and valuable judicial time arguing over whether the doctrine applies—most recently in the continuing controversy over whether cash bids by public companies trigger *Revlon*.[376] Such arguments seem more suited to medieval monks than to corporate attorneys and a sophisticated judiciary, given that no one is really sure what the doctrine does anyway and no one has put forth a persuasive rationale for having the doctrine. It is time to remove *Revlon* from the face of corporate law.

376. *See supra* notes 172–94 and accompanying text (discussing the issue of how *Revlon* is triggered).