UNIFYING THE LAW OF HOSTILE TAKEOVERS: BRIDGING THE UNOCAL/REVLON GAP

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INTRODUCTION

If a takeover bidder makes an offer that a target company's board of directors decides to oppose, there are a wide variety of devices that the board can employ to resist the bidder. These defensive tactics include shark repellent amendments, lock-up options, greenmail, poison pills, self-tender offers, target litigation, and dual class stock plans.[1] The success or failure of the bid often hinges on litigation challenging the legitimacy of these tactics.

There is currently a wide gap in takeover defense law. If directors take defensive action to maintain the target company's independence, *Unocal Corp. v. Mesa Petroleum Co.*[2] supplies the standard for judicial review. *Unocal* and its progeny grant the board wide latitude in defending against hostile bids. Under the *Unocal* standard, the board may preclude hostile offers without demonstrating that maintaining the independence of the target company is a more valuable course than accepting the bid.[3] *Unocal* also allows the board to consider the interests of nonshareholder constituencies in responding to a takeover bid.[4]

Once the target company's board decides to sell the company, *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*[5] governs judicial review of defensive tactics. Under *Revlon*, the board's duties change dramatically. The board must prove that any defensive action is reasonably designed to enhance immediate shareholder value. The board is no longer able to consider the interests of nonshareholder constituencies.[6]

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1. *See* William J. Carney, *Controlling Management Opportunism in the Market for Corporate Control: An Agency Cost Model*, 1988 WIS. L. REV. 385, 392–402.
2. 493 A.2d 946 (Del. 1985).
3. *See infra* part I.A.1–2.
4. *See infra* part I.A.3.
5. 506 A.2d 173 (Del. 1986).
6. *See infra* part I.B.1.

Not surprisingly, much recent litigation focuses on whether particular defensive actions trigger the board's enhanced *Revlon* duties. A conscious decision to sell the entire company triggers these duties. Beyond this easy case, the precedents are inconclusive. Although some cases suggest that the sale of a controlling interest triggers *Revlon*, the Delaware Supreme Court has recently cast a cloud over this theory.[7] The courts have generally rejected the argument that substantial restructurings trigger *Revlon* but have not provided persuasive reasons for this result.[8] Part I of this Article surveys the legal background in the takeover defense area and analyzes *Unocal*, *Revlon*, and their progeny.

The inability of the courts to articulate cogently when and why enhanced *Revlon* duties apply suggests that the distinction between directors' duties prior and subsequent to the time of a sale decision is without foundation. This Article argues that any distinction in the duties of target company directors should be eliminated. It argues that the current gap in takeover law exists because, in certain respects, *Unocal* is too lenient and *Revlon* is too strict.

Part II of this Article considers the board's duties when preserving the target company's independence is the board's goal. It argues that, to the extent the board is relying on shareholder interests to justify defensive action, *Unocal* should be construed to require the board to prove that it has reasonable grounds to believe that the target company is worth more as a going concern than the pending bid. Currently, the board is able to escape comparing the target company's going concern value to the bid on three theories: (a) the board is entitled to preserve the corporate enterprise; (b) the going concern value of the company cannot be compared to the sale value because only the latter includes a control premium; and (c) the going concern value of the company cannot be compared to the sale value because short- and long-term values are not comparable. Part II argues that the target company's board has no duty to the enterprise itself and that a company's going concern and sale values are directly comparable.

Part III of this Article considers the role of nonshareholder constituencies in the board's decision-making process. It surveys general corporate law on the role of nonshareholder constituencies and concludes that, in the every-day operation of a business, directors are empowered to consider the interests of nonshareholder constituencies as long as any negative impact on shareholders is not excessive. Part III concludes that there is no reason to treat nonshareholder constituencies differently in the takeover context. It argues that *Unocal* correctly allows the target company's board to consider the interests of nonshareholders but places insufficient limits on this power. It also argues that *Revlon* is too strict to the extent it prevents directors from considering the interests of nonshareholder constituencies in the sale context.

In sum, this Article argues that *Unocal* and *Revlon* should be harmonized and that a single standard should govern all takeover defense litigation. In all contexts, the target company's board should have to prove that any defensive action is reasonably related to maximizing shareholder value. In all contexts, the board should be allowed to consider the interests of nonshareholder constituencies but should have to demonstrate that any diminution in shareholder value is not excessive.

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7. *See infra* part I.B.2.a.
8. *See infra* part I.B.2.b.

I. THE LEGAL BACKGROUND

A. *The Board's Duties Prior to the Time of Sale*

When preserving the target company's independence is the board's goal, the legitimacy of takeover defense is governed by the Delaware Supreme Court's seminal decision in *Unocal Corp. v. Mesa Petroleum Co.*[9] To have defensive tactics upheld under *Unocal,* the target company's board must prove that it had "reasonable grounds for believing that a danger to corporate policy and effectiveness existed" and that such tactics were "reasonable in relation to the threat posed."[10] The following sections examine the application of the *Unocal* test.

1. Threats to Shareholder Value

The Delaware Supreme Court has viewed inadequacy of the bid price as a threat warranting the adoption of defensive tactics[11] and has been accommodating in accepting proof of inadequacy. In three major cases, the Delaware

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9. 493 A.2d 946 (Del. 1985). Other states usually follow Delaware on takeover defense questions. *See, e.g.,* Dynamics Corp. of Am. v. CTS Corp., 794 F.2d 250, 253 (7th Cir. 1986) (noting that "Indiana takes its cues in matters of corporation law from the Delaware courts"), *rev'd on other grounds,* 481 U.S. 69 (1987); Amanda Acquisition Corp. v. Universal Foods Corp., 708 F. Supp. 984, 1009 (E.D. Wis. 1989) (predicting that "a Wisconsin court would apply the *Unocal* standard for reviewing a board's actions in connection with a hostile takeover offer"), *aff'd on other grounds,* 877 F.2d 496 (7th Cir.), *cert. denied,* 493 U.S. 955 (1989); Jeffrey N. Gordon, *Corporations, Markets, and Courts,* 91 COLUM. L. REV. 1931, 1969 (1991) (noting that "the Delaware Supreme Court remains the national supreme court on corporate law").

10. *Unocal,* 493 A.2d at 955. Prior to *Unocal,* courts applied two tests to determine the legitimacy of takeover defenses. Some courts applied the traditional business judgment rule to takeover defense questions. *See, e.g.,* Panter v. Marshall Field & Co., 646 F.2d 271, 293–94 (7th Cir.), *cert. denied,* 454 U.S. 1092 (1981). Other courts required the target company's board to prove that it had a legitimate primary purpose in adopting defensive tactics. *See* Cheff v. Mathes, 199 A.2d 548, 554 (Del. 1964); Bennett v. Propp, 187 A.2d 405, 408 (Del. 1962). Under the business judgment rule, the board prevails whenever it can articulate a rational, unselfish business purpose for its actions. *E.g.,* Sinclair Oil Corp. v. Levien, 280 A.2d 717, 720 (Del. 1971). In practice, the primary purpose test proved indistinguishable from the business judgment rule. *See* Ronald J. Gilson, *A Structural Approach to Corporations: The Case Against Defensive Tactics in Tender Offers,* 33 STAN. L. REV. 819, 829 (1981). As a consequence, pre-*Unocal* judicial review of defensive tactics was heavily weighted in the board's favor. *See* AC Acquisitions Corp. v. Anderson, Clayton & Co., 519 A.2d 103, 111 (Del. Ch. 1986) (noting that application of the business judgment rule is usually outcome-determinative). *Unocal*'s new test provided the courts with an opportunity for enhanced judicial scrutiny of takeover defense decisions. Ronald J. Gilson & Reinier Kraakman, *Delaware's Intermediate Standard for Defensive Tactics: Is There Substance to Proportionality Review?,* 44 BUS. LAW. 247, 249–51 (1989).

11. Ivanhoe Partners v. Newmont Mining Corp., 535 A.2d 1334, 1342 (Del. 1987); Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 180 (Del. 1986); *Unocal,* 493 A.2d at 956; *see also* Nomad Acquisition Corp. v. Damon Corp., No. CIV.A.10173, 10189, 1988 WL 383667, at *5 (Del. Ch. Sept. 16, 1988) (noting that "[u]nder Delaware law, the Board has both the duty and responsibility to oppose inadequate offers"). The Delaware Supreme Court has squarely rejected the view of the efficient market proponents and held that there is no reason to assume that the market price captures the intrinsic value of the target company or that a premium takeover bid is value-enhancing. Paramount Communications, Inc. v. Time Inc., 571 A.2d 1140, 1150 n.12 (Del. 1990); *Unocal,* 493 A.2d at 955 n.10; Smith v. Van Gorkom, 488 A.2d 858, 875–78 (Del. 1985). I have argued in support of this aspect of the Delaware Supreme Court's takeover jurisprudence. Robert A. Ragazzo, *The Legitimacy of Takeover Defense in the '90s,* 41 DEPAUL L. REV. 689, 710–17 (1992).

Supreme Court has sustained a board's inadequacy determination based on an investment banker's opinion that the target company's liquidation value was higher than the bid price.

In *Unocal* itself, the court approved a finding that a $54 bid was inadequate based on an investment banker's opinion that Unocal was worth at least $60 per share on a liquidation basis.[12] Similarly, in *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*,[13] the court approved a finding that a $47.50 bid was "grossly inadequate" based on an investment banker's opinion that Revlon as a whole could be sold for about $55 per share and that Revlon's divisions could be sold piecemeal for between $60 and $70 per share.[14] Finally, in *Ivanhoe Partners v. Newmont Mining Corp.*,[15] the court approved a finding that a $105 bid was inadequate based on an investment banker's study concluding that, at the $105 bid price, the bidder would acquire Newmont's gold subsidiaries at a substantial discount.[16]

Unocal, Revlon, and *Newmont* are troubling because the court compared the target company's liquidation value to the bid price even though the target company's board was not considering liquidation in any of these cases.[17] Because the board desired to continue the business of the target company rather than accept the bid, the company's going concern value, rather than its liquidation value, was the appropriate benchmark for comparison.[18]

Applying *Unocal*'s second prong, the Delaware Supreme Court has also been generous in finding that defensive measures were proportional responses to the threat of inadequacy.[19] It has allowed the target company's board simply

12. *Unocal,* 493 A.2d at 950, 956; *see also* Newell Co. v Vermont Am. Corp., 725 F. Supp. 351, 358, 372 (N.D. Ill. 1989) (upholding a board's rejection of a bid that was inadequate as compared to the company's sale value); Gelco Corp. v. Coniston Partners, 652 F. Supp. 829, 846 (D. Minn. 1986) (upholding a restructuring whose value was concededly lower than a pending bid), *vacated,* 811 F.2d 414 (8th Cir. 1987).

13. 506 A.2d 173 (Del. 1986).

14. *Id.* at 177, 181.

15. 535 A.2d 1334 (Del. 1987).

16. *Id.* at 1339 n.12, 1342. The target company's board was probably on solid ground in arguing that its gold assets were undervalued. Natural resource companies are attractive takeover targets because they tend to trade at prices discounted from the direct sale values of their underlying mineral assets. *See* Lucian A. Bebchuk, *The Case for Facilitating Competing Tender Offers,* 95 HARV. L. REV. 1028, 1032 (1982); Reinier Kraakman, *Taking Discounts Seriously: The Implications of "Discounted" Share Prices as an Acquisition Motive,* 88 COLUM. L. REV. 891, 906–07 (1988).

17. *See* Dale A. Oesterle, *The Negotiation Model of Tender Offer Defenses and the Delaware Supreme Court,* 72 CORNELL L. REV. 117, 145 (1986) (criticizing the *Unocal* court for basing its inadequacy determination on the target company's liquidation value). Unocal adopted an exclusionary self-tender offer that was designed to preclude the existing bid and preserve the company as a going concern. *See Unocal,* 493 A.2d at 951. Although the Revlon board ultimately decided to sell the company, it was not considering liquidation at the time it adopted the defensive tactics approved by the court on the basis of inadequacy. *See Revlon,* 506 A.2d at 176–77. Although Newmont engaged in a substantial restructuring that involved selling significant assets to finance a large dividend, the company sold only its nongold subsidiaries. *See Newmont,* 535 A.2d at 1339.

18. *See infra* part II.B.

19. The Delaware Supreme Court has rejected a suggestion flowing from several chancery court cases, *see* Grand Metro. Pub. Ltd. v. Pillsbury Co., 558 A.2d 1049, 1058–60 (Del. Ch. 1988); City Capital Associates v. Interco, Inc., 551 A.2d 787, 798 (Del. Ch. 1988); Robert M. Bass Group, Inc. v. Evans, 552 A.2d 1227, 1242 (Del. Ch. 1988); AC Acquisitions Corp. v. Anderson, Clayton & Co. 519 A.2d 103, 112–16 (Del. Ch. 1986), that the only legitimate board response to noncoercive inadequate offers is to provide shareholders with

to preclude inadequate offers.[20] It has not required the board to negotiate with the bidder or to conduct an auction of the company to ascertain if an adequate bid can be elicited.[21] Since the board is allowed to preclude inadequate offers

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alternatives. *See* Paramount Communications, Inc. v. Time Inc., 571 A.2d 1140, 1153 (Del. 1989). I have argued that the supreme court was correct to reject the chancery court's shareholder choice model. Ragazzo, *supra* note 11, at 718–31.

20. In *Newmont,* the Delaware Supreme Court approved a restructuring plan that limited a 49% shareholder, and any prospective purchaser of that shareholder's stock, to 40% of Newmont's board seats. *See Newmont,* 535 A.2d at 1340, 1345–46. Because it is hard to imagine any purchaser accepting this limitation, the Newmont board's restructuring plan essentially precluded all offers, including adequate offers. *See* Portia Policastro, Note, *When Delaware Corporate Managers Turn Auctioneers: Triggering the* Revlon *Duty After the* Paramount *Decision,* 16 DEL. J. CORP. L. 187, 211 (1991).

By contrast, in *Unocal* and *Revlon* the Delaware Supreme Court approved defensive tactics that were proportional responses to the inadequate bids in those cases if one accepts that the investment bankers' opinions regarding the target companies' liquidation values were appropriate indicators of inadequacy. In *Unocal,* Unocal offered to purchase its own stock for $72 per share from all stockholders other than Mesa in the event the first stage of Mesa's $54 offer succeeded. *See Unocal,* 493 A.2d at 951. Assuming that Mesa purchased half of Unocal for $54 per share and then was required to pay $72 per share to purchase the remaining half, Mesa would have been willing to proceed if it valued Unocal at $63 per share or more. Since the board's investment banker opined that the company was worth "in excess of $60 per share" on a liquidation basis, *id.* at 950, it was not unreasonable for the board to preclude offers by Mesa below $63 per share if the liquidation value was accurate and relevant.

In *Revlon,* the Delaware Supreme Court noted its approval of a back-end rights plan that allowed each Revlon shareholder to exchange one common share for a Revlon note valued at $65 after any entity acquired 20% or more of Revlon's shares. *See Revlon,* 506 A.2d at 177. In this case, the board's investment banker opined that, if the company's divisions were sold piecemeal, Revlon was worth between $60 and $70 per share. *Id.* As a consequence, the back-end rights simply guaranteed each nontendering shareholder no more than an adequate price if one accepts liquidation value as the appropriate indicator of adequacy. *See* Dynamics Corp. of Am. v. CTS Corp., 805 F.2d 705, 713–16 (7th Cir. 1986) (holding that a $50 back-end rights plan is not justified unless the target company is worth $50 per share); Buckhorn, Inc. v. Ropak Corp., 656 F. Supp. 209, 229–31 (S.D. Ohio) (invalidating a back-end rights plan because the board could not justify the back-end price), *aff'd,* 815 F.2d 76 (6th Cir. 1987); *see also* Dynamics Corp. of Am. v. CTS Corp., 794 F.2d 250, 259 (7th Cir. 1986) (invalidating a flip-in poison pill rights plan that the court viewed as "preclud[ing] a hostile takeover"), *rev'd on other grounds,* 481 U.S. 69 (1987); Air Line Pilots Ass'n, Int'l v. UAL Corp., 717 F. Supp. 575, 587–88 (N.D. Ill. 1989) (invalidating change of control provisions in a labor contract because they were "irredeemable, and, thus, fatal to any transaction to which they may apply, regardless of how attractive an offer may be"), *aff'd,* 897 F.2d 1394 (7th Cir. 1990).

21. *See Paramount,* 571 A.2d at 1152; Mills Acquisition Co. v. Macmillan, Inc., 559 A.2d 1261, 1285 n.35 (Del. 1988); *Newmont,* 535 A.2d at 1344–45; Chrysogelos v. London, No. CIV.A.11910, 1992 WL 58516, at *6 (Del. Ch. Mar. 25, 1992); Lewis v. Honeywell Inc., [1987–1988 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 93,565, at 97,534 (Del. Ch. July 28, 1987); *see also* Amanda Acquisition Corp. v. Universal Foods Corp., 708 F. Supp. 984, 1013 (E.D. Wis.), *aff'd on other grounds,* 877 F.2d 496 (7th Cir.), *cert. denied,* 493 U.S. 955 (1989); Torchmark Corp. v. Bixby, 708 F. Supp. 1070, 1082 (W.D. Mo. 1988); Desert Partners, L.P. v. USG Corp., 686 F. Supp. 1289, 1299–1300 (N.D. Ill. 1988) (holding that, where the target company was not for sale, the board had no duty to negotiate with the bidder or identify a range of adequate sale values); MAI Basic Four, Inc. v. Prime Computer, Inc. [1988–1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,179, at 91,634–35 (Del. Ch. Dec. 20, 1988) (upholding use of a poison pill rights plan to preclude an offer despite the fact that the target company's board had not determined the value of an adequate bid). Although there is no duty to negotiate with a bidder, some courts have required the equivalent on the theory that the target company's board is required to investigate the bidder's offer in fulfillment of its duty of care. *See In re* Desoto, Inc., Shareholder Litig., [1989–1990 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,964, at 95,397–8 (Del. Ch. Feb. 5, 1990); *Robert M. Bass Group, Inc.,* 552 A.2d at 1240; *see also UAL,* 717 F. Supp. at 587 (holding that a supposedly inadequate offer was not a threat because the offer was "open to negotiation"); *Interco,* 551 A.2d at 803 n.21

without making any effort to procure an adequate offer, one may question what is left of *Unocal's* requirement that defensive tactics be proportional responses to the threat of inadequacy.[22]

2. Threats to the Board's Business Plan

In *Paramount Communications, Inc. v. Time Inc.*,[23] the Delaware Supreme Court went further than its prior cases and held that a target company's board does not have to make any financial comparisons to justify defensive action. In that case, Time and Warner announced a merger agreement after many years of planning.[24] Prior to Paramount's offer, Time's stock traded as high as $126 per share.[25] Paramount ultimately offered to purchase Time for $200 per share.[26] The Time board found the $200 offer to be inadequate, rejected it, and proposed a tender offer for Warner to consummate its merger plans.[27]

Time's board advanced two grounds for finding the $200 offer inadequate. First, the board's investment bankers opined that Time could be auctioned for more than $200 per share.[28] Second, the board's advisors believed that, although Time's stock would only trade at $150 after the merger with Warner, it would trade between $208 and $402 within four years of the merger.[29] Based on *Unocal*, *Revlon*, and *Newmont*, Time's board was on solid ground in arguing that it could compare the auction value of Time to Paramount's bid even though it had no intention of auctioning the company. In addition, although the gap in the predicted four-year, post-merger trading value is suspiciously large, Time's board at least presented some evidence that its chosen alternative to the pending bid was more valuable than the bid. Although the Delaware Supreme Court could easily have accepted the Time board's proof of inadequacy, the court rejected the view that Time's board was required to

(noting that the board's "duty to shareholders may not permit the board to simply ignore the offeror").

22. *See* Gilson & Kraakman, *supra* note 10, at 252. In addition to threats to shareholder value, the Delaware Supreme Court has recognized that threats to shareholder choice warrant the adoption of defensive devices. *See* Moran v. Household Int'l, Inc., 500 A.2d 1346, 1357 (Del. 1985). It should be noted that *Newmont* and *Unocal* involved partial offers whose structure pressured shareholders to tender. As a consequence, the defensive devices in those cases were not adopted solely in response to the threat of inadequacy. However, the court in both cases presented inadequacy as an independent justification for sustaining the conduct of the target company's board. *See Newmont*, 535 A.2d at 1342; *Unocal*, 493 A.2d at 956.

23. 571 A.2d 1140 (Del. 1989).

24. *Id.* at 1143–47.

25. *Id.* at 1147.

26. *Id.* at 1149.

27. *Id.* at 1148–49.

28. *Id.* at 1148.

29. Paramount Communications, Inc. v. Time Inc., [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,514, at 93,272–73 (Del. Ch. July 14, 1989), *aff'd*, 571 A.2d 1140 (Del. 1990). These estimates turned out to be extraordinarily optimistic. On the day the Delaware Supreme Court published its decision in *Paramount*, seven months after the court affirmed the denial of the plaintiff's request for a preliminary injunction from the bench and allowed the Time–Warner combination to proceed, Time's stock traded at $95.75 per share. E. Ashton Johnston, Note, *Defenders of the Corporate Bastion in the* Revlon *Zone:* Paramount Communications, Inc. v. Time Inc., 40 CATH. U. L. REV. 155, 184 (1990). "[L]ess than one and a half years after Paramount's offer, [Time's] stock was trading in the $70 range." Thomas L. Hazen, *The Corporate Persona, Contract (and Market) Failure, and Moral Values*, 69 N.C. L. REV. 273, 291 n.105 (1991).

present any proof that its combination with Warner was more valuable than Paramount's offer.[30] It found that Paramount's offer threatened Time's pre-existing merger plans and that this threat was sufficient to justify defensive action[31] impeding Paramount's offer.[32]

Given the extraordinary scope of *Paramount*, one must ask whether there are any limiting factors. Two readily suggest themselves but are unsatisfying upon further analysis. First, Time's board did not adopt preclusive defensive measures that gave the board the right to veto Paramount's offer.[33] Perhaps *Paramount* stands for the proposition that a target company's board may pursue its business objectives without regard to the existence of a takeover bid as long as the board does not preclude hostile offers. However, Time's combination with Warner was fully sufficient to defeat Paramount's offer. It is, therefore, hard to distinguish this case from other cases involving preclusive defensive measures.[34] Moreover, as a practical matter Time's combination with Warner precluded all hostile offers since it is prohibitively expensive to buy a $30 billion company such as the combined Time-Warner.[35] As a consequence, *Paramount* would appear to justify preclusive defense to preserve a target company's independence.

30. *Paramount*, 571 A.2d at 1153 (noting that "[t]he open-ended analysis mandated by *Unocal* is not intended to lead to a simple mathematical exercise: that is, of comparing the discounted value of Time–Warner's expected trading price at some future date with Paramount's offer and determining which is the higher"). *But see* Dynamics Corp. of Am. v. CTS Corp., 794 F.2d 250, 257 (7th Cir. 1986) (concluding that "[h]ow the fairness of the tender offer could be determined without any consideration of the fairness of the offer price is mystifying"), *rev'd on other grounds*, 481 U.S. 69 (1987).

31. Time's tender offer for Warner was itself a defensive measure because, in response to Paramount's offer, Time changed the form of its deal with Warner to eliminate the need for a vote of Time's shareholders. *Paramount*, 571 A.2d at 1148, 1152. To protect their merger plans, Time and Warner also agreed that: (a) the two companies would buy each other's shares; (b) Time would attempt to purchase agreements from various banks not to finance any third-party attempt to acquire Time; and (c) Time would not consider any third-party acquisition proposal. *Id.* at 1146–47.

32. *See id.* at 1154–55 (holding that "[d]irectors are not obliged to abandon a deliberately conceived corporate plan for a short-term shareholder profit unless there is clearly no basis to sustain the corporate strategy"); *see also* Newell Co. v. Vermont Am. Corp., 725 F. Supp. 351, 373–75 (N.D. Ill. 1989) (upholding defensive conduct in response to an offer that would have "maximized shareholders' profits in the short-run" because the bidder's "corporate culture was substantially different and fundamentally at odds" with the target company's); Paul E. Burns, *Timing is Paramount: The Impact of* Paramount v. Time *on the Law of Hostile Takeovers*, 19 FLA. ST. U. L. REV. 761, 798 (1991) (arguing that "the directors' power to manage the corporation includes the power to select a time frame for the achievement of corporate goals"); David Millon, *Theories of the Corporation*, 1990 DUKE L.J. 201, 251–61 (justifying the *Paramount* result as necessary to protect Time's corporate culture). The court also found that the timing of Paramount's offer created a threat that Time's shareholders would be forced to respond to Paramount's bid with incomplete information. *See Paramount*, 571 A.2d at 1153.

33. *See supra* note 31.

34. *See* Lyman Johnson & David Millon, *The Case Beyond Time*, 45 BUS. LAW. 2105, 2116–17 (1990) (arguing that *Paramount*'s logic should apply to a board's refusal to redeem a poison pill rights plan that precludes an offer even if the target company's board does not develop an alternative transaction).

35. Gordon, *supra* note 9, at 1946. The only example of a transaction of this scope is Kohlberg Kravis Roberts & Co.'s $25 billion purchase of RJR Nabisco. *In re* RJR Nabisco, Inc. Shareholders Litig., [1988–1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,194, at 91,701 (Del. Ch. Jan. 31, 1989).

Second, *Paramount* may come to be limited to cases involving extraordinary transactions which are the products of many years of planning.[36] However, there is no basis in logic for this limitation. To the extent that the court held that a target company's board is not required to demonstrate that its alternative to a pending bid is more valuable than the bid, the nature of the alternative does not matter. The target company's board always has some business plan that it intends to execute if a bid is defeated, and the bid always presents a threat to that plan.[37]

3. *Threats to Nonshareholder Constituencies*

Academics have long debated whether a company's board of directors may consider the interests of constituencies other than shareholders.[38] In the nontakeover context, the law has generally allowed directors to favor nonshareholder constituencies as long as the impact on shareholders is not excessive.[39] In responding to a takeover bid prior to the time of sale, the *Unocal* court explicitly empowers a target company's board to consider "the impact on 'constituencies' other than shareholders (i.e., creditors, customers, employees, and perhaps even the community generally)."[40] On occasion, the courts have cited the impact of a bid on nonshareholder constituencies in upholding defensive action.[41] Courts have upheld defensive responses to highly

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36. Ragazzo, *supra* note 11, at 703 & n.85; *see also* Chrysogelos v. London, No. CIV.A.11910, 1992 WL 58516, at *6 (Del. Ch. Mar. 25, 1992) (noting that *Paramount* allows a board to "reject (or resist) an acquisition proposal in favor of a preexisting transaction"); *In re* Desoto, Inc., Shareholder Litig., [1989–1990 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,964, at 95,398 (Del. Ch. Feb. 5, 1990) (holding that a "modest restructuring plan which ha[d] been prepared in the ordinary course of business" did not "protect[] the corporation from a tender offer" because it fell "far short of the business plan of Time, Inc."); Burns, *supra* note 32, at 797 n.200 (noting that "[t]he Delaware courts have yet to address the issue of whether the formulation of a 'deliberately conceived plan' that does not involve some form of a transactional alternative to the hostile bid would be sufficient" to come within *Paramount*'s holding).

37. *See* Gordon, *supra* note 9, at 1946 (arguing that the court "notably failed to draw a sharp distinction between a threat to a pre-existing transaction and a threat to other strategies that the board has already decided on, including a pre-existing business plan to remain independent"). In Air Line Pilots Ass'n, Int'l v. UAL Corp., 717 F. Supp. 575 (N.D. Ill. 1989), *aff'd*, 897 F.2d 1394 (7th Cir. 1990), the court rejected an argument that a company was entitled to place antitakeover provisions in its labor contracts to protect the corporation's long-term plans because the corporation had recently abandoned those plans and the company's "corporate policy was in flux." *See id.* at 585–86. The *UAL* case seems to be unusual in this regard. *See, e.g.*, Amanda Acquisition Corp. v. Universal Foods Corp., 708 F. Supp. 984, 1012 (E.D. Wis.) (upholding defensive measures and noting that the target company's "business plans extend for several years into the future"), *aff'd on other grounds*, 877 F.2d 496 (7th Cir.), *cert. denied*, 493 U.S. 955 (1989); Gelco Corp. v. Coniston Partners, 652 F. Supp. 829, 846 (D. Minn. 1986) (upholding a restructuring in part because it was "adopted almost a full month *prior* to [the bidder's] initial ... proposal"), *vacated*, 811 F.2d 414 (8th Cir. 1987); *see also* Cheff v. Mathes, 199 A.2d 548, 556 (Del. 1964) (approving a greenmail transaction where a potential bidder threatened "a material change in [the target company's] sales policies, which the board considered vital to its future success").

38. *Compare* E. Merrick Dodd, Jr., *For Whom Are Corporate Managers Trustees?*, 45 HARV. L. REV. 1145, 1162–63 (1932) (arguing that corporate directors should represent constituencies in addition to shareholders) *with* Adolf A. Berle, Jr., *For Whom Corporate Managers Are Trustees: A Note*, 45 HARV. L. REV. 1365, 1367 (1932) (arguing that corporate directors should represent only shareholders).

39. *See infra* part III.A.

40. *Unocal*, 493 A.2d at 955.

41. *See, e.g.*, Herald Co. v. Seawell, 472 F.2d 1081, 1094–95 (10th Cir. 1972) (upholding defensive action against a bidder with a history of labor difficulties and noting that

leveraged bids that threatened to dismember target companies so that the bidders could satisfy their acquisition debt.[42] The courts have also permitted boards to oppose offers that threaten legal violations.[43]

The cases that have upheld defensive action under *Unocal* based on threats to nonshareholder constituencies are difficult to evaluate for proportionality because each of these cases also involved threats to shareholders.[44] Therefore, although the courts have allowed directors to preclude bids that threatened nonshareholder constituencies, it is impossible to determine whether such preclusion was justified by the threats to shareholders, nonshareholders, or both.

4. Conclusion

In sum, the board has great latitude in responding to hostile takeover bids under the *Unocal* standard. It can take defensive action to preserve the target company's independence in the face of a bid the board views as inadequate without offering proof that the company's going concern value is higher than the bid. The board is not required to negotiate with the bidder or institute an auction to determine whether an adequate bid can be procured. The board may also consider the interests of nonshareholder constituencies in defending against particular offers.

"[a] corporation publishing a newspaper ... has an obligation to ... the thousands of people who buy the paper, read it, and rely on its contents").

42. *See* Amanda Acquisition Corp. v. Universal Foods Corp., 708 F. Supp. 984, 1015 (E.D. Wis.), *aff'd on other grounds*, 877 F.2d 496 (7th Cir.), *cert. denied*, 493 U.S. 955 (1989) (upholding defensive tactics against a highly leveraged offer because, among other reasons, the pending bid posed "a danger to a corporation's [nonshareholder] constituencies (customers, suppliers, employees)"); GAF Corp. v. Union Carbide Corp., 624 F. Supp. 1016, 1019–20 (S.D.N.Y. 1985) (upholding defensive measures against a bust-up takeover bid and noting that "[a] corporation with a perceived threat of dismemberment of large divisions of the enterprise, employing thousands of employees, owes substantial regard for their pension benefits, and in the case of loyal management, severance benefits"); Moran v. Household Int'l, Inc., 500 A.2d 1346, 1357 (Del. 1985) (approving adoption of a poison pill rights plan as a device to fight "'bust-up' takeovers").

43. *E.g.*, West Point-Pepperell, Inc. v. J.P. Stevens & Co., 542 A.2d 770, 781 n.6 (Del. Ch. 1988) (permitting the board to consider whether a bidder's offer violated the antitrust laws).

44. For example, in *Household* the Delaware Supreme Court upheld the adoption of a poison pill rights plan that allowed the target company's board to preclude highly leveraged offers that require the bidder to sell pieces of the target company to finance the bidder's acquisition debt and threaten to disrupt the company's relationships with its employees and other groups. *See Household*, 500 A.2d at 1357. However, the poison pill also allows the board to defend against inadequate bids. The target company's board often uses the poison pill to buy time to allow an auction to proceed. *See, e.g.*, BNS Inc. v. Koppers Co., 683 F. Supp. 458, 475–76 (D. Del. 1988); CRTF Corp. v. Federated Dep't Stores, Inc., 683 F. Supp. 422, 439 (S.D.N.Y. 1988). Similarly, in *Universal Foods* a federal district court, applying *Unocal*, approved the use of a poison pill plan to preclude a highly leveraged offer that threatened the target company's nonshareholder constituencies. *Universal Foods*, 708 F. Supp. at 1015. It is impossible to distinguish the independent significance of the threat to nonshareholder constituencies because the court also accepted that the offer was inadequate. *Id.* at 1014.

B. The Board's Duties in the Sale Context

1. The Revlon Standard

In *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*,[45] the Delaware Supreme Court drastically changed the duties of a target company's board once the board decides to sell the company. In *Revlon*, Pantry Pride commenced a highly leveraged tender offer for 100% of Revlon at $47.50 per share, which Revlon's board viewed as inadequate. In response, among other actions, Revlon commenced an exchange offer. It purchased ten million of its own shares for notes and preferred stock. The notes were a defensive device because they contained covenants that limited the company's ability to incur additional debt, sell assets, or pay dividends.[46] As a consequence, the notes impeded any highly leveraged offer for control of the company.

After Pantry Pride raised its offer to $53 per share, the Revlon board commenced an auction.[47] Forstmann Little emerged as Pantry Pride's chief competitor and the Revlon board's preferred suitor. After Pantry Pride raised its offer to $56.25, the Revlon board enticed Forstmann Little to make a $57.25 bid by agreeing to an asset lock-up option,[48] a no-shop provision,[49] and a cancellation fee.[50] Forstmann Little agreed to support the value of the notes that were created by the exchange offer, which had fallen in value upon an announcement that the Revlon board intended to waive the note covenants.[51] Pantry Pride raised its offer to $58 per share and conditioned its offer on nullification of the favoritism shown to Forstmann Little.[52]

The Revlon board's conduct can be defended on two grounds: (a) the board was entitled to advance the interests of the noteholders even if there was a small diminution in shareholder value; and (b) the concessions granted to Forstmann Little were reasonably designed to maximize shareholder value by generating a $1 increase in the bidding. The Delaware Supreme Court invalidated the lock-up option, no-shop clause, and cancellation fee and rejected both arguments.[53]

The Delaware Supreme Court began by noting that the board's duties had changed once the board decided to sell the company:

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

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45. 506 A.2d 173 (Del. 1986).
46. *See id.* at 177.
47. *See id.* at 178.
48. The Revlon board granted Forstmann Little the option to purchase two of Revlon's divisions at bargain prices in the event another acquirer purchased 40% of Revlon. *Id.*
49. Although the Revlon board was free to consider offers from parties other than Forstmann Little, it agreed to negotiate and share information only with Forstmann. *Id.* at 184.
50. Revlon agreed to pay Forstmann Little $25 million in the event another acquirer purchased more than 19.9% of Revlon. *Id.* at 178.
51. *Id.*
52. *Id.* at 179.
53. *Id.* at 182–84.

> 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.[54]

As a consequence of the board's decision to sell the company, the board was no longer entitled to consider the interests of the company's noteholders. The court noted that the interests of nonshareholder constituencies may be considered only to the extent that "there are rationally related benefits accruing to the stockholders."[55] Because the Revlon board's decision to sell the company severed the interests of stockholders and noteholders, the Revlon board was charged with "obtaining the highest price for the benefit of the stockholders."[56] To the extent the Revlon directors favored the noteholders at the expense of shareholders, they "breached their primary duty of loyalty."[57]

The Delaware Supreme Court also rejected the argument that the concessions granted to Forstmann Little were designed to enhance shareholder value. The court noted that provisions favoring particular bidders are not illegal per se in Delaware because they have the potential to increase shareholder value.[58] Such provisions benefit shareholders to the extent they elicit higher bids that would not otherwise have been made. They harm shareholders to the extent they decrease the likelihood that further higher bids will be made, either by the latest high bidder or a third party. The *Revlon* court was probably correct that

54. *Id.* at 182.
55. *Id.*
56. *Id.*
57. *Id.*
58. *See id.* at 183; *see also* Cottle v. Storer Communication, Inc., 849 F.2d 570, 575–77, 578–79 (11th Cir. 1988) (granting summary judgment against a *Revlon* claim challenging an asset lock-up option and a cancellation fee where the board granted concessions to the winning bidder after an extensive auction); Gray v. Zondervan Corp., 712 F. Supp. 1275, 1281–82 (W.D. Mich. 1989) (approving a stock lock-up option, topping fee, and termination fee granted to the winning bidder); Samjens Partners I v. Burlington Indus., Inc., 663 F. Supp. 614, 624–25 (S.D.N.Y. 1987) (approving break-up fees, expense fees, and a no-shop clause granted to the highest bidder); Hastings-Murtagh v. Texas Air Corp., 649 F. Supp. 479, 484–86 (S.D. Fla. 1986) (refusing to grant a preliminary injunction against a lock-up option and no-shop clause issued to the only existing bidder); *In re* Holly Farms Corp. Shareholders Litig., 564 A.2d 342, 349 (Del. Ch. 1989) (upholding bidder favoritism to prevent collusion between competing bidders); Doskocil Cos. v. Griggy, No. CIV.A.10,095, 1988 WL 105751, at *3 (Del. Ch. Oct. 7, 1988) (noting that "the target board may favor one bidder over another 'if in good faith and advisedly it believes shareholder interests would be thereby advanced'") (quoting *In re* Fort Howard Corp. Shareholders Litig., No. CIV.A.9991, 1988 WL 83147, at *14 (Del. Ch. Aug. 8, 1988)); *In re* J.P. Stevens & Co., 542 A.2d 770, 778–84 (Del. Ch. 1988) (approving the provision of information, a break-up fee, and a topping fee to one of two competing bidders); Freedman v. Restaurant Associates, [1987–1988 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 93,502, at 97,219 (Del. Ch. Oct. 16, 1987) (noting that "defensive steps such as lock-up options or asset sales are valid when designed or intended to promote higher bidding and invalid if designed to favor one bidder and stop the bidding"); Ian Ayres, *Analyzing Stock Lock-Ups: Do Target Treasury Sales Foreclose or Facilitate Takeover Auctions?*, 90 COLUM. L. REV. 682, 715 (1990) (concluding that "[a]lthough the sale of treasury stock reduces bidders' reservation price for the target shares, an auction with reduced reservation prices may produce a higher tender offer for target shareholders than no auction at all"); Stephen M. Bainbridge, *Exclusive Merger Agreements and Lock-Ups in Negotiated Corporate Acquisitions*, 75 MINN. L. REV. 239, 323–32 (1990) (proposing an objective standard to distinguish preclusive from nonpreclusive lock-ups).

the auction-ending concessions granted Fortsmann Little were not justified by a $1 increase in the bidding price.[59] However, the opinion is noteworthy for its willingness to second-guess the business judgment of Revlon's board on this issue.[60] By contrast, the court has seldom been willing to second guess the business judgment of a target company's board that an offer is inadequate in the pre-sale context.[61]

After *Revlon*, the courts proceeded to define the precise contours of the board's duties once the board decides to sell the company. Despite the "auction" language from the *Revlon* opinion,[62] the board is not required to commence an auction.[63] It is only required to take actions that are reasonably designed to maximize shareholder value.[64] If the board does not commence an auction, it is required to have a reasonable basis on which to determine the target company's value.[65] The board may determine the target company's value based on

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59. *See Revlon*, 506 A.2d at 183–84.

60. *See* Mills Acquisition Co. v. Macmillan, Inc., 559 A.2d 1261, 1275–77, 1284–86 (Del. 1988) (invalidating a lock-up option and no-shop clause that generated a $1.05 increase in the bidding price); *see also* Edelman v. Fruehauf Corp., 798 F.2d 882, 885–87 (6th Cir. 1986) (enjoining favoritism shown to a management-LBO group to impede a third-party proposal); Hanson Trust PLC v. ML SCM Acquisition, Inc., 781 F.2d 264, 281–83 (2d Cir. 1986) (invalidating an asset lock-up, hello fee, and break-up fee that resulted in about a $1 increase in the bid price); Black & Decker Corp. v. American Standard, Inc., 682 F. Supp. 772, 786 (D. Del. 1988) (invalidating favoritism where "the value of the competing offers [were] substantially similar"). *Revlon* and *Macmillan* taken together stand for the proposition that bidder favoritism that results in a marginal increase in the bidding price is unlawful. *See Macmillan*, 559 A.2d at 1284 (noting that "[i]f the grant of an auction-ending provision is appropriate, it must confer a substantial benefit upon the stockholders in order to withstand exacting scrutiny by the courts"); Bainbridge, *supra* note 58, at 300–01.

61. *See supra* part I.A.1.

62. *See supra* text accompanying note 54.

63. *See* Barkan v. Amsted Indus., Inc., 567 A.2d 1279, 1286 (Del. 1989); Yanow v. Scientific Leasing, Inc., [1991 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 96,189, at 91,011 (Del. Ch. July 31, 1991); Herd v. Major Realty Corp., [1990–1991 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 95,772, at 98,717 (Del. Ch. Dec. 21, 1990); Freedman v. Restaurant Associates, [1990–1991 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 95,617, at 97,887 (Del. Ch. Sept. 21, 1990); TW Services, Inc. Shareholders Litig. [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,334, at 92,179 (Del. Ch. Mar. 2, 1989); City Capital Associates v. Interco Inc., 551 A.2d 787, 803 (Del. Ch. 1988).

64. *See Macmillan*, 559 A.2d at 1286–88. The board is not an insurer of maximum shareholder value. It is only required to take action that is reasonably likely to maximize shareholder value. *See* Norberg v. Young's Mkt. Co., [1990 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 95,468, at 97,438–39 (Del. Ch. Dec. 19, 1989) (refusing to enjoin an insider transaction based on speculation that a higher offer could be obtained); *In re* RJR Nabisco, Inc. Shareholders Litig., [1988–1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,194, at 91,715 (Del. Ch. Jan. 31, 1989) (upholding a board's choice of a nominally lower bid and noting that "effectiveness" in the conduct of a bidding contest "cannot mean perfection"); Citron v. Fairchild Camera & Instrument Corp., [1988–1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 93,915, at 90,102 n.17 (Del. Ch. May 19, 1988) (upholding a board's decision to take a $66 bid for all shares instead of a partial $70 bid without a guaranteed second-step transaction), *aff'd*, 569 A.2d 53 (Del. 1989); Freedman v. Restaurant Associates, [1987–1988 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 93,502, at 97,220 (Del. Ch. Oct. 16, 1987) (noting that "the likelihood that one of the alternatives may be less likely to close supplies a rational basis for preferring another proposal, even though it may be at a lower price").

65. *See Barkan*, 567 A.2d at 1286–87. This obligation is equivalent to the directors' obligation to make an informed decision in fulfillment of the duty of care. *See In re* MCA, Inc. Shareholders Litig., 598 A.2d 687, 693 (Del. Ch. 1991); *Freedman*, [1990–1991 Transfer Binder] Fed. Sec. L. Rep. (CCH) at 97,887; *Interco*, 551 A.2d at 802 (noting that *Revlon* requires "a reasonable basis for the board of directors involved to conclude that the transaction involved is in the best interest of the shareholders"); *see also RJR Nabisco*, [1988–1989

traditional financial analyses[66] or conduct a market test procedure that is short of an auction.[67]

In sum, once the board's decides to sell the company, *Revlon* changes the board's duties in two ways: (a) the board is no longer entitled to consider the interests of nonshareholder constituencies;[68] and (b) the board is required to take steps to maximize short-term shareholder value.[69] Once *Revlon* is triggered, judicial review of the board's conduct also appears to be enhanced. Later cases posed the question of whether selling something less than 100% of the company would trigger any enhanced *Revlon* duties. Given the sharp contrast between the board's duties under *Unocal* and *Revlon*, these cases posed a key question. The following section discusses this problem.

Transfer Binder] Fed. Sec. L. Rep. (CCH) at 91,714 (noting that "the amount of information that it is prudent to have before a decision is made is itself a business judgment of the very type that courts are institutionally poorly equipped to make"). In Cede & Co. v. Technicolor, Inc., Nos. 336, 1991, 337, 1991, 1993 WL 437646 (Del. Nov. 1, 1993), and Smith v. Van Gorkom, 488 A.2d 858 (Del. 1985), the Delaware Supreme Court held that directors breached their duty of care by failing adequately to investigate the target company's value before accepting an acquisition proposal.

66. *See In re* Vitalink Communications Corp. Shareholders Litig., [1991–1992 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 96,585, at 92,740–43 (Del. Ch. Nov. 8, 1991), *aff'd sub nom.*, Grimes v. John P. McCarthy Profit Sharing Plan, 610 A.2d 725 (Del. Ch. 1992); Roberts v. General Instrument Corp., [1990 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 95,465, at 97,403–05 (Del. Ch. Aug. 13, 1990).

67. *See Barkan*, 567 A.2d at 1287 (approving a management buyout where a company had been in play for ten months); *Yanow*, [1991 Transfer Binder] Fed. Sec. L. Rep. (CCH) at 91,012 (approving a sale transaction without an active auction where previous attempts to elicit higher bids had been unsuccessful); *MCA*, 598 A.2d at 693 (approving a merger transaction where no higher bid emerged after two months of public negotiations); *Roberts*, [1990 Transfer Binder] Fed. Sec. L. Rep. (CCH) at 97,405 (approving a management-sponsored buyout where potential bidders came forward and received full information but did not top the pending bid); *In re* Envirodyne Indus., Inc. Shareholders Litig., No. CIV.A.10702, 1989 WL 40792, at *4 (Del. Ch. Apr. 20, 1989) (approving a negotiated deal where "[t]he board ... sought offers for the company for almost a year, without any realistic success"); *In re* Formica Corp. Shareholders Litig., [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,362, at 92,393 (Del. Ch. Mar. 22, 1989) (approving a management buyout subject to a 30-day market check procedure that included the active solicitation of potential buyers); *In re* KDI Corp. Shareholders Litig., No. CIV.A.10,278, 1988 WL 116448, at *6 (Del. Ch. Nov. 1, 1988) (approving a management buyout where an investment banker unsuccessfully sought to solicit superior offers); *In re* Fort Howard Corp. Shareholders Litig., No. CIV.A.9991, 1988 WL 83147, at *13 (Del. Ch. Aug. 8, 1988) (approving a post-contract market-check procedure); Solash v. Telex Corp., [1987–1988 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 93,608, at 97,728 (Del. Ch. Jan. 19, 1988) (approving a transaction where the board "probed the market for control transactions in a way that gave reasonable assurance that all third-party possibilities had been explored"). Some have argued that notifying the market of a proposed sale transaction is the functional equivalent of conducting an auction. *See In re* Wheelabrator Technologies Inc. Shareholders Litig., [1990 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 95,489, at 97,560 (Del. Ch. Sept. 6, 1990); Ronald J. Gilson & Reinier Kraakman, *What Triggers* Revlon*?*, 25 WAKE FOREST L. REV. 37, 56 (1990). *But see In re* Amsted Indus. Litig., No. CIV.A.8224, 1988 WL 92736, at *8 (Del. Ch. Aug. 24, 1988) (approving settlement of a *Revlon* claim but noting that "one remains deeply troubled by the failure of the board in this instance actively to shop the Company").

68. *See* TW Services, Inc. Shareholders Litig. [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,334, at 92,178–79 (Del. Ch. Mar. 2, 1989).

69. *See* Gilbert v. El Paso Co., 575 A.2d 1131, 1146 (Del. 1990); Citron v. Fairchild Camera & Instrument Corp., 569 A.2d 53, 68 (Del. 1989); Barkan v. Amsted Indus., Inc., 567 A.2d 1279, 1286 (Del. 1989); Mills Acquisition Co. v. Macmillan, Inc., 559 A.2d 1261, 1288 (Del. 1988); Ivanhoe Partners v. Newmont Mining Corp., 535 A.2d 1334, 1344–45 (Del.

2. The Triggering of Revlon

a. Sales of Control

The cases initially suggested that selling control of a company was sufficient to trigger *Revlon*.[70] The control test is appropriate if shareholder wealth concerns provide an independent basis to trigger *Revlon*.[71] Taking a company in which ownership is widely dispersed and selling control to one person radically changes the nature of the remaining shareholders' investments. The new majority shareholder has the power to engage in self-dealing at the expense of the minority.[72] The market for corporate control no longer acts as a check on management's decision-making.[73] The minority shareholders will not have the opportunity to sell their stock at a premium in the future.[74] The sale of a controlling interest in effect forces the remaining shareholders to trade in their previous investments for new, less desirable investments. Because of the negative impact that the sale of a controlling interest has on the value of minority shares, it is appropriate to require that the company's board offer proof that the control transaction provides the largest possible benefits to shareholders.

The Delaware Supreme Court appeared to adopt the control test in *Mills Acquisition Co. v. Macmillan, Inc.*[75] In that case, management proposed a complicated restructuring in response to a hostile takeover bid. The restructuring would have split the company into two parts. Management would have owned 39% of one of the successor companies.[76] The legality of the restructuring became moot when the restructuring was abandoned to allow an auction of the entire company.[77] Nevertheless, the Delaware Supreme Court cited with

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1987); *Vitalink*, [1991–1992 Transfer Binder] Fed. Sec. L. Rep. (CCH) at 92,738; *TW Services*, [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) at 92,178–79.

70. *See* Black & Decker Corp. v. American Standard, Inc., 682 F. Supp. 772, 781–84 (D. Del. 1988) (holding that a recapitalization plan that would have increased the combined ownership of management and an ESOP to 55% triggered *Revlon*).

71. *See* Gilson & Kraakman, *supra* note 67, at 40–44; Ronald J. Rinaldi, Note, *Radically Altered States: Entering the* "Revlon *Zone*", 90 COLUM. L. REV. 760, 778–81 (1990).

72. *See* Beebe v. Pacific Realty Trust, 578 F. Supp. 1128, 1137 (D. Or. 1984) (noting that acquisition of a 51% interest would "subject the remaining stockholders to a captive status"); Lucian A. Bebchuk, *Toward Undistorted Choice and Equal Treatment in Corporate Takeovers*, 98 HARV. L. REV. 1693, 1710–13 (1985); Jesse A. Finkelstein, *Antitakeover Protection Against Two-Tier and Partial Tender Offers: The Validity of Fair Price, Mandatory Bid, and Flip-Over Provisions Under Delaware Law*, 11 SEC. REG. L.J. 291, 293 (1984); Edward F. Greene & James J. Junewicz, *A Reappraisal of Current Regulation of Mergers and Acquisitions*, 132 U. PA. L. REV. 647, 678–79 (1984).

73. *See* Gilson & Kraakman, *supra* note 10, at 271–73.

74. Takeover bids typically involve a substantial control premium. *See infra* text accompanying note 135. The minority cannot force the majority shareholder to sell his controlling interest, *see* Bershad v. Curtiss-Wright Corp., 535 A.2d 840, 845 (Del. 1987); Kleinhandler v. Borgia, [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,525, at 93,326 (Del. Ch. July 7, 1989); *cf.* Freedman v. Restaurant Associates, [1987–1988 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 93,502, at 97,220–21 (Del. Ch. Oct. 16, 1987) (noting that the board is not compelled to dilute a controlling shareholder to allow an offer to proceed), or to share the control premium if he does, *see, e.g., In re* Sea-Land Corp. Shareholders Litig., No. CIV.A.8453, 1993 WL 93436, at *9 (Del. Ch. Mar. 26, 1993); Citron v. Steego Corp., No. CIV.A.10171, 1988 WL 94738, at *8 (Del. Ch. Sept. 9, 1988).

75. 559 A.2d 1261 (Del. 1988).

76. *See id.* at 1270.

77. *See id.* at 1272.

approval the chancery court's conclusion that Macmillan's management would have had effective control over the 39%-owned subsidiary[78] and noted that the restructuring triggered *Revlon* duties.[79] Although the court did not articulate what triggered *Revlon*,[80] a fair assumption is that the transfer of control of the 39%-owned subsidiary was the cause.[81]

Despite *Macmillan*, the control test was called into question by the Delaware Supreme Court's decision in *Paramount*. The planned merger of Time and Warner contemplated giving Warner's shareholders 62% of the combined entity.[82] Because Time's shareholders saw their interest decrease to less than a majority, there was an argument that *Revlon* was triggered. The chancery court held that *Revlon* was not triggered because control had not been sold to a single entity. Prior to the merger, control was dispersed in the market, and the combination with Warner did nothing to change this state of affairs.[83]

The Delaware Supreme Court agreed that *Revlon* was not triggered.[84] However, it rejected the chancery court's control analysis.[85] The supreme court cited two circumstances that trigger *Revlon*. First, commencement of "an active bidding process seeking to sell" the company triggers *Revlon*.[86] Second, responding to a hostile bid with "an alternative transaction involving the breakup of the company" triggers *Revlon*.[87] The court noted that *Revlon* is not triggered absent "an abandonment of the corporation's continued existence."[88] The supreme court held that *Revlon* was not triggered in the instant case

78. *See id.* at 1270. The chancery court's conclusion is consistent with practical reality. *See* Essex Universal Corp. v. Yates, 305 F.2d 572, 579 (2d Cir. 1962) (observing that a 28.3% owner "is almost certain to have share control as a practical matter"); *Freedman*, [1987–1988 Transfer Binder] Fed. Sec. L. Rep. (CCH) at 97,215–16 (Del. Ch. Oct. 16, 1987) (noting that individuals owning 37% of a corporation's stock had control).

79. *See Macmillan*, 559 A.2d at 1285.

80. The court asserted that "[b]y any standards [Macmillan] was for sale" pursuant to the restructuring. *Id.*

81. *See* Gilson & Kraakman, *supra* note 67, at 43. The Delaware Supreme Court seemingly endorsed the control test in two cases subsequent to *Macmillan*. *See* Citron v. Fairchild Camera & Instrument Corp., 569 A.2d 53, 68 (Del. 1989) (citing with approval the chancery court's determination that *Revlon* was triggered "once it became clear that a control transaction would be forced upon the company"); Barkan v. Amsted Indus., Inc., 567 A.2d 1279, 1286 (Del. 1989) (noting that "the general principles announced in *Revlon* ... govern ... every case in which a fundamental change of corporate control occurs or is contemplated"). The court was not required squarely to face the question of what triggers *Revlon* in these cases because both *Citron* and *Barkan* involved liquidation of 100% of the public stockholders' interests, which triggers *Revlon* whatever the test. *See* Herd v. Major Realty Corp., [1990–1991 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 95,772, at 98,717 (Del. Ch. Dec. 21, 1990).

82. *See Paramount*, 571 A.2d at 1146.

83. *See id.* at 1150. Two commentators have argued that a substantial dilution of the combined voting power of a target company's shareholders in a merger transaction should trigger *Revlon* because such a dilution threatens the continuity of the target company's management and raises the danger that, in negotiating the merger, management will act to advance its own interests rather than those of the shareholders. *See* Gilson & Kraakman, *supra* note 67, at 49, 52–55. These commentators agree that *Revlon* was not triggered on the facts of *Paramount* because the continuity of Time's management was assured. *See id.* at 53.

84. *See Paramount*, 571 A.2d at 1150–51.

85. *See id.* at 1150.

86. *Id.*

87. *Id.* The court noted that its two examples were not exclusive. *See id.*

88. *Id.*

because Time's combination with Warner did not make "the dissolution or break-up of the corporate entity inevitable."[89]

Paramount identifies the break-up of the corporate enterprise as the key factor in the *Revlon* analysis.[90] The court did not articulate what constitutes a break-up. Perhaps the court meant to refer to acquisitions, like that of Revlon itself, that result in a piecemeal sale of a corporation's component divisions.[91] However, this interpretation would reject a now established body of law which holds that selling off substantial pieces of a corporation does not trigger *Revlon*.[92] Although this precedent does not derive from the Delaware Supreme Court, it is hard to believe that *Paramount*, which took great pains to narrow the scope of *Revlon* in the control context, meant to expand *Revlon* in another context.

It is more likely that the *Paramount* court used break-up as a synonym for the sale of an entire business. To this extent, *Paramount* focuses on when a target company's board becomes disabled from considering the interests of nonshareholder constituencies. Sale of the entire enterprise dissolves the link between the shareholders and other corporate constituencies, and, in the view of the Delaware Supreme Court, makes the consideration of nonshareholder constituencies illegitimate. The sale of a controlling interest does not sever the fortunes of shareholders and other corporate constituencies. For example, to the extent the company's board gives employees benefits to which they are not contractually entitled, and those employees increase their work product as a result, all shareholders, including minority shareholders, benefit. *Paramount* suggests that shareholder welfare concerns are not independently sufficient to trigger enhanced *Revlon* duties.

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89. *Id.* Prior to both *Macmillan* and *Paramount*, the Delaware Supreme Court's *Newmont* decision had called the control test into question. In *Newmont*, the target company's board defeated a hostile bid by proposing a restructuring that limited a 49% shareholder, and any subsequent purchaser of that shareholder's stock, to 40% of the board. The supreme court held that this restructuring did not trigger *Revlon*. *See* Ivanhoe Partners v. Newmont Mining Corp., 535 A.2d 1334, 1345 (Del. 1987). The restructuring made it practically impossible for any bidder to acquire Newmont and for the company's shareholders to receive a control premium for their stock. *See supra* note 20. *Newmont* might be consistent with some version of the control test because the restructuring did not have many of the negative features associated with a transfer of control. Although the restructuring prevented future transfers of control, it did not pass current control to any one entity. It distributed control between the company's current board and largest shareholder. As a consequence, minority shareholders were not in danger of being dominated by one entity. Although the market for corporate control would not serve as a check on management, the designees of the company's largest shareholder, plus the company's nonmanagement, independent directors, might have served this function. *See Newmont*, 535 A.2d at 1345–46 (noting that the restructuring did not sell the company to the 49% shareholder and that the company's independent directors would continue to control the board). After *Paramount*, however, it seems more likely that *Revlon* was not triggered by *Newmont*'s restructuring because, although the restructuring affected ownership percentages and board seats, it did not effect the total break-up of the corporate enterprise. *See id.* at 1345 (noting that "the Newmont board held fast to its decision to keep the company independent"). Although Newmont sold its nongold subsidiaries as part of the restructuring, *see id.* at 1339, such partial dissolutions have not been thought to trigger *Revlon*. *See infra* part I.B.2.b.

90. *See also* Barry Reder, *The Obligation of a Director of a Delaware Corporation to Act as an Auctioneer*, 44 BUS. LAW. 275, 280 (1989) (arguing that "*Revlon* is not a change in control case; it is a break-up case"); Policastro, *supra* note 20, at 204–05 (arguing that *Revlon* is triggered by a break-up rather than a sale).

91. *See* Bainbridge, *supra* note 58, at 312.

92. *See infra* part I.B.2.b.

Neither *Macmillan* nor *Paramount* represents a square holding on the issue of whether a sale of control triggers *Revlon*. In *Macmillan*, the restructuring that the court believed triggered *Revlon* had been abandoned. The portion of the court's discussion relating to the restructuring is a dictum. In *Paramount*, the supreme court agreed with the chancery court that the Time-Warner merger did not result in a transfer of control.[93] Although the court suggested that transferring control was irrelevant to its analysis, *Paramount* leaves the court free to apply *Revlon* to future cases in which control is actually transferred.[94]

b. Restructurings

Substantial restructurings also pose the question of whether enhanced *Revlon* duties are triggered. In a typical case, the target company: (a) incurs substantial debt; (b) sells a substantial amount, but less than 100%, of its assets; (c) makes a large dividend to shareholders; and (d) leaves the shareholders with an equity interest in a smaller, more highly leveraged company.[95] In this way, the target company's board mimics the conduct of the highly leveraged, bust-up takeover bidders of the 1980s.[96]

City Capital Associates v. Interco Inc.[97] is representative of this type of case. In response to a hostile $74 bid, Interco's board proposed a restructuring that, in the board's view, would have provided shareholders with a $66 dividend (payable in cash, debentures, and preferred stock) and a stub share worth $10.[98] To finance the dividend, Interco proposed to sell approximately one-half of its assets and incur substantial debt.[99] Assuming that Interco was worth $76 per share and the stub shares were worth $10 each, the restructuring involved a liquidation of 87% of the shareholders' equity in the company.

Nevertheless, the Delaware Chancery Court rejected the argument that *Revlon* applied to the restructuring.[100] Other cases are in accord that substantial restructurings do not by themselves trigger *Revlon*.[101] The results in the

93. *See Paramount*, 571 A.2d at 1150.

94. *See In re* Wheelabrator Technologies Inc. Shareholders Litig., No. 11495C, 1992 WL 212595, at *7–*8 (Del. Ch. Sept. 1, 1992) (noting that whether *Paramount* overrules prior Delaware Supreme Court cases accepting the control test is an unresolved question).

95. *See* Deborah A. DeMott, *Directors' Duties in Management Buyouts and Leveraged Recapitalizations*, 49 OHIO ST. L.J. 517, 524–27 (1988).

96. *See* John C. Coffee, Jr., *The Uncertain Case for Takeover Reform: An Essay on Stockholders, Stakeholders and Bust-Ups*, 1988 WIS. L. REV. 435, 443–47.

97. 551 A.2d 787 (Del. Ch. 1988).

98. *See id.* at 793.

99. *See id.* at 793, 802.

100. *See id.* at 801–03.

101. *See* Ivanhoe Partners v. Newmont Mining Corp., 535 A.2d 1334, 1344–45 (Del. 1987) (refusing to apply *Revlon* to a restructuring involving the sale of substantial assets and the payment of a $33 dividend that was approximately one-third of the bid price); *see also* Gelco Corp. v. Coniston Partners, 652 F. Supp. 829, 847 (D. Minn. 1986) (holding *Revlon* inapplicable to a restructuring that included sale of significant assets and an exchange offer), *vacated*, 811 F.2d 414 (8th Cir. 1987); Tomczak v. Morton Thiokol, Inc., [1990 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 95,327, at 96,586–87 (Del. Ch. Apr. 5, 1990) (holding *Revlon* inapplicable to the sale of one of a company's four divisions); TW Services, Inc. Shareholders Litig., [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,334, at 92,179 n.13 (Del. Ch. Mar. 2, 1989) (noting that most restructuring cases have been analyzed under *Unocal* rather than *Revlon*); Grand Metro. Pub. Ltd. v. Pillsbury Co., 558 A.2d 1049, 1053–60 (Del. Ch. 1988) (applying the *Unocal* test to a restructuring involving the sale of significant

restructuring cases suggest that shareholder value considerations are not independently sufficient to trigger *Revlon*. Were *Revlon*'s focus on shareholders, substantial restructurings would trigger a *Revlon* duty to attempt to maximize shareholder value.[102] It is true that restructurings such as Interco's do not make the shareholders captives of a new majority shareholder or prevent the market for corporate control from exercising discipline on management.[103] However, if liquidating 100% of the shareholders' interests, as in *Revlon*, requires the board to attempt to maximize immediate shareholder value, it is hard to understand why liquidating substantially all of the shareholders' equity does not trigger this duty.

Moreover, although the stub share provided in Interco's restructuring could itself have been the subject of a later premium takeover bid, such a bid would have been limited to the 13% of the company that the shareholders had left. Consequently, the shareholders' ability to receive a premium bid for 87% of their equity was irretrievably lost.[104] Were shareholder value considerations independently sufficient to trigger *Revlon*, the correct rule would be that an enhanced *Revlon* duty to maximize immediate shareholder values is triggered whenever a company liquidates all or substantially all of the shareholders' investment.[105]

In fact, *Revlon*'s focus appears to be on when dissolution of the link between shareholders and other constituencies precludes the board from considering the interests of the nonshareholder constituencies. Although Interco's restructuring eliminated half its assets and 87% of the shareholders' equity, its shareholders continued to be linked to other constituencies, such as employees, in the half of the company's businesses that the firm kept.

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assets); DeMott, *supra* note 95, at 551–52 (noting that "[s]o long as a leveraged recapitalization does not count as a 'sale' of the company, directors' endorsement of a proposal for a leveraged recapitalization is not a determination by the company's directors that metamorphoses their role into one of neutral auctioneering"). *But see* Southdown, Inc. v. Moore McCormack Resources, Inc., 686 F. Supp. 595, 602–03 (S.D. Tex. 1988) (applying *Revlon* to a leveraged restructuring).

102. *But see* Gilson & Kraakman, *supra* note 67, at 45–46 (arguing that restructurings should not trigger *Revlon* absent the sale of control); Rinaldi, *supra* note 71, at 773–74 (same).

103. Indeed, the increased leverage resulting from restructurings is thought to increase the discipline of management. *See* Michael C. Jensen, *Agency Costs of Free Cash Flow, Corporate Finance, and Takeovers*, 76 AM. ECON. REV. 323 (1986).

104. Given the amount of leverage involved in the restructuring, it was also unlikely that Interco's shareholders would receive a premium offer for their stub shares. *See* DeMott, *supra* note 95, at 529.

105. *See Southdown*, 686 F. Supp. at 599, 603 (invalidating preclusive defensive tactics designed to protect a leveraged restructuring where the board could not demonstrate that the value of the restructuring exceeded the bid price). In a related context, the Delaware legislature has refused to distinguish between selling all and substantially all of a corporation's assets. In either case, shareholders have a right to vote on the sale transaction. *See* DEL. CODE ANN. tit. 8, § 271(a) (1991). The courts have given an expansive interpretation of "substantially all" under this section. *See* Katz v. Bregman, 431 A.2d 1274, 1275–76 (Del. Ch. 1981) (holding that the sale of approximately one-half of a corporation's assets triggered section 271); Gimbel v. Signal Cos., 316 A.2d 599, 605–08 (Del. Ch.) (holding that the sale of less than half of a corporation's assets triggered section 271), *aff'd*, 316 A.2d 619 (Del. 1974). As a consequence, section 271 appears to apply to the sale of any significant amount of assets. One commentator has suggested that *Revlon* should be triggered according to an analogous test. *See* Marc I. Steinberg, *Nightmare on Main Street: The* Paramount *Picture Horror Show*, 16 DEL. J. CORP. L. 1, 16–17 (1991).

Therefore, the Interco board remained entitled to act on behalf of nonshareholder constituencies.

c. Tender Offers

The Delaware Supreme Court once recognized that the imminent consummation of a tender offer triggered *Revlon*. In *Gilbert v. El Paso Co.*,[106] a bidder made a $24 tender offer for 51% of El Paso that El Paso's board viewed as inadequate.[107] After unsuccessfully attempting to generate a higher alternative, the board became resigned to the fact that the tender offer would succeed and began negotiations with the bidder to ensure protections for the El Paso shareholders that would remain after the tender offer.[108] The court held *Revlon* applicable because "it had become apparent that the breakup of the company was inevitable."[109]

El Paso is unusual because it involved conduct occurring in 1982 and 1983, before most companies had adopted defensive mechanisms that allowed a target company's board to preclude undesirable offers.[110] El Paso had adopted a defensive mechanism that was a forerunner of the modern poison pill rights plan but was less effective.[111] The effect of the modern tender offer defense, and the courts' willingness to permit it, is that it will seldom be the case that the existence of a popular hostile offer makes the sale of a company inevitable. In this regard, the Delaware Supreme Court has squarely held that the mere making of an offer, although it puts the company "in play," does not trigger *Revlon*.[112]

3. Conclusion

Once the board decides to sell the entire company, *Revlon* requires the board to attempt to maximize immediate shareholder value without regard to the interests of nonshareholder constituencies. However, nothing short of a

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106. 575 A.2d 1131 (Del. 1990).
107. *See id.* at 1134–36.
108. *See id.* at 1137–39.
109. *Id.* at 1146; *see also* TW Services, Inc. Shareholders Litig., [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,334, at 92,180 (Del. Ch. Mar. 2, 1989) (questioning whether *Revlon* is triggered by an offer into which 88% of the target company's shareholders have tendered).
110. *Revlon* is applied retroactively by the Delaware courts. *See* Barkan v. Amsted Indus., Inc., 567 A.2d 1279, 1286 n.2 (Del. 1989).
111. El Paso's board created a new series of preferred stock that precluded any business combination with a 25% shareholder absent the approval of 90% of the outstanding preferred shares. *See* El Paso, 575 A.2d at 1136. A hostile bidder was able to acquire El Paso as long as 90% of the preferred stockholders tendered into its offer. Modern poison pill plans give the target company's shareholders the right to purchase the bidder's stock at half price in the event the bidder attempts a second-step merger. *See, e.g.*, Moran v. Household Int'l, Inc., 500 A.2d 1346, 1348–49 (Del. 1985). These "flip-over" plans do not have a 90% escape mechanism. More stringent plans, called "flip-in" plans, give all target company shareholders other than the bidder the right to buy the target company's stock at half price once the bidder crosses a particular ownership threshold. *See, e.g.*, City Capital Associates v. Interco, Inc., 551 A.2d 787, 791–92 (Del. Ch. 1988).
112. *See* Paramount Communications, Inc. v. Time Inc., 571 A.2d 1140, 1151 (Del. 1990); *see also* Buckhorn, Inc. v. Ropak Corp., 656 F. Supp. 209, 228 (S.D. Ohio 1987) (holding that an abandoned attempt to market a target company did not trigger *Revlon* duties); Gelco Corp. v. Coniston Partners, 652 F. Supp. 829, 847 (D. Minn. 1986) (holding that the making of a tender offer does not trigger the duty to maximize immediate shareholder value), *vacated in part*, 811 F.2d 414 (8th Cir. 1987).

complete sale is certain to trigger *Revlon*. The possibility that a sale of control triggers *Revlon* remains extant but is called into question by *Paramount*. The law appears settled that substantial restructurings and the commencement of tender offers do not trigger *Revlon*.

II. THE DUTY TO MAXIMIZE SHAREHOLDER VALUE

The Delaware Supreme Court has required a target company's board of directors to justify that its responses to a hostile takeover bid are value-maximizing only in very limited circumstances. Before the board decides to sell the company, the board may defend against a bid for the purpose of continuing the company's business without demonstrating that the going concern value of the business is higher than the bid price.[113] Although *Revlon* requires the board to maximize immediate shareholder value upon a sale of the entire company, later cases have sharply limited the scope of *Revlon*.[114]

This part of the Article examines the proffered justifications for allowing the board to defend against hostile bids without demonstrating that its chosen course offers more value for shareholders and finds these justifications wanting. This part assumes that the board is focusing on the interests of shareholders in formulating its takeover defense. The next part will consider the degree to which the interests of nonshareholder constituencies may be considered.

A. *Preserving the Corporate Entity*

1. *Preserving the Entity for Its Own Sake*

Underlying much of the Delaware Supreme Court's jurisprudence in the takeover defense area is the notion that a target company's board is entitled to take action to preserve the corporate entity. *Paramount* allows the board to preclude offers that threaten to disrupt the company's business plan without requiring the board to demonstrate that the expected value of the plan is higher than the bid because, if the emphasis is on the corporation as an entity, there is no reason to focus on share values.[115] Changes of control may not, and substantial restructurings do not, trigger enhanced *Revlon* duties because the corporation continues as an entity.[116]

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113. *See supra* parts I.A.1 & I.A.2.

114. *See supra* part I.B.

115. *See* Johnson & Millon, *supra* note 34, at 2112 (noting that "what warrants emphasis about the Supreme Court's [Paramount] opinion is that, absent the limiting circumstances of *Revlon, Unocal*'s focus is wholly on director duty to the continuing enterprise, not on satisfying the desires or enhancing the well-being of shareholders"); Trevor S. Norwitz, *"The Metaphysics of Time": A Radical Corporate Vision,* 46 BUS. LAW. 377, 378–79 (1991) (noting that, in *Paramount,* the Delaware Supreme Court "clearly distinguishes between the *corporate entity* and its *shareholders,* and suggests that the board owes its fiduciary duties to the former (metaphysical) body"); *see also* Amanda Acquisition Corp. v. Universal Foods Corp., 708 F. Supp. 984, 1015 (E.D. Wis.) (upholding defensive tactics designed to prevent not only harm to the shareholders and other corporate constituencies but also "to the corporation itself"), *aff'd on other grounds,* 877 F.2d 496 (7th Cir.), *cert. denied,* 493 U.S. 955 (1989); Cheff v. Mathes, 199 A.2d 548, 556 (Del. 1964) (upholding a greenmail transaction because the board "believed, with justification, that there was a reasonable threat to the continued existence of [the target company], or at least existence in its present form").

116. *See supra* part I.B.2.

The assumption that the corporate entity has intrinsic interests special to itself carries a legal fiction too far without any policy basis.[117] Although the corporation is recognized as a legal "person,"[118] it has no interests apart from those constituencies that the law recognizes as interested stakeholders.[119] The shareholders clearly constitute one such group.[120] Whether and to what extent nonshareholders may count as corporate stakeholders is the subject of fair argument. Part III considers this question. To the extent the law's focus on the corporation as an entity is a coded attempt to legitimize the interests of nonshareholder constituencies,[121] the place of nonshareholder constituencies in corporate decision-making is better considered directly.[122]

2. Protecting Shareholders

The board's ability to defend the corporate entity may be justified purely on shareholder protection grounds. In this context, the board is arguably entitled to run the company's business without taking the view that the company is perpetually for sale.[123] This idea finds voice in the doctrines that *Unocal*

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117. *But see* Hazen, *supra* note 29, at 309 (arguing in favor of the traditional view that "the corporation [is] an 'artificial being' possessing its own 'individuality'" and rejecting "the contractarian model [which] views the corporation as simply an aggregate of its individual constituents") (quoting Trustees of Dartmouth College v. Woodward, 17 U.S. (4 Wheat.) 518, 636–37 (1819)).

118. *See, e.g.*, DEL. CODE ANN. tit. 8, § 122 (1991) (listing specific powers that a corporation has in its own right).

119. *See* Mark L. Loewenstein, *Toward an Auction Market for Corporate Control and the Demise of the Business Judgment Rule*, 63 S. CAL. L. REV. 65, 79–80 (1989) (arguing that liquidation does not pose any threat to the target company); Norwitz, *supra* note 115, at 384–85 (arguing that the corporate entity "can really amount to no more than a collection of stakeholders"). *But see* John C. Carter, *The Rights of Other Corporate Constituencies*, 22 MEM. ST. U. L. REV. 491, 498 (1992) (arguing that "there are corporate interests that are distinct from the aggregate of shareholder and other-constituency interests"); Martin Lipton & Steven A. Rosenblum, *A New System of Corporate Governance: The Quinquennial Election of Directors*, 58 U. CHI. L. REV. 187, 203 (1991) (arguing that "the corporate enterprise has an independent interest of its own in the successful operation of its business").

120. *See, e.g.*, Oliver Williamson, *Corporate Governance*, 93 YALE L.J. 1197, 1210 (1984) (arguing that "the board of directors should be seen as a governance instrument of the stockholders"). *But see* Abram Chayes, *The Modern Corporation and the Rule of Law*, *in* THE CORPORATION IN MODERN SOCIETY 25, 40–41 (Edward S. Mason ed., 1960) (arguing that shareholders who can liquidate their investments with ease have less of a permanent stake in any particular corporation than other constituencies and are less deserving of board representation).

121. The argument that directors may act to preserve the corporate entity is often in essence an argument that the board may consider the interests of nonshareholder constituencies. Commentators have viewed *Paramount*'s emphasis on the corporate entity as a proxy for a broader set of social interests. *See* Gordon, *supra* note 9, at 1972 (explaining *Paramount* as a response to "a widely-shared social sense that self-interested, market-oriented behavior had gotten out of hand in the takeover area, that non-economic values such as loyalty, community, and cultural continuity deserved protection, even in a corporate setting, and that the corporation itself could foster these values in the general society"); Johnson & Millon, *supra* note 34, at 2114 (noting that *Paramount*'s focus on the corporate enterprise allows a target company's board to focus on nonshareholder interests); Norwitz, *supra* note 115, at 385 (arguing that *Paramount* "fashioned a judicial mandate for the consideration of [nonshareholder] constituencies").

122. *See* TW Services, Inc. Shareholders Litig., [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,334, at 92,178 & n.5 (Del. Ch. Mar. 2, 1989) (noting that although the directors owe a duty to the "corporation and its shareholders," this phraseology "masks the most fundamental issue: to what interest does the board look in resolving conflicts between interests in the corporation").

123. *See* Ivanhoe Partners v. Newmont Mining Corp., 535 A.2d 1334, 1345 (Del. 1987) (declining to apply *Revlon* because "Newmont was never for sale").

allows the board to preclude an inadequate bid without determining whether an adequate offer can be procured[124] and that the making of an offer does not trigger *Revlon*.[125] Contrary rules would allow third parties unilaterally to place the target company's board in a sale mode.

Two fundamental assumptions are inherent in the notion that companies are allowed to take the position that they are not for sale at a particular moment in time. First, this view assumes that sale decisions are fundamentally different from other business decisions. Second, it assumes that sale considerations pose disruptions that the board is not required to tolerate. Both of these assumptions prove to be inaccurate.

Liquidation has negative connotations. Indeed, one of the worst charges that can be leveled at a takeover bid is that it is a "bust-up" bid (i.e., the bidder intends to sell off pieces of the target company).[126] However, there is no logical reason to view liquidation in this fashion. Presumably, assembling the company's assets in their current form was thought to be a value-maximizing procedure at some time in the past.[127] If this position continues to be accurate, the company's current aggregation of assets results in synergy because the assets are worth more combined than they would be apart. In this case, the company's going concern value is higher than its liquidation value.

By contrast, if the company's liquidation value is higher than its going concern value, the company's assets should be disaggregated.[128] Much of the takeover craze of the 1980s was driven by the fact that the liquidation values of

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124. *See supra* text accompanying notes 19–22.

125. *See supra* part I.B.2.c.

126. *See Newmont*, 535 A.2d at 1342 (noting that Pickens' offer posed a threat to Newmont because Pickens "had been involved in several attempts to acquire and break-up other corporations"); Moran v. Household Int'l, Inc., 500 A.2d 1346, 1357 (Del. 1985) (upholding the adoption of a poison pill rights plan in light of "the increasing frequency in the financial services industry of 'boot-strap' and 'bust-up' takeovers"); Kors v. Carey, 158 A.2d 136, 141 (Del. Ch. 1960) (noting that a company may protect itself against a tender offeror whose methods "stress liquidity ... and a readiness to sacrifice an established mode of doing business for quick profits"); Coffee, *supra* note 96, at 444 (noting that "'[b]ust-up' is a pejorative word, the use of which implicitly conveys a sense that there is something wrong (and even vaguely immoral) with breaking up companies").

127. A more cynical view is that management increased the company's size to increase management's power and perquisites. According to this view, unjustified accumulation of assets is one of the agency costs that disloyal managers can impose on shareholders. *See, e.g.*, Yakov Amihud & Baruch Lev, *Risk Reduction as a Managerial Motive for Conglomerate Mergers*, 12 BELL J. ECON. 605, 615 (1981) (concluding that managers engage in conglomerate mergers to "decrease their 'employment risk'" rather than to reduce risk from the shareholders' point of view); *see also* John C. Coffee, Jr., *Shareholders Versus Managers: The Strain in the Corporate Web*, 85 MICH. L. REV. 1, 20 (1986) (noting that corporate managers often engage in "an empire-building policy ... to increase the[ir] security ... because the acquisition of additional divisions and product lines both reduces the risk of insolvency and provides opportunities for personal advancement").

128. *See* Southdown, Inc. v. Moore McCormack Resources, Inc., 686 F. Supp. 595, 601 (S.D. Tex. 1988) (arguing that "[i]f the directors cannot devise a business plan that earns a sufficient return to justify the owners investment in the present form, a liquidation, merger, or disconglomeration may be required by their duty to profit the owners"); Coffee, *supra* note 96, at 443 (arguing that breaking up a corporation often results in "negative synergy"); Oesterle, *supra* note 17, at 145 (arguing that, when a company's liquidation value exceeds its going concern value, "the existing managers are breaching their fiduciary duty to their shareholders by not liquidating the undervalued company").

companies were higher than their going concern values[129] and that the conglomerate mergers of years past had proven to be inefficient.[130] Moreover, although boards complained mightily about the bust-up nature of tender offers they opposed, they showed little reservation in adopting management leveraged buy-outs and restructurings that had the same characteristics[131] or seeking out white knights that had the same liquidation plans as the original bidder.[132]

Viewed in this manner, liquidation is an ordinary business decision. When liquidation produces the greatest value for shareholders, it should be undertaken. When it does not, the board should continue the company's business. In this context, the company is always for sale at the right price. If the price is not right, the board should be required to articulate reasonable grounds for believing that the offered price is too low.[133] This burden is not an unreasonable one to place on the board because the board presumably values the company on a continuing basis as part of its normal business practices.[134]

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129. *See* Coffee, *supra* note 127, at 3 (noting that "[s]ince 1984, we have entered the era of the 'bust-up' takeover—that is, a takeover motivated by the perceived disparity between the target's liquidation and stock market values"); Thomas L. Hazen, *The Short-Term/Long-Term Dichotomy and Investment Theory: Implications for Securities Market Regulation and for Corporate Law,* 70 N.C. L. REV. 137, 139 (1991) (noting that "[t]he takeover movement of the last two decades has shown that publicly held shares trade at a minority discount below the asset, takeover, or break-up value of the firm"). Interestingly, both corporate raiders, *see* James W. Michaels & Phyllis Berman, *My Story—Michael Milken,* FORBES, Mar. 16, 1992, at 78, 80, and defenders of the corporate bastion, *see* Martin Lipton, *Corporate Governance in the Age of Finance Corporatism,* 136 U. PA. L. REV. 1, 32–33 (1987), agree on this point.

130. *See* Sanjai Bhagat et al., *Hostile Takeovers in the 1980's: The Return to Corporate Specialization, in* BROOKINGS PAPERS ON ECONOMIC ACTIVITY: MICROECONOMICS 1, 2 (1990) (studying hostile takeovers between 1984 and 1986 and concluding that these "takeovers represent the deconglomeration of American business and a return to corporate specialization"); Amar Bhide, *The Causes and Consequences of Hostile Takeovers,* 2 J. APPLIED CORP. FIN. 36, 50 (1989) (concluding that "'bust-up' takeovers do not destroy valuable synergies" but rather "telescope into a short period the divestitures that would have taken place in the normal course of events"); Randall Morck et al., *Do Managerial Objectives Drive Bad Acquisitions?,* 45 J. FIN. 31, 47 (1990) (concluding that "the source of bust-up gains in the 1980's is the reversal of the unrelated diversification of the 1960's and the 1970's"); *see also* Bernard S. Black, *The Value of Institutional Investor Monitoring: The Empirical Evidence,* 39 UCLA L. REV. 895, 903 (1992) (noting that "[t]he evidence that corporate diversification reduces company value is consistent and collectively damning"); Hazen, *supra* note 129, at 194 (noting "the now widely accepted wisdom that the conglomerate craze of the 1960s and 1970s was ill-conceived"); Steven V. Mann & Neil W. Sicherman, *The Agency Costs of Free Cash Flow: Acquisition Activity and Equity Issues,* 64 J. BUS. 213 (1991) (concluding that firms with a history of diversifying acquisitions show excessive negative abnormal returns when announcing equity offerings); Michael E. Porter, *From Competitive Advantage to Corporate Strategy,* HARV. BUS. REV., May–June 1987, at 43 (concluding that most acquisitions of unrelated businesses are subsequently divested).

131. *See, e.g., Interco,* 551 A.2d at 793; Coffee, *supra* note 127, at 43–44; DeMott, *supra* note 95, at 517–18.

132. *See Revlon,* 506 A.2d at 178.

133. *See* Air Line Pilots Ass'n, Int'l v. UAL Corp., 717 F. Supp. 575, 584–86 (N.D. Ill. 1989) (holding that, although the target company's board may refuse to negotiate with a bidder when the company is "not for sale," the board may not take preclusive defensive action on this basis), *aff'd,* 897 F.2d 1394 (7th Cir. 1990); *In re* Desoto, Inc., Shareholder Litig., [1989–1990 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,964, at 95,394, 95,398 (Del. Ch. Feb. 5, 1990) (disapproving a board's defensive action based in part on the view that the target company was "not for sale" where the board failed to consider whether a pending offer maximized share values).

134. In light of directors' expertise in valuing their own businesses, the courts do not require directors to obtain an investment banker's opinion evaluating the fairness or adequacy of acquisition offers. *See* Smith v. Van Gorkom, 488 A.2d 858, 876 (Del. 1985) (refusing to

Of course, the board is not required to consider all potential business options at all times. Just as the board is not required continually to consider plant expansion, it should not be required continually to consider liquidation. Which options to consider at which times is itself a quintessential business decision. However, takeover premiums in the 1980s averaged 50% over market.[135] A bid offering a large premium provides adequate cause to require the board to consider immediate liquidation as a potential option.

It is also true that considering liquidation has the potential to disrupt the company's relationships with other groups (e.g., employees, customers, and suppliers). As a consequence, the board must weigh the potential costs of considering liquidation against the potential benefits.[136] Once again, the potential gains inherent in a large premium offer would seem to outweigh the potential costs in most cases and provide adequate justification to require the board at least to consider immediate liquidation.

3. Conclusion

The foregoing discussion challenges the philosophical justifications for allowing a target company's board to adopt defensive tactics without examining whether a particular bid is value-maximizing. The board should not be allowed to preserve the corporate entity for its own sake or take the position that the target company is not for sale in response to a bid that offers a substantial premium. The following sections consider the manner in which the board should be required to demonstrate that its defensive tactics are value-maximizing.

B. Comparing Going Concern and Sale Values

Under *Unocal*, the board may adopt defensive tactics designed to preserve the target company's independence without demonstrating that the

"state that fairness opinions by independent investment bankers are required as a matter of law" because "[o]ften insiders familiar with the business of a going concern are in a better position than are outsiders to gather relevant information"); *see also* Estate of Detwiler v. Offenbecher, 728 F. Supp. 103, 151 (S.D.N.Y. 1989) (holding that "[i]n light of their extensive knowledge," two directors "had no obligation to obtain an independent valuation of the Company"); Amanda Acquisition Corp. v. Universal Foods Corp., 708 F. Supp. 984, 1013 (E.D. Wis.) (upholding a board's finding of inadequacy without the aid of an investment banker's opinion because "the independent directors ascertained from their own knowledge and experiences that the offer was inadequate in light of the future prospects of the company"), *aff'd on other grounds*, 877 F.2d 496 (7th Cir.), *cert. denied*, 493 U.S. 955 (1989); Torchmark Corp. v. Bixby, 708 F. Supp. 1070, 1082 (W.D. Mo. 1988) (noting that "insiders are frequently in a better position [than outside investment advisors] to assess the intrinsic value of the corporation's shares"); *In re* Formica Corp. Shareholders Litig., [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,362, at 92,393 (Del. Ch. Mar. 22, 1989) (noting that the independent directors of a target company were "knowledgeable about the company's operations and finances, were sophisticated in financial matters, and were fully capable of making their own independent judgment of the adequacy and fairness of the transaction"); Citron v. Steego Corp., No. CIV.A.10171, 1988 WL 94738, at *9 (Del. Ch. Sept. 9, 1988) (noting that "whether the advice of an investment banker would be helpful or not in making a business decision of importance is itself a question demanding business judgment").

135. *See, e.g.*, Bernard S. Black, *Bidder Overpayment in Takeovers*, 41 STAN. L. REV. 597, 601 (1989).

136. *See* Yanow v. Scientific Leasing, Inc., [1991 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 96,189, at 91,012 (Del. Ch. July 31, 1991) (upholding a board's decision not to canvass the market to prevent departure of key employees and disruption of the company's business relationships).

company's going concern value is higher than a pending bid. The board is entitled to find an offer inadequate if the company's liquidation value exceeds the bid price even where the board has no intention of liquidating the company.[137] Indeed, in the takeover defense context, "inadequacy" has come to mean that the board could sell the company for more than the bid if it desired to try.[138]

The justification most often given for allowing the board to determine adequacy by comparing liquidation value to the bid is that going concern and sale values are not comparable.[139] The latter typically includes a control premium that the former does not.[140] The control premium notion is also central to the cases holding that only sales of control arguably trigger the *Revlon* duty to maximize shareholder value short of an outright sale of the entire company.[141] It is well accepted that a bidder typically pays a premium for a control block of stock.[142] To determine whether the control premium rationale for refusing to compare going concern and sale values is legitimate, one must examine the potential sources of the bidder's control premium and the time framework in which it is received.

1. Sources of the Control Premium

Initially, it is clearly true that a control block is worth more than the sum of the individual shares. The control block gives the purchaser the power to run the corporation's affairs as he sees fit. A control block purchaser is willing to pay a premium for this valuable privilege.[143]

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137. *See supra* part I.A.1.

138. *See, e.g.*, Paramount Communications, Inc. v. Time Inc., 571 A.2d 1140, 1148 (Del. 1990); Citron v. Fairchild Camera & Instrument Corp., 569 A.2d 53, 63 n.15 (Del. 1989); *Revlon*, 506 A.2d at 182; Lucian A. Bebchuk & Marcel Kahan, *Fairness Opinions: How Fair Are They and What Can Be Done About It?*, 1989 DUKE L.J. 27, 46 (noting that "[i]n friendly transactions, banks couch opinions in terms of fairness (Would a rational board accept the offer?), whereas in hostile deals banks evaluate the offers in terms of adequacy (Can a higher offer be obtained?)"). In investment bankers' parlance, a bid can be fair but inadequate. *See, e.g.*, Robert M. Bass Group, Inc. v. Evans, 552 A.2d 1227, 1241 (Del. Ch. 1988).

139. *See, e.g.*, *Bass*, 552 A.2d at 1242 (rejecting this justification); Hazen, *supra* note 129, at 189 (arguing that an "explanation for the discrepancy between market value and take-out value is that trading in the public market reflects a discount for minority shares and it is only in a control-related transaction that the premium emerges").

140. Thus, in *Paramount*, Time's advisors believed that the value of the combination with Warner was not comparable to Paramount's offer because only the latter included a control premium. In finding Paramount's offer inadequate, Time's board compared the offer to the company's auction value. *See Paramount*, 571 A.2d at 1148; *see also* TW Services, Inc. Shareholders Litig., [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,334, at 92,179 n.7 (Del. Ch. Mar. 2, 1989) (suggesting that going concern and takeover values are not comparable because takeover bids typically include a 40% to 50% premium).

141. *See supra* part I.B.2. In *Paramount*, the court noted that *Revlon* duties were not triggered by Time's merger with Warner because, although the merger would create a $30 billion company, a premium bid for the combined company remained a possibility. *See Paramount*, 571 A.2d at 1151.

142. *See, e.g.*, Cheff v. Mathes, 199 A.2d 548, 555 (Del. 1964); *see also* Essex Universal Corp. v. Yates, 305 F.2d 572, 573–74 (2d Cir. 1962); Zetlin v. Hanson Holdings, Inc., 397 N.E.2d 387, 388 (N.Y. 1979).

143. *See* William D. Andrews, *The Stockholder's Right to Equal Opportunity in the Sale of Shares*, 78 HARV. L. REV. 505, 526 (1965); Richard A. Booth, *Discounts and Other Mysteries of Corporate Finance*, 79 CAL. L. REV. 1053, 1079–80 (1991); Einer Elhauge, *The Triggering Function of Sale of Control Doctrine*, 59 U. CHI. L. REV. 1465, 1487 (1992).

However, purchase of a control block where a control block did not previously exist also diminishes the value of the remaining shares. Just as the control block purchaser pays a premium to reflect his increased empowerment, the remaining minority shares should decrease in value to reflect their disempowerment.[144] The control purchaser has the power to divert assets to his own use or force a second-step merger on terms favorable to him and unfavorable to the minority.[145] If the value of the premium is balanced by the diminution in the value of minority shares, the total worth of the company has not changed. Its value has simply been redistributed.[146]

A bidder who purchases an entire company buys not only the control block but also the diminished minority shares. One may therefore question why the bidder pays any premium in this circumstance. Indeed, it is occasionally said that "to a true believer of efficient markets, there cannot be a premium for control."[147] Although the source of the control premium from 100% buyers remains something of a mystery,[148] three theories are the most common: (a) the target company is undervalued by the market;[149] (b) the bidder can increase the efficiency of the target company's management;[150] or (c) the target company's assets can be combined with the bidder's to produce synergy.[151]

If undervaluation is the source of the bidder's premium, the bidder is attempting to acquire the target company for less than its intrinsic value and the company's board has legitimate grounds to defend against the takeover. Disciples of the efficient market hypothesis discount the undervaluation

144. This conclusion follows absent countervailing considerations, such as an increase in the efficiency of management or synergy, that increase the value of the company as a whole. In such cases, all shares, including minority shares, should increase in value. *See* Michael Bradley, *Interfirm Tender Offers and the Market for Corporate Control,* 53 J. BUS. 345 (1980) (concluding that after consummation of partial tender offers the post-takeover value of minority shares exceeds the pre-takeover market price).

145. *See supra* note 72 and accompanying text.

146. *See* Bebchuk, *supra* note 72, at 1715–16.

147. *See Paramount,* [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) at 93,276 (quoting Martin Shubik, *Corporate Control, Efficient Markets, and the Public Good, in* KNIGHTS, RAIDERS & TARGETS: THE IMPACT OF THE HOSTILE TAKEOVER 31, 33 (John C. Coffee, Jr. et al. eds., 1988)).

148. *See* Coffee, *supra* note 96, at 443.

149. *See, e.g.,* Kraakman, *supra* note 16, at 908–14.

150. *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, 1168–74 (1981); Gilson, *supra* note 10, at 841–44; *see also* Kenneth J. Martin & John J. McConnell, *Corporate Performance, Corporate Takeovers, and Managerial Turnover,* 46 J. FIN. 671 (1991) (concluding that target companies whose chief executive officers were replaced within two years of an acquisition significantly underperformed other target companies in the pre-acquisition period).

151. *See, e.g.,* Michael Bradley et al., *The Rationale Behind Interfirm Tender Offers: Information or Synergy?,* 11 J. FIN. ECON. 183, 185–87 (1983); Gilson, *supra* note 10, at 873; Gregg A. Jarrell & Michael Bradley, *The Economic Effects of Federal and State Regulations of Cash Tender Offers,* 23 J.L. & ECON. 371, 381–82 (1980). One commentator has recently suggested that the takeover premium reflects the elasticity in the supply curve for securities. According to this theory, the market price of a company's stock represents the worth of a single share to that shareholder most willing to sell. The bidder pays a premium to obtain enough shares from more optimistic shareholders to obtain control. *See* Lynn A. Stout, *Are Takeover Premiums Really Premiums? Market Price, Fair Value, and Corporate Law,* 99 YALE L.J. 1235, 1262 (1990).

theory.[152] I have argued that neither the target company's board nor the courts should give dispositive effect to the market and that the board should be entitled to present proof that the target company is undervalued.[153] For present purposes, I will assume that the target company's intrinsic value corresponds to its market value.

If an expected increase in the efficiency of management or synergy is the source of the bidder's premium, the target company is worth more in the hands of the bidder than in the hands of current management, and the bidder should be willing to pay a premium. Moreover, consummation of a takeover by a single entity should increase the efficiency of management in most cases even if no personnel changes are made. When a single purchaser buys shares that are currently dispersed, he reduces the agency costs involved in running the business. A single shareholder has an incentive and an ability to monitor management that dispersed shareholders do not have. As a consequence, all purchasers should pay a premium purely to obtain control even if the bidder seeks to acquire 100% of the target company's shares.[154]

The target company's board is, therefore, on solid ground when it argues that a takeover bid should always include an appropriate control premium and that preclusion of a current bid leaves open the possibility of obtaining a premium bid in the future. To the extent that a current bidder can improve the efficiency of management or create synergy, future bidders may be able to produce the same efficiency gains and pay a similar or larger control premium.[155] However, the fact that the target company's board might obtain a premium bid in the future does not justify the board in refusing to consider a current bid where the bid is higher than the company's going concern value. As demonstrated below, boards have failed to apply appropriate discounts to potential future offers when rejecting current bids and to realize that going concern and sale values are directly comparable.

2. Discounting Future Offers

For purposes of analyzing the discounting problem, let us assume that: (a) the present value of a corporation's expected income stream (i.e., the company's going concern value) is $100 per share; (b) a bidder offers $125 per share; (c) takeover premiums in the target company's industry approximate the

152. *See, e.g.*, Dynamics Corp. of Am. v. CTS Corp., 794 F.2d 250, 253 (7th Cir. 1986) (Posner, J.), *rev'd on other grounds*, 481 U.S. 69 (1987); Easterbrook & Fischel, *supra* note 150, at 1165–68; Alan Schwartz, *The Fairness of Tender Offer Prices in Utilitarian Theory*, 17 J. LEGAL STUD. 165, 188–89 (1988).

153. *See* Ragazzo, *supra* note 11, at 710–18.

154. For support of the agency cost explanation for takeover premiums, see Easterbrook & Fischel, *supra* note 150, at 1173; Elhauge, *supra* note 143, at 1487–88. Although the target company may be worth more in the hands of single owner than in the hands of dispersed owners, the purchaser increases the value of his portfolio of investments by diversifying that portfolio. *See, e.g.*, RONALD J. GILSON, THE LAW AND FINANCE OF CORPORATE ACQUISITIONS 125–32 (1986). For control to be a valuable commodity, its value must exceed the cost of reduced diversification that results from limiting the purchaser's opportunity to pursue other investments. *See* Booth, *supra* note 143, at 1080–81.

155. There is evidence that when a target company defeats a bid, its stock price remains above the pre-bid price. However, where an acquisition has not occurred within five years, the target company's stock falls back to pre-offer levels. This evidence suggests that the market expects defeated bids to be followed by other bids. *See* Bradley, *supra* note 151, at 185–86.

national average of 50% that such premiums had in the 1980s;[156] and (d) the target company's board rejects the bid on the theory that it is inadequate and the board could probably achieve a higher bid from another bidder if it tried. Is the board's conduct justified?

Initially, the bid may not be inadequate even if the board is allowed to compare the current bid to potential future bids. A future premium bid may not be forthcoming.[157] The current bidder may have an ability or a desire to improve the efficiency of a target company's management that other potential bidders do not share. The current bidder may have a unique ability to produce synergies after a combination with the target company. A downturn in market conditions may make it more difficult to finance a future acquisition.[158] For all of these reasons, the expected value of any future premium must be discounted by the chance that such a bid will occur.[159] Assume that there is a 50-50 chance that the target company's board can generate a $150 bid in the future. The expected value of this potential $50 premium is only $25, which is identical to the expected value of the premium offered by the pending $125 bid.

The prospect of a future premium bid must also be discounted for two other factors. First, potential future bids must be discounted for the time value of money. As a consequence, rejection of a current premium can only be justified by the expectation of a larger premium in the future. The further in the future this prospect is, the larger the future premium must be. Second, potential future bids must be discounted for risk.[160] If the current bidder has solid financing, his bid is a certainty. Future bids may not occur. A larger premium is required to justify turning down a certain bid for an uncertain one. Discounting potential future bids whose expected values are worth $125 for the time value of money and risk make them less valuable than the pending $125 offer. Under these conditions, the target company's board would not be justified in rejecting the $125 bid based on potential future bids.[161]

Inadequacy determinations are usually based in part on an investment banker's comparison of the premium offered by the pending bidder to

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156. *See supra* text accompanying note 135.

157. *Cf.* David W. Leebron, *Games Corporations Play: A Theory of Tender Offers,* 61 N.Y.U. L. REV. 153, 194–95 (1986) (noting that "the vast majority of tender offers are not competitive").

158. *See, e.g., Revised UAL Plan Seen,* N.Y. TIMES, Dec. 4, 1989, at D2 (noting that the United Airlines Pilots Union was required to abandon its $6.75 billion bid for United when its junk bond financing collapsed).

159. *See* Gregg H. Kanter, Comment, *Judicial Review of Antitakeover Devices Employed in the Noncoercive Tender Offer Context: Making Sense of the Unocal Test,* 138 U. PA. L. REV. 225, 254 (1989) (implying that tender offer defense based on a potential future offer is justified only where the discounted value of the difference between the value of the future offer and the bid exceeds the discounted value of the difference between the bid and the target company's going concern value).

160. Although discounting for the risk might seem to involve double counting, it does not. A 50% chance of receiving $2 million has an expected value of $1 million. However, a rational person would prefer the certainty of receiving $1 million to taking the 50% chance of receiving $2 million. That is because the latter outcome is riskier and rational persons will not take extra risk without compensation. Thus, the value of a future premium bid must first be discounted by the chance that such a bid will occur to generate an expected value and then be discounted for the risk or variation in expected return.

161. *See* Bradley, *supra* note 151, at 185 (arguing that rejecting a tender offer is rational only where "the present value of [the] anticipated future bid exceeds the value of the outstanding offer").

premiums offered in recent comparable transactions.[162] The above analysis demonstrates that these comparisons are deficient to the extent that they do not discount the value of potential premium bids for the chance that such bids will not occur, the time value of money, and risk.[163]

3. Comparing Relevant Values

The above analysis demonstrates that when boards compare current bids to potential future bids, they often do so inaccurately. However, potential future bids are not the appropriate benchmark for comparison. If the board's goal is to maintain the target company's independence, it should be required to compare the going concern value of the company to the bid.

Let us assume that if the target company's board attempted to generate future premium bids, the discounted present value of such bids would be $130, which exceeds the pending bid. Is the target company's board justified in refusing to consider the pending bid if it intends to continue running the company's business and has no plans to consider liquidation? The answer to this question must be no because, if the board has no intention to pursue liquidation and signals that it will resist future bids, the potential value of future premium bids must also be discounted for these factors.[164] Taking an extreme case, if the board refuses to consider liquidation, refuses to consider any bids for the company, adopts defensive mechanisms that make hostile offers impossible to consummate, and there is a 100% chance that the courts will uphold such mechanisms, the expected value of future premium bids is $0. This conclusion holds without regard to the present value future bids would have if encouraged by board.

Much of the courts' reluctance to require the comparison of going concern and sale values derives from the assumption that these values cannot be compared directly. This assumption is false. In an efficient market, a company's current stock price reflects the possibility of receiving future premium offers, with appropriate discounts for decreased expected value, the time value of money, and risk.[165] If the target company's board believes that the market has inefficiently accounted for the possibility of future bids, or has inefficiently priced its stock for any other reason, it should be required to offer a reasonable basis for its position.

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162. *See, e.g.,* Desert Partners, L.P. v. USG Corp., 686 F. Supp. 1289, 1299 (N.D. Ill. 1988); Buckhorn, Inc. v. Ropak Corp., 656 F. Supp. 209, 215 (S.D. Ohio), *aff'd,* 815 F.2d 76 (6th Cir. 1987); City Capital Associates v. Interco, Inc., 551 A.2d 787, 792 (Del. Ch. 1988); *see also* Citron v. Fairchild Camera & Instrument Corp., 569 A.2d 53, 58 (Del. 1989) (noting that a target company's board rejected a bid because the control premium was below the industry average); MAI Basic Four, Inc. v. Prime Computer Inc., [1988–1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,179, at 91,634 (Del. Ch. Dec. 20, 1988) (upholding a board's rejection of an offer in part because the offer represented "a relatively small premium over the recent selling price of [the target company's] shares").

163. *See, e.g., Buckhorn,* 656 F. Supp. at 230–31 (criticizing a break-up analysis for not considering, among other factors, the time value of money).

164. *See* Gilson, *supra* note 10, at 844–45 (noting that access to preclusive defensive tactics allows the target company's board to increase the transaction costs associated with offers and decreases the likelihood that such offers will occur).

165. *See* Robert M. Bass Group, Inc. v. Evans, 552 A.2d 1227, 1242 (Del. Ch. 1988) (noting that the current market value "tak[es] into account whatever control premium might be realized in the future").

4. Conclusion

As a consequence of the foregoing, the *Unocal* standard should incorporate *Revlon*'s requirement that the target company's board attempt to maximize immediate shareholder wealth.[166] If the target company's board defends against an offer to maintain the independence of the target company, it should be required to present reasonable grounds to believe that the going concern value of the company is higher than the bid.[167] If the board defends on the ground that the company's future liquidation value is higher than the bid, it should be required to prove that it plans to consider liquidation in a specific time frame and that it has reasonable grounds to conclude that the discounted present value of potential future bids is higher than the current bid. The wealth maximization principle should also be triggered whether or not control is sold or the company is restructured as part of any defensive response. To this extent, the progeny of *Revlon* are too narrow.[168]

Generalizing *Revlon*'s shareholder wealth criterion would eliminate the gap between *Unocal* and *Revlon* to the extent the board is acting on behalf of shareholders. Some of the hesitation to extend *Revlon* may derive from the fact

166. In *In re* Desoto, Inc. Shareholder Litig., [1989–1990 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,964 (Del. Ch. Feb. 5, 1990), the court disapproved defensive measures designed to preserve the target company's independence where the target company's board declined to consider whether a pending offer maximized shareholder value. The court explicitly viewed this result as an application of *Revlon*'s wealth maximization principle. *Id.* at 95,397–98. Although *Desoto* is contrary to the weight of authority, *see supra* parts I.A.1 & I.A.2, *Desoto* rather than the weight of authority states the better view. *See also* Dynamics Corp. of Am. v. CTS Corp., 794 F.2d 250, 256 (7th Cir. 1986) (noting that to be legal defensive tactics must be "plausibly related to the goal of stockholder wealth maximization"), *rev'd on other grounds,* 481 U.S. 69 (1987); Oesterle, *supra* note 17, at 153 (criticizing *Revlon* for "limit[ing] its analysis to auctions and other situations in which target managers recognize the inevitability of the company's sale"); Eugenia C. Avery, Note, *Time for a Change: An Argument Against the All-or-Nothing Approach to Shareholders' Rights Taken in Paramount v. Time,* 10 J.L. & COM. 113, 132 (1990) (arguing that "Revlon should be interpreted more expansively" to "allow[] for greater consideration of short-term interests of shareholders in instances where the company does not enter a 'Revlon mode'").

167. In Dynamics Corp. of Am. v. CTS Corp., 805 F.2d 705 (7th Cir. 1986), the target company's board adopted a back-end rights plan that precluded offers below $50 per share. *Id.* at 713. The board presented proof that the company was worth $50 per share by using a price-earnings multiplier. *Id.* at 714. The Seventh Circuit remanded for a reconsideration of whether the board's proof was overly optimistic. *Id.* at 714–16. This case implies that it is appropriate to compare the target company's going concern value to the bid because the value derived from the application of a price-earnings multiplier is a going concern value. *See also* Amanda Acquisition Corp. v. Universal Foods Corp., 708 F. Supp. 984, 1014 (E.D. Wis.) (upholding a finding of inadequacy where analysts projected that the trading price of the target company's stock would exceed the tender offer price within one year), *aff'd on other grounds,* 877 F.2d 496 (7th Cir.), *and cert. denied,* 493 U.S. 955 (1989); *Buckhorn,* 656 F. Supp. at 229 (upholding a finding of inadequacy based in part on a conclusion that the target company's "performance would probably improve in the future and that its current stock price was undervalued"); Gilson & Kraakman, *supra* note 10, at 260–62 (arguing that the target company's board can plausibly refuse to negotiate with a bidder or conduct an auction only where the bidder offers less than the company's going concern value); John H. Matheson & Brent A. Olson, *Shareholder Rights and Legislative Wrongs: Toward Balanced Takeover Legislation,* 59 GEO. WASH. L. REV. 1425, 1514–15 (1991) (arguing that one of the "factors to be considered in determining whether an offer is in the shareholders' best interests" is "whether the board has competent and persuasive evidence demonstrating ... that the present value of the corporation's stock, given the probable outcome of consummating a current, bona fide, long-term plan demonstrably exceeds the value of the tender offer").

168. *See supra* part I.B.2.

that the *Revlon* test is perceived to be too onerous.[169] However, *Revlon* does not command a court to second guess business decisions made by a corporation's board any more than *Unocal* does.[170] As long as the board can prove that it had reasonable grounds to believe that its defensive actions advanced the goal of shareholder wealth maximization, the board should be entitled to prevail even if the court concludes that it would have adopted a different strategy. The error in current law is that the board is not required even to make this showing.

I also do not mean to suggest that the target company's board must accept any premium bid that is higher than the company's going concern value. The target company's board should have the capacity to bargain with the bidder or conduct an auction to ensure that the target company's shareholders receive an appropriate share of any efficiency gains flowing from the takeover.[171] For example, if a company's going concern value is $100 per share, a bidder offers $125 per share, and the company is worth $200 in the bidder's hands due to synergy gains, the target company's board could justifiably bargain to increase the price to the $150 range.[172] As a consequence, in some cases the board will be justified in precluding premium bids to give its negotiating threats force. My point is simply that the board should attempt to procure an adequate bid once it determines that a pending bid is higher than the company's going concern value.[173] To say that a bid is inadequate in these circumstances because the

169. *See* Gilson & Kraakman, *supra* note 67, at 56.

170. *Compare In re* Vitalink Communications Corp. Shareholders Litig., [1991–1992 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 96,585, at 92,742 (Del. Ch. Nov. 8, 1991) (holding that an investment banker's fairness opinion constituted "reliable information upon which the Board partially could judge the adequacy of [a bidder's] offer" under *Revlon* "[d]espite the infirmities" of one of the banker's analyses) *with* Gilbert v. El Paso Co., 575 A.2d 1131, 1145 n.29 (Del. 1990) (noting that *Unocal* "implicitly acknowledges that courts should not impose their own business judgment upon independent directors who reasonably respond to a threat to the corporate enterprise in good faith and on an informed basis").

171. *See* Ragazzo, *supra* note 11, at 707–10. A target company's stock often trades above the price of a pending offer reflecting the expectation that the target company's board will be able to achieve a higher value through negotiation or an auction. *See, e.g.*, Roberts v. General Instrument Corp., [1990 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 95,465, at 97,405 (Del. Ch. Aug. 13, 1990); Nomad Acquisition Corp. v. Damon Corp., [1988–1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,040, at 90,868 (Del. Ch. Sept. 20, 1988); Tate & Lyle PLC v. Staley Continental, Inc., [1987–1988 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 93,764, at 98,587 (Del. Ch. May 9, 1988); Facet Enters. v. Prospect Group, Inc., No. CIV.A.9746, 1988 WL 36140, at *5 (Del. Ch. Apr. 15, 1988). Target companies have successfully used defensive tactics to appropriate most of the gains flowing from combinations for the target company's shareholders. Although the gains to target company shareholders from successful acquisitions have been large, *see, e.g.*, Michael C. Jensen & Richard S. Ruback, *The Market for Corporate Control: The Scientific Evidence*, 11 J. FIN. ECON. 5 (1983), such acquisitions are either neutral from the perspective of the bidder's shareholders or result in a small loss in value. *See, e.g.*, Black, *supra* note 135, at 602–04; George W. Dent, Jr., *Unprofitable Mergers: Toward a Market-Based Legal Response*, 80 NW. U. L. REV. 777, 778–79 (1986). The studies generally show that target companies that defeat an initial offer but are subsequently acquired gain from the use of defensive tactics. *See, e.g.*, *Dynamics*, 794 F.2d at 255; Bradley, *supra* note 151, at 193; Gilson & Kraakman, *supra* note 10, at 264–65. *But see* Richard S. Ruback, *Do Target Shareholders Lose in Unsuccessful Control Contests?*, *in* CORPORATE TAKEOVERS: CAUSES AND CONSEQUENCES 137, 148 (Alan J. Auerbach ed., 1988).

172. *See* Dynamics Corp. of Am. v. CTS Corp., 794 F.2d 250, 254 (7th Cir. 1986) (arguing that bargaining by the target company's board can maximize shareholder value).

173. *See* Oesterle, *supra* note 17, at 131 (arguing that, in the absence of confidential business information, only "a failed negotiation gambit aimed at securing a higher price justifies a target manager's total defeat of a tender offer").

company has available a more valuable course that it refuses to pursue is a logical non sequitur.

C. Comparing Short- and Long-Term Values

Another rationale for allowing preclusive defensive tactics without requiring the target company's board to compare the company's going concern value to the bid is that requiring such a comparison forces the board to focus inordinately on short-term value.[174] According to this view, valuable long-term projects, such as research and development, are neglected for the purpose of maximizing short-term value.[175] Upon close inspection, this rationale has no independent significance. It devolves into an argument that the market has inefficiently priced the target company's stock.[176]

To a believer in efficient markets, there is no dichotomy between short- and long-term values.[177] In an efficient market, the current market price of a company's stock represents the market's best estimate of the company's future returns properly discounted for the time value of money and risk.[178] Research and development, and other long-term expenditures, are not inherently sacred activities. Managers should engage in research and development if and only if the discounted future returns justify the current cost.[179] If loyal and efficient managers decide to forego future research and development expenditures, they do so because the current cost outweighs the future benefits, not because they are inordinately focused on the short term.[180] Indeed, a firm that spends too much on research and development should be a prime takeover target because potential bidders can increase the value of the firm by reducing the firm's research and development budget. A firm whose research and development

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174. *See, e.g.*, TW Services, Inc. Shareholders Litig., [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,334, at 92,178 & n.6 (Del. Ch. Mar. 2, 1989); Hazen, *supra* note 129, at 178–83; *see also* Lipton & Rosenblum, *supra* note 119, at 225–28 (arguing for the quinquennial election of directors to eliminate the short-term focus of management).

175. *See, e.g.*, Lipton, *supra* note 129, at 23.

176. *See* Paramount Communications, Inc. v. Time Inc., [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,514, at 93,276–77 (Del. Ch. July 14, 1989); Gordon, *supra* note 9, at 1949–50 & n.61; Hazen, *supra* note 129, at 143, 181–82.

177. *See* Jonathan R. Macey, *State Anti-Takeover Legislation and the National Economy*, 1988 WIS. L. REV. 467, 481 (arguing that "the distinction between maximizing firm value for the present versus maximizing firm value for the future is wholly false"); Oesterle, *supra* note 17, at 144 (noting that any distinction between short- and long-term value "flies in the face of efficient market theory").

178. *See, e.g.*, THOMAS E. COPELAND & J. FRED WESTON, FINANCIAL THEORY AND CORPORATE POLICY 77–108, 841–43 (3d ed. 1988); GILSON, *supra* note 154, at 68–124.

179. *See, e.g.*, GILSON, *supra* note 154, at 152–55.

180. *See* OFFICE OF THE CHIEF ECONOMIST, SEC. AND EXCH. COMM., INSTITUTIONAL OWNERSHIP, TENDER OFFERS, AND LONG-TERM INVESTMENTS 1 (1985) (concluding that takeover threats do not "preoccup[y] corporate executives with propping up short-term earnings, at the expense of investing in long-term projects, such as research and development"). *Cf.* Lisa K. Meulbroek et al., *Shark Repellents and Managerial Myopia: An Empirical Test*, 98 J. POL. ECON. 1108, 1114–16 (1990) (concluding that firms reduce research and development expenditures after insulating management from takeovers through the adoption of shark repellent amendments). *But see* Robert D. Buzzell & Mark J. Chussil, *Managing for Tomorrow*, SLOAN MGMT. REV., Summer 1985, at 3, 10–11 (concluding that managers are sacrificing beneficial long-term investments to maximize short-term earnings).

expenditures are efficient should experience no change in this area after a takeover.[181]

Assume that a company's stock is selling on the market for $100 per share and a bidder offers $150 per share. If the target company's board believes that the going concern value of the company is higher than the bid, the board is effectively arguing that the market has inefficiently priced its stock. In individual cases, the board may be able to prove that the market has overly discounted the potential returns flowing from such long-term expenditures as research and development.[182] As stated above, despite the view of the efficient market proponents, I believe the board should be entitled to the opportunity to persuade a court of this proposition. However, this conclusion only implies that, despite the premium offered by the bidder, the board should have the opportunity to present proof on the issue of comparative value. The possibility of market inefficiency does not justify allowing the board to preclude offers without comparing the values offered by continuing the company's business and accepting the bid.[183]

The argument that a target company's directors may take into account long-term interests even though a bid maximizes short-term value is, like the argument that the board may act to preserve the corporate entity, often a thinly

181. *See* Bhide, *supra* note 130, at 46 (concluding that takeover acquisitions do not decrease research and development spending).

182. Indeed, proponents of allowing the board to focus on long-term value make precisely this claim. *See, e.g.*, Hazen, *supra* note 129, at 181 & n.197 (noting that "[c]ommentators have suggested that the stock markets tend to overreact to short-term information and fail to take into account the longer-term view"); *see also* Paramount Communications, Inc. v. Time Inc., [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,514, at 93,276 (Del. Ch. July 14, 1989) (noting that the distinction between short- and long-term values implies "that current stock market values fail to reflect 'accurately' achievable future value").

183. The above analysis assumes that market price, although not dispositive of value, is a sufficiently good indicator of value that directors should be required to justify conduct that contradicts the market. By contrast, if the market systematically prices companies incorrectly, the market price cannot serve as a benchmark for comparisons of short- and long-term value. There is evidence that the market overvalues short-term considerations and undervalues long-term considerations. *See* Hazen, *supra* note 129, at 181; Wayne Joerding, *Are Stock Prices Excessively Sensitive to Current Information,* 9 J. ECON. BEHAV. & ORGANIZATION 71, 72–81 (1988). There is also evidence that the market undervalues certain types of companies on a systematic basis, *see* Kraakman, *supra* note 16, at 902–08 (noting that the market undervalues closed-end investment funds, companies with large investments in marketable securities, and natural resource companies), and that this tendency toward undervaluation may be general, *see id.* at 908–14. However, there is a wealth of evidence that the market is efficient in the semi-strong sense—that is, that the market price of a company's stock accurately reflects all public information about the company. *See, e.g.*, Jeffrey N. Gordon & Lewis A. Kornhauser, *Efficient Markets, Costly Information, and Securities Research,* 60 N.Y.U. L. REV. 761, 834–41 (1985) (collecting studies); Macey, *supra* note 177, at 471 (noting the "overwhelming evidence" supporting the semi-strong form of the efficient capital markets hypothesis). Although this evidence is not uniform, *see* Gordon & Kornhauser, *supra*, at 841–46, the evidence on market efficiency is sufficiently strong to allow the use of market price as a starting point in discussing value questions. In the related context of appraisal, the existence of a reliable market price is given some weight by all jurisdictions and presumptive weight in a number of jurisdictions. *See* HARRY G. HENN & JOHN R. ALEXANDER, LAWS OF CORPORATIONS AND OTHER BUSINESS ENTERPRISES 1002–03 (3d ed. 1983). As a consequence of the foregoing, deviations from market parameters should require justification.

disguised plea for the recognition of nonshareholder interests.[184] As noted above, such interests are better considered on their own merits.[185]

D. Conclusion

In sum, to the extent the board is acting on behalf of shareholders, the board should be prepared to demonstrate that the target company's going concern value is higher than a pending bid whenever the board takes defensive action to preserve the target company's independence. The board should not be allowed to take the position that the target company is not for sale or that going concern and sale values are not comparable. The law should no longer mask the difficult policy question involved in deciding whether and to what extent the board may represent nonshareholder constituencies by assuming the board may protect the corporate entity or focus on long-term interests. Part III considers whether and to what extent the board may consider the interests of nonshareholder constituencies.

III. THE INTERESTS OF NONSHAREHOLDER CONSTITUENCIES

Corporate takeovers pose a substantial danger to nonshareholder constituencies. The highly leveraged takeover bids of the 1980s adversely affected employees, creditors, and the community as a whole.[186] Target companies often adopted leveraged restructurings as defensive maneuvers that had the same impacts.[187] In many cases, the effects were devastating.[188] Of course, the bidder's disruption of established relationships may flow from the fact that those relationships have become a substantial drag on shareholder

184. *See Paramount*, [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) at 93,277 & n.15; TW Services, Inc. Shareholders Litig., [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,334, at 92,178 & n.6 (Del. Ch. Mar. 2, 1989); Hazen, *supra* note 129, at 143, 196–202; John H. Matheson & Brent A. Olson, *Corporate Law and the Longterm Shareholder Model of Corporate Governance*, 76 MINN. L. REV. 1313, 1323 (1992) (equating short-term interests with shareholders and long-term interests with nonshareholders).

185. *See supra* text accompanying notes 117–22.

186. *See* Coffee, *supra* note 127, at 68–73.

187. *See, e.g.*, Capital City Associates v. Interco, Inc., 551 A.2d 787, 793, 802 (Del. Ch. 1988); DeMott, *supra* note 95, at 532.

188. *See, e.g.*, Edgar v. Mite Corp., 457 U.S. 624, 646 n.* (1982) (Powell, J., concurring) (noting that "[w]hen corporate headquarters are transferred out of a city and State ... the State and locality from which the transfer is made inevitably suffer significantly"); Stephen M. Bainbridge, *Interpreting Nonshareholder Constituency Statutes*, 19 PEPP. L. REV. 971, 1003–04 (1992) (noting estimates that about 500,000 jobs were lost as a result of takeover activity in the mid-1980s and that takeovers have the potential to devastate local communities built around a single firm); Coffee, *supra* note 127, at 7 (noting that "600,000 or more 'white collar' managerial positions have been eliminated in recent years as the result of corporate restructurings and similar efforts to trim excess staff"); Lipton, *supra* note 129, at 26 (noting that Sir James Goldsmith's bid for Goodyear implicated one-eighth of Akron, Ohio's workforce and a company that generated $300 million in local supplier income); Robert O'Brien & Richard Kline, *An Rx for Jobs Lost Through Mergers*, N.Y. TIMES, Feb. 22, 1987, § 4, at 23 (noting that Owens–Corning cut its workforce from 28,000 to 13,000 as part of an effort to defeat a takeover bid); Kenneth R. Sheets, *People Pay the Highest Price in a Takeover*, U.S. NEWS & WORLD REP., July 22, 1985, at 51 (noting that Gulf Oil contributed millions annually to local charities prior to its exodus from Pittsburgh to avoid a takeover).

value.[189] Indeed, the target company may be attractive precisely because the bidder sees an opportunity to eliminate inefficient behavior.[190]

The substantial impact that the takeover boom of the 1980s had on nonshareholder constituencies raises sharply the issues of whether and to what extent a target company's board may consider the interests of nonshareholder constituencies in responding to a takeover bid. The answers to these questions are unclear under current law. *Unocal* suggests that the board has at least the same ability to consider the interests of nonshareholder constituencies in the takeover context that it has in other contexts.[191] *Revlon* cuts off the ability to consider nonshareholder constituencies once a sale decision has been made and suggests that, prior to a sale, action taken on behalf of nonshareholder constituencies must also benefit shareholders.[192]

This part of the Article attempts to resolve the tension between *Unocal* and *Revlon* with regard to the interests of nonshareholder constituencies. The first section considers general corporate law on the legitimacy of considering the interests of nonshareholder constituencies. The following sections consider the board's ability to protect the interests of nonshareholder constituencies under *Unocal* and *Revlon* in the takeover context.

A. General Corporate Law and Nonshareholder Constituencies

1. The Legitimacy of Nonshareholder Interests

The traditional common law rule was that, absent proof of a benefit to shareholders, disbursements on behalf of nonshareholder constituencies were *ultra vires*.[193] For example, the courts often invalidated payments to widows of executives in recognition of past services.[194] The modern view is that nonshareholder constituencies are the legitimate subject of board concern. As a consequence, corporations may make charitable and philanthropic contri-

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189. *See, e.g.*, Frank J. Garcia, *Protecting Nonshareholder Interests in the Market for Corporate Control: A Role for State Takeover Statutes*, 23 J.L. REFORM 507, 522 (1990); Gordon, *supra* note 9, at 1953–54.

190. A bidder has an interest in discharging a substantial number of workers only where it has reason to believe the target company's management has made inefficient employment decisions. *See* Macey, *supra* note 177, at 478–79 (arguing that acquisitions normally do not result in a substantial loss of jobs).

191. *See supra* part I.A.3.

192. *See supra* text accompanying notes 54–57, 68.

193. *See, e.g.*, Dodge v. Ford Motor Co., 170 N.W. 668, 684 (Mich. 1919) (noting that "it is not within the lawful powers of a board of directors to shape and conduct the affairs of a corporation for the merely incidental benefit of shareholders and for the primary purpose of benefitting others").

194. *See, e.g.*, Adams v. Smith, 153 So. 2d 221, 223–25 (Ala. 1963); Moore v. Keystone Macaroni Mfg. Co., 87 A.2d 295, 297–98 (Pa. 1952).

butions,[195] make pension contributions based on past services,[196] or perform contractual obligations whose enforcement is barred by the statute of frauds.[197]

The new direction taken by the law no doubt reflects the reality that much socially concerned corporate behavior benefits shareholders.[198] Corporations spend substantial sums on advertising to improve their public image. In particular cases, a board might reasonably believe that charitable contributions are a cost effective method of positive image-building. In this vein, the law might require proof of a connection to shareholder welfare before allowing charitable donations.[199]

Given the intangible nature of the benefits involved, proof of a direct connection between charitable activity and shareholder value might be difficult. One could deal with the proof problem in either of two ways. First, we might allow directors to be the primary judges of the intangible benefits conferred on shareholders by charitable activity and forego judicial second-guessing of such decisions except in extreme cases.[200] This practice is consistent with the business judgment rule protection accorded most other decisions made by directors[201] and is the way in which courts handle compensation decisions that arguably involve gifts to employees.[202] Second, one might dispense with the proof requirement altogether on the theory that most charitable activity benefits shareholders and examining proof in individual cases is not worth the effort. According to either procedure, the need for proof of a direct connection between charitable activity and shareholder value would be eliminated without abandoning shareholder value as the philosophical object of board conduct.[203]

However, the modern view goes further and allows directors to take action for ethical and humanitarian purposes even if such action decreases

195. *See, e.g.*, DEL. CODE ANN. tit. 8, § 122(9) (1991); A.P. Smith Mfg. Co. v. Barlow, 98 A.2d 581, 583–86 (N.J.), *appeal dismissed*, 346 U.S. 861 (1953); *see also* State *ex rel.* Sorensen v. Chicago B. & Q.R. Co., 199 N.W. 534, 537 (Neb. 1924) (noting that the court saw "no reason why a railroad corporation may not, to a reasonable extent, donate funds or services to aid in good works").

196. *See* Fogelson v. American Woolen Co., 170 F.2d 660, 663 (2d Cir. 1948); A.L.I., PRINCIPLES OF CORPORATE GOVERNANCE § 2.01 cmt. i, illus. 13 (Proposed Final Draft 1992).

197. *See* A.L.I., *supra* note 196, § 2.01(b) cmt. h, illus. 11.

198. *See* A.L.I., *supra* note 196, § 2.01 cmt. f (noting that most charitable activity can be justified on shareholder value grounds).

199. Under the traditional view, courts sometimes sustained charitable contributions based upon "liberal findings that the donations tended reasonably to promote corporate objectives." *Barlow*, 98 A.2d at 584; *see generally* Theodore W. Cousens, *How Far Corporations May Contribute to Charity*, 35 VA. L. REV. 401 (1949) (surveying categories of corporate charitable activity allowed by the law based on remote corporate benefits).

200. *See* Bainbridge, *supra* note 188, at 977–80 (noting that courts often apply the business judgment rule to determine whether seemingly altruistic corporate behavior benefits shareholders).

201. *See supra* note 10.

202. When a disinterested majority of directors grant stock options to employees in addition to their regular compensation, the courts usually defer to the board's judgment that the corporation may reasonably expect to receive a benefit from the issuance of such options and that the value of the options is proportional to the corporate benefit. *See* Beard v. Elster, 160 A.2d 731, 735–39 (Del. 1960).

203. *See* Ray Garrett, *Corporate Donations*, 22 BUS. LAW. 297, 301 (1967) (noting that, when making charitable donations, "[d]irect corporate benefit is no longer necessary, but corporate interest remains as a motive").

shareholder value.[204] This position is harder to justify.[205] Directors are elected by shareholders to manage the shareholders' money.[206] Other than to elect directors and participate in certain fundamental corporate decisions,[207] the shareholders have no say in the operation of the business.[208] To this extent, directors and shareholders stand in the position of trustees and beneficiaries. The directors' fiduciary duties of care and loyalty are owed to the shareholders.[209] One may fairly ask why shareholders as a group should be required to tolerate directors making altruistic decisions on their behalf. To the extent

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204. *See* A.L.I., *supra* note 196, § 2.01, cmt. f (noting that a company's board may consider the interests of nonshareholder constituencies "even if the conduct either yields no economic return or entails a net economic loss"). It is worth noting that Professor Berle himself once conceded that Professor Dodd's view on considering the interests of nonshareholder constituencies, see *supra* note 38, has prevailed. *See* ADOLF A. BERLE, JR., THE 20TH CENTURY CAPITALIST REVOLUTION 169 (1954); Adolf A. Berle, Jr., *Forward* to THE CORPORATION IN MODERN SOCIETY at xii (Edward S. Mason ed., 1960) (noting that "modern directors are not limited to running business enterprise for maximum profit, but are in fact and recognized in law as administrators of a community system").

Some commentators assert that the law persists in its insistence on shareholder benefits to justify action taken on behalf of nonshareholder constituencies. However, upon a closer reading, even these commentators do not dispute the modern view because they admit that the benefit to shareholders may be so indirect and remote that the benefit is equivalent to a benefit to the community at large. *See* Bainbridge, *supra* note 188, at 973 (noting that the law's requirement that directors act only to benefit shareholders is "rhetorical[]"); William J. Carney, *Does Defining Constituencies Matter?,* 59 U. CIN. L. REV. 385, 421 (1990) (arguing that benefits to nonshareholder constituencies "must have some relationship, however attenuated, to shareholder welfare"); Carter, *supra* note 119, at 503–04 (arguing that "the law today is clear that expenditures of corporate funds, whether or not they benefit other constituencies, may be made only to the extent that directors deem them to be in the corporate interest and that some benefit to the corporation is found" but noting that "[t]his benefit may be direct or indirect, certain or contingent, or present or remote"). Bainbridge notes that the broad protection of the business judgment rule provides cover for altruistic board behavior. *See* Bainbridge, *supra* note 188, at 977–80; *see also* Eric W. Orts, *Beyond Shareholders: Interpreting Corporate Constituency Statutes,* 61 GEO. WASH. L. REV. 14, 92 (1992). Carney admits that "'the law has found it convenient to look the other way'" on the issue of whether shareholders actually received a benefit. Carney, *supra*, at 421 n.144 (quoting Kenneth B. Davis, Jr., *Discretion of Corporate Management to Do Good at the Expense of Shareholder Gain—A Survey of, and Commentary on, the U.S. Corporate Law,* 13 CANADA-U.S. L.J. 7, 19 (1988)). Carter objects that "[o]nly in the case of a change of control transaction must the benefit to shareholders be considered." Carter, *supra* note 119, at 504.

205. *See* MILTON FRIEDMAN, CAPITALISM AND FREEDOM 133 (1982) (arguing that "[f]ew trends could so thoroughly undermine the very foundations of our free society as the acceptance by corporate officials of a social responsibility other than to make as much money for their stockholders as possible").

206. *See, e.g.,* DEL. CODE ANN. tit. 8, § 211(b) (1991).

207. Shareholders are typically permitted to vote on such matters as charter amendments, mergers, sales of all or substantially all of the corporation's assets, and liquidations. *See, e.g.,* DEL. CODE ANN. tit. 8, §§ 242(b)(1), 251(c), 271(a), 275(b) (1991).

208. *See, e.g.,* Charlestown Boot & Shoe Co. v. Dunsmore, 60 N.H. 85, 86–87 (1880).

209. *See* Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 182 (Del. 1986). In special cases, the board may owe fiduciary duties to nonshareholder constituencies. *See, e.g.,* Francis v. United Jersey Bank, 432 A.2d 814, 824–25 (N.J. 1981) (holding that directors owe fiduciary duties to creditors where a trust relationship exists between the corporation and the creditor); William D. Hager & James G. Leach, *An Unsolicited Addition to the Wachtell, Lipton Takeover Response Checklist: The Merger of* Revlon *and McCarran–Ferguson,* 41 FICC Q. 189, 189 (1991) (noting that "insurance companies ... have a responsibility to policy owners and the public at large").

nonshareholder constituencies are affected by board conduct, their rights are protected by contract.[210]

Allowing managers to consider nonshareholder interests also has the capacity to cause inefficiency.[211] It has now been over sixty years since Berle and Means demonstrated that the distinguishing feature of modern capitalism is the separation of ownership from control.[212] This separation is on balance a positive factor because it allows for specialization in the ownership and managerial functions.[213] However, the separation of ownership from control gives management the opportunity to advantage themselves at the shareholders' expense and exposes the shareholders to agency costs.[214] To the extent directors are allowed to consider the interests of nonshareholder constituencies, and are not required to justify their conduct on shareholder value grounds, it is harder to detect selfish board behavior. As a consequence, agency costs are increased.[215]

The modern view on altruistic conduct by corporate directors has prevailed because the public policy considerations permitting good corporate citizenship are strong.[216] Corporations, with their entity status and limited liability privileges, owe their existence to community action and can fairly be

210. *See Revlon*, 506 A.2d at 182; Carney, *supra* note 204, at 389 (arguing that "the contractual arrangements we observe have survived because they serve [nonshareholder] constituencies well and that in well-run corporations little would change if constituency representation were added"); Gordon, *supra* note 9, at 1953 (arguing that bondholders should protect themselves against takeover related losses through contract); Oesterle, *supra* note 17, at 138–40 (arguing in support of the traditional view that "[c]reditors, customers, suppliers, and employees create and protect their interests through contracts with the corporation"); Williamson, *supra* note 120, at 1228 (arguing that labor, suppliers, and customers can protect themselves through contract).

211. *See, e.g.*, EDWARD J. EPSTEIN, WHO OWNS THE CORPORATION? 42 (1986); FRIEDMAN, *supra* note 205, at 133; Eugene V. Rostow, *To Whom and For What Ends is Corporate Management Responsible?*, *in* THE CORPORATION IN MODERN SOCIETY 46, 64 (Edward S. Mason ed., 1960); J.A.C. Hetherington, *Fact and Legal Theory: Shareholders, Managers, and Corporate Social Responsibility*, 21 STAN. L. REV. 248, 281 (1969).

212. *See* ADOLPH A. BERLE, JR. & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY 119–25 (1932).

213. *See* Frank H. Easterbrook & Daniel R. Fischel, *Corporate Control Transactions*, 91 YALE L.J. 698, 700–01 (1982).

214. *See* Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305, 308 (1976).

215. *See* Bainbridge, *supra* note 188, at 1013 (noting that "[t]here is a very real possibility that unscrupulous directors will use nonshareholder interests to cloak their own self-interested behavior"); Carney, *supra* note 204, at 423 (arguing that "[a]ny legal rule that permits managers to consider other constituencies at the expense of the shareholder interests increases management discretion" and the danger that such "discretion will be exercised not to maximize the total welfare of all constituencies but to maximize managers' welfare"); Matheson & Olson, *supra* note 184, at 1353 (arguing that "[d]irectors who are free to consider nonshareholder interests would be less accountable to shareholders"); Larry E. Ribstein, *Takeover Defenses and the Corporate Contract*, 78 GEO. L.J. 71, 149 (1989) (noting that allowing "managers [to] hide behind vague duties to conflicting groups" would "exacerbate agency costs, and thereby increase the corporation's cost of capital").

216. *See* A.L.I., *supra* note 196, § 2.01 cmt. h (asserting that "[c]orporate officials are not less morally obliged than any other citizens to take ethical considerations into account, and it would be unwise social policy to preclude them from doing so"); Robert L. Knauss, *Corporate Governance—A Moving Target*, 79 MICH. L. REV. 478, 498 (1981) (arguing that the board has a duty to ensure the corporation does what society expects).

expected to support the community in return.[217] Prior to the American Revolution, incorporation was the prerogative of the British Crown.[218] After independence, incorporation required a special act of the state legislature.[219] This legislative power was used sparingly and only in return for particular benefits to the community at large.[220] The legislature often imposed limitations on the corporation's size and powers as a condition of granting the corporate franchise.[221]

The system of limited incorporation fell into disfavor as a consequence of corruption in the granting of special charters and the indomitable power of the industrial revolution.[222] At the turn of the twentieth century, most states allowed general incorporation and placed no limits on the size or powers of corporations.[223] As a consequence, corporations have come to play the dominant role in American economic life. America owes much of her prosperity to the success of her corporate system. However, the prominence of corporations in modern American life makes it impossible to relegate all eleemosynary activity to individuals. Many charities and other worthwhile social activities would cease to exist without corporate sponsorship.[224] Because shareholders are also citizens, they presumably support maintenance of the fabric of American life through the auspices of corporate philanthropy.[225]

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217. *See* Carter, *supra* note 119, at 491 (arguing that "[c]orporations, which are entities created by law, should rightfully have some obligations to the society from which the law arose"); Garcia, *supra* note 189, at 513 (arguing that "the state, as representative of the community, is in a position to demand that the enterprise be conducted in a manner that best serves the interests of the community as a whole"); Hazen, *supra* note 29, at 296 (arguing that "[b]ecause the corporate franchise has long been viewed as resulting from a contract between the members of the corporation and the state that grants the charter, the state is not only free but perhaps obligated to extract a quid pro quo in return for the corporate privilege"); Norwitz, *supra* note 115, at 387 (arguing that "the corporation is a legal fiction—a creature of the law—and the benefits of participation in [an] enterprise with limited liability are provided for the benefit of society").

218. *See* Adolf A. Berle, Jr., *Historical Inheritance of American Corporations, in* SOCIAL MEANING OF LEGAL CONCEPTS 189, 192–93 (Edmond N. Cahn ed., 1950).

219. *See id.* at 193–94; William L. Cary, *Federalism and Corporate Law: Reflections upon Delaware,* 83 YALE L.J. 663, 663 (1974).

220. *See* Louis K. Liggett Co. v. Lee, 288 U.S. 517, 549 (1933) (Brandeis, J., dissenting) (noting that special incorporation was allowed, "only when the grant seemed necessary in order to procure for the community some specific benefit otherwise unattainable"); Berle, *supra* note 218, at 194 (noting that, prior to 1800, "there were ... not more than a few dozen corporations in all of the thirteen colonies combined").

221. *See* Liggett, 288 U.S. at 549–56 (Brandeis, J., dissenting).

222. *See id.* at 549; Berle, *supra* note 218, at 195–99; Cary, *supra* note 219, at 663–64.

223. *See* Liggett, 288 U.S. at 557–64 (Brandeis, J., dissenting) (describing the competition among states to relax limitations on the size and scope of corporate activity); Cary, *supra* note 219, at 664.

224. *See, e.g.,* A.P. Smith Mfg. Co. v. Barlow, 98 A.2d 581, 586 (N.J. 1953) (arguing that "the transfer of most of the [nation's] wealth" to corporations requires corporations to "assume the modern obligations of good citizenship in the same manner as humans do"). To the extent socialized charity is desirable, government might appear to be a more appropriate benefactor than the modern corporation. To some extent, government already plays this role. The federal tax deduction for corporate charitable donations represents a social expenditure. *See* 26 U.S.C. § 170(a)(2) (1988). However, a wholesale transfer of charitable donative power to government seems impracticable.

225. *See* Orts, *supra* note 204, at 131 (questioning "the assumption that maximizing shareholder value best indicates shareholders' preferences"); Larry D. Soderquist & Robert P. Vecchio, *Reconciling Shareholders' Rights and Corporate Responsibility: New Guidelines for Management,* 1978 DUKE L.J. 819, 840 (1978) (arguing that shareholders expect directors to

Moreover, nonshareholder constituencies often make firm-specific investments of personal and financial resources that exceed those made by the shareholders. Shareholders who are dissatisfied with their company's performance can sell their shares.[226] Employees, and other nonshareholder constituencies, often make firm-specific, nontransferable investments in a corporation[227] and have difficulty protecting themselves adequately through contract.[228] Given the inherent limitations of the contracting process, and the lack of 20-20 foresight, it is arguably impossible to relegate all issues affecting nonshareholder constituencies to the explicit contracting process.[229]

2. *The Primary Focus on Shareholders*

The fact that directors may consider the interests of nonshareholder constituencies does not mean that directors may disregard the interests of shareholders. State law places limitations on the board's ability to disadvantage shareholders and requires that any detriment to shareholders be kept within reasonable limits. Some states have statutes that impose this reasonableness limitation.[230] The common law imposes the same limitation in jurisdictions without such statutes.[231]

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consider the interests of a wide variety of corporate constituencies). The text considers the board's ability to take altruistic actions on behalf of shareholders. Although the law is not entirely uniform, the law generally supports the shareholders' ability to use the corporate machinery for such purposes. *Compare* Credit Bureau Reports, Inc. v. Credit Bureau, 290 A.2d 691, 692 (Del. 1972) (holding that shareholders have a right to inspect a stockholders' list for the purpose of waging a proxy fight without regard to any secondary purposes the shareholders might have in waging the fight) *and* Lovenheim v. Iroquois Brands, Ltd., 618 F. Supp. 554, 558–61 (D.D.C. 1985) (requiring a company to mail at its own expense a shareholder proposal designed to prevent the force-feeding of geese in connection with the making of pate) *with* Minnesota *ex rel.* Pillsbury v. Honeywell, Inc., 191 N.W.2d 406, 410–13 (Minn. 1971) (holding that a shareholder had no right to inspect a stockholder list and other corporate records for the purpose of opposing a company's production of Vietnam War munitions).

226. *See* Chayes, *supra* note 120, at 40.

227. *See* Coffee, *supra* note 127, at 17 (arguing that "investors, whether individual or institutional, are better diversified than managers"); Clyde W. Summers, *Codetermination in the United States: A Projection of Problems and Potentials,* 4 J. COMP. CORP. L. & SEC. REG. 155, 170 (1982) (noting that "employees may have made a much greater investment in the enterprise [simply] by their years of service").

228. *See* Victor Brudney, *Corporate Bondholders and Debtor Opportunism: In Bad Times and Good,* 105 HARV. L. REV. 1821, 1832, 1868 (1992) (arguing that bondholder consent to disadvantageous changes in contract rights "may be induced by the debtor's engaging in various forms of strategic behavior that taint the informed and volitional character of the consent" and that the debtor has the power to engage in "unilateral acts ... that disadvantage bondholders"); Chayes, *supra* note 120, at 42–43 (arguing that nonlabor constituencies lack mechanisms as effective as collective bargaining); Coffee, *supra* note 127, at 68–73 (arguing that creditors, employees, and the state have been unable to acquire contractual protection against the adverse consequences of hostile takeovers); Morey W. McDaniel, *Bondholders and Corporate Governance,* 41 BUS. LAW. 413, 455–56 (1986) (arguing that bondholders have not been able to protect themselves through contract).

229. *Cf.* Frank H. Easterbrook & Daniel R. Fischel, *Voting in Corporate Law,* 26 J.L. & ECON. 395, 401 (1983) (noting that it is inefficient to detail every element of a relationship by contract).

230. *See, e.g.,* LA. REV. STAT. ANN. § 9:2280 (West 1991); N.J. STAT. ANN. § 14A:3-4 (West Supp. 1993); MASS. GEN. LAWS ANN. ch. 155, § 12c (West 1992).

231. *See, e.g.,* Kahn v. Sullivan, 594 A.2d 48, 61 (Del. 1991); *see also* A.L.I., *supra* note 196, § 2.01(b)(3) (allowing directors to devote a "reasonable amount" of resources to charitable endeavors); Matheson & Olson, *supra* note 184, at 1375 (arguing that directors "should be allowed to consider nonshareholder interests to the extent such consideration does not substantially compromise shareholders' interests").

One might challenge these limitations and argue that certain nonshareholder groups, and perhaps the community as a whole, have an ownership stake in the modern corporation.[232] According to this view, directors would have a duty, not merely a capacity, to protect nonshareholder constituencies. Directors acting on behalf of nonshareholder constituencies might be seen as enforcing the entitlements of those constituencies rather than mitigating externalities or extending gratuities.[233]

However, the traditional limitations on the board's ability to consider the interests of nonshareholder constituencies are justified. Shareholders must remain the primary focus of board conduct.[234] Shareholders are the only corporate constituency not entitled to a fixed contractual return and bear the residual risk in the corporate enterprise.[235] To hold that directors could disregard shareholder interests for the benefit of nonshareholder constituencies would seriously impair the ability of corporations to obtain capital.[236] Although the ability of nonshareholder constituencies to protect themselves through state regulation or contract may be imperfect, such protections are not so imperfect that they justify the cost of allowing directors to abandon their primary obligation to shareholders.[237]

3. Conclusion

In sum, although the place of the corporation in modern America justifies board consideration of nonshareholder interests, the place of the

232. *See, e.g.*, RALPH NADER ET AL., TAMING THE GIANT CORPORATION 125 (1976) (arguing that directors must balance "social concern[s] against responsibility for the overall health of the enterprise"); DAVID VOGEL, LOBBYING THE CORPORATION 6 (1978) (arguing that corporations must be held accountable to society because they exercise governmental power); Coffee, *supra* note 127, at 104 ("view[ing] the modern public corporation as an unstable risk-sharing arrangement among managers, employees, creditors, and shareholders"); Harold Williams, *Speech Before the Seventh Annual Securities Regulation Institute, reprinted in* [1979–1980 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 82,445, at 82,876 (Jan. 17, 1980) (arguing that a corporation "is an institution with a complex of interpersonal and contractual relationships that create legitimate interests in the corporation among employees, suppliers, customers, communities, and the economy at large").

233. *See* Coffee, *supra* note 96, at 448 & n.46 (arguing that because "long-term contracting among shareholders and other constituencies is costly, and numerous contingencies can arise that cannot be covered even in a very detailed contract," the board should act as a mediator whose role is "to prevent the disruption of implicit contracts by protecting the fair expectations of those contracting within the corporation").

234. *See* Matheson & Olson, *supra* note 184, at 1371.

235. *See, e.g.*, Frank H. Easterbrook & Daniel R. Fischel, *Voting in Corporate Law*, 26 J.L. & ECON. 395, 403–06 (1983) (arguing that only shareholders should possess voting rights because they are the residual equity owners); Jonathan R. Macey, *Externalities, Firm-Specific Capital Investments, and the Legal Treatment of Fundamental Corporate Changes*, 1989 DUKE L.J. 173, 175 (arguing that directors should represent shareholders because "at the margin, [shareholders] have the greatest stake in the outcome of corporate decision-making"); Williamson, *supra* note 120, at 1210 (arguing for stockholder primacy because stockholders "invest for the life of the firm and their claims are located at the end of the queue should liquidation occur").

236. *Cf.* Bainbridge, *supra* note 188, at 994, 1019 (arguing that nonshareholder constituency statutes do not "allow[] directors to disregard shareholder interests" but "permit directors to select a plan that is second-best from the shareholders' perspective, but which alleviates the decision's impact on the firm's nonshareholder constituencies").

237. *See id.* at 990 (arguing that "[i]f directors are entitled to ignore shareholder interests, the directors' fiduciary duties are rendered meaningless"); Macey, *supra* note 235, at 174 (arguing that "the private contracting process, though not perfect, generates outcomes superior to the outcomes generated by government regulation").

shareholder in the corporate enterprise requires that there be limits on such consideration. Modern law allows directors to consider the interests of nonshareholder constituencies as long as the impact on shareholders is not excessive. The remaining sections of this Article consider whether the takeover context provides any reason to depart from the general rule and conclude that it does not.

B. Unocal and Nonshareholder Constituencies

Prior to the time of sale, *Unocal* confirms the general notion that directors may consider the interests of nonshareholder constituencies.[238] The notions that the board is entitled to preserve the corporate entity and consider the long-term interests of the corporation are essentially coded descriptions of the board's ability to consider the interests of nonshareholder constituencies in response to a takeover bid.[239]

The difficulty with *Unocal's* progeny in this area is that they show insufficient respect for the limitations on a board's ability to consider the interests of nonshareholder constituencies.[240] The cases that directly consider the interests of nonshareholder constituencies under *Unocal* do not discuss the degree to which shareholders may be disadvantaged.[241] However, in *Paramount* the Delaware Supreme Court held that a board could preclude an offer to preserve the corporate entity without comparing the bid to the value of pursuing the board's chosen alternative.[242] Although *Paramount* does not explicitly base this result on the interests of nonshareholder constituencies, its emphasis on the corporate entity may be taken as a proxy.[243]

To the extent *Paramount* allows a target company's board to further the interests of nonshareholder constituencies without considering the impact on shareholders, *Paramount* goes too far.[244] That the board is entitled to prefer the interests of nonshareholder groups to those of shareholders does not mean the board is exempt from having to compare relevant values. In ordinary business contexts, the board is required to demonstrate that any diminution in shareholder value flowing from the advancement of nonshareholder interests is not excessive.[245] The same requirement should exist when the board acts on behalf of nonshareholder constituencies in responding to a takeover bid.

In some cases, the board should be allowed to choose a less valuable alternative from the shareholders' perspective. For example, if the board estimates that the company's going concern value is $100 per share, the board should be able to reject an offer of $101 from a bidder who threatens to fire half the work force. However, the board should not be allowed to choose an

238. *See supra* part I.A.3.
239. *See supra* text accompanying notes 115–22, 184–85.
240. *See* Coffee, *supra* note 127, at 85–86 (noting that actions taken for the benefit of nonshareholder constituencies in the takeover context should be subject to a reasonableness limitation).
241. *See supra* note 44 and accompanying text.
242. *See supra* note 30 and accompanying text.
243. *See supra* note 115 and accompanying text.
244. *See* Alan A. Garfield, Paramount: *The Mixed Merits of Mush,* 17 DEL. J. CORP. L. 33, 58 (1992) (noting that *Paramount* "seems to suggest that a board can 'just say no' to protect nonshareholder interests").
245. *See supra* part III.A.2.

alternative that is significantly lower than the bid. If the same bidder offers $150 per share, the board should not be allowed to deny the shareholders a 50% increase in the value of their investments based on the interests of other constituencies. Where courts should draw the line between the 1% and 50% premium cases is an interesting question that is well worth the effort.

The case for allowing directors to escape the limitations placed on nonshareholder activity is arguably stronger in the takeover context than in the ordinary business context. Labor and creditors have had special difficulty protecting their legitimate expectations by contract in the takeover context. As a consequence, one might view a portion of recent takeover gains as flowing from a breach of implicit contractual obligations and a redistribution of value from nonshareholder constituencies to shareholders.[246]

However, the inability of nonshareholder constituencies to protect themselves against the adverse consequences of hostile takeovers is to some extent a transitional phenomenon.[247] Such groups as employees and creditors were injured as a consequence of hostile takeovers, and preventive measures taken by management to avoid hostile takeovers, in the 1980s because they did not anticipate the scope and consequences of the takeover movement.[248] Now that the 1980s have established the normalcy of the hostile takeover as a change of control mechanism, there is no reason such groups as employees and creditors cannot use the contracting process to enforce their rights. Employees have the means to protect themselves against changes of control.[249] Creditors also have the power to protect themselves against the deleterious effects of hostile takeovers now that they know what to anticipate.[250] The state, which protects general community interests, can limit takeover activity it deems unwise through legislation.[251] Significantly, most state legislation that addresses the

246. *See* Bainbridge, *supra* note 188, at 1007; William W. Bratton, Jr., *Corporate Debt Relationships: Legal Theory in a Time of Restructuring,* 1989 DUKE L.J. 92, 136–39; Coffee, *supra* note 127, at 68–73, 81.

247. *See* Coffee, *supra* note 127, at 104.

248. *See* Bratton, *supra* note 246, at 139–42 (noting that, prior to 1985, bondholders had ceased to insist on covenants restricting additional debt because they believed such covenants were unnecessary); John C. Coffee, Jr., *Unstable Coalitions: Corporate Governance as a Multi-Player Game,* 78 GEO. L.J. 1495, 1507 (1990) (noting the arguments of certain bondholders that "they did not seek negative covenants on additional debt issuances" to protect themselves from the consequences of a leveraged acquisition because "they assumed that debt would be issued only for 'business purposes'") (quoting Metropolitan Life Ins. Co. v. RJR Nabisco, Inc., 716 F. Supp. 1504, 1516 (S.D.N.Y. 1989)).

249. *See* Macey, *supra* note 235, at 185 (arguing that, now that the impact of hostile takeovers is known, managers "can demand compensation packages that protect them from the vagaries of the market for corporate control"). Senior managers often have access to golden parachutes that pay them substantial sums in the event of termination after a change of control. *See* Coffee, *supra* note 127, at 75–78. Lower level employees have the capacity to insert change of control clauses into their collective bargaining agreements. *See* Air Line Pilots Ass'n, Int'l v. UAL Corp., 717 F. Supp. 575, 578 n.4 (N.D. Ill. 1989) (noting that a collective bargaining agreement gave a union the right to automatic wage benefits and pension increases in the event of a change of control), *aff'd,* 897 F.2d 1394 (7th Cir. 1990). Although the UAL court invalidated such provisions under *Unocal, see id.* at 586–88, this result is suspect after *Paramount.*

250. *See* Bratton, *supra* note 246, at 95 (noting that, by the end of the 1980s, "[m]arket actors drafted and publicized contract provisions that effectively protected bondholders from restructuring related wealth transfers"); Coffee, *supra* note 248, at 1519–21 (noting that bondholders now often insist on the right to put their bonds to the corporation in the event of such fundamental changes as takeovers, restructurings, or mergers).

251. *Cf.* Loewenstein, *supra* note 119, at 85 (arguing that legislation is the best method of protecting the interests of nonshareholder constituencies).

issue of nonshareholder constituencies gives the target company's board the capacity to consider such interests but does not require the board to consider anyone but shareholders.[252]

Moreover, the cost of allowing directors to escape the limitations placed on nonshareholder activity is also larger in the takeover context. Self-interested director behavior is more of a concern in the takeover context than in the day-to-day running of a business. *Unocal* replaced the traditional business judgment rule as the standard for judging the legitimacy of defensive tactics due to "the omnipresent specter that a board may be acting primarily in its own interests, rather than those of the corporation and its shareholders" in the takeover context.[253]

Directors, especially management directors, have a substantial interest in safeguarding their jobs. If directors are able to reject bids out of hand based on the interests of nonshareholder constituencies, the board has a substantial ability to advance its selfish interests on the pretense of protecting nonshareholder groups.[254] Requiring the board to compare the target company's going concern value to the bid price and demonstrate that any diminution of shareholder value is not excessive decreases the board's ability to hide disloyal behavior behind the screen of nonshareholder interests.

As a consequence of the foregoing, the traditional limitation that board action designed to benefit nonshareholder constituencies should not excessively harm shareholders should be retained in the takeover context. Moreover, even if we accepted that a wide variety of nonshareholder groups had entitlements worthy of protection in the takeover context, the lax view of *Unocal* exemplified by *Paramount* would still be erroneous. *Paramount* gives the board the power to disregard shareholder interests entirely once it reasonably perceives a threat to nonshareholder constituencies. Even if we admitted that nonshareholder groups had extra-contractual rights in the takeover context, the board would presumably be required to consider the degree to which those rights were unjustifiably infringed by a particular bid and compare that detriment to the cost to shareholders of precluding the offer.[255] If shareholders lose more

252. Of the twenty-nine nonshareholder constituency statutes that had been passed as of 1991, only three mandate that the board consider the interests of nonshareholder constituencies. *See* Matheson & Olson, *supra* note 167, at 1540–44; *see also* Bainbridge, *supra* note 188, at 987 (noting that most nonshareholder constituency statutes are permissive and "should not be interpreted as creating new director fiduciary duties running to nonshareholder constituencies").

253. *Unocal,* 493 A.2d at 954.

254. *See supra* text accompanying notes 211–15.

255. *See* Bainbridge, *supra* note 188, at 1019 (arguing that a board "decision must impose no greater burden on the shareholders than necessary to protect the nonshareholder constituencies"); Coffee, Jr., *supra* note 248, at 1548 (noting that takeovers are efficient in the sense that stockholder gains exceed the losses of nonshareholder constituencies); Norwitz, *supra* note 115, at 389 (suggesting that the target company's board should consider "how many jobs lost equal a 100% premium"); Orts, *supra* note 204, at 100 & n.569 (suggesting that the board weigh and balance the interests of all relevant constituencies). Quantification of the noncontractual "entitlements" affected by a takeover bid would, of course, be extremely difficult because there is no standard against which to measure the existence or scope of such entitlements. *See* Matheson & Olson, *supra* note 184, at 1353 (noting that "the 'standard' by which courts articulate a director's duty to stakeholders defies precise definition"). As a consequence of the extreme proof difficulties in this area, we might adopt a per se rule either giving directors carte blanche to protect the interests of nonshareholder constituencies upon intuition or prohibiting such conduct. Even in a regime that considers nonshareholder constituencies as corporate owners, shareholders would presumably still be the primary focus of

from defeating an offer than nonshareholder constituencies gain as a result of protecting their entitlements, the correct course is not to preclude the offer but to compensate the nonshareholder groups for their loss.[256] As a consequence, the license that *Paramount* gives the board to preclude offers without comparing the value of the bid to the value of the board's chosen alternative is unjustified on any view.

In sum, under *Unocal's* first prong, a target company's board of directors may act to prevent threats to nonshareholder constituencies in responding to a takeover bid, and may do so even at some cost to shareholders. This result is in accordance with general corporate law on the legitimacy of altruistic behavior. However, *Unocal's* second prong should be deemed to require that any diminution in shareholder value be kept within reasonable limits. Otherwise, the board's conduct is not any sense proportional to the relevant threat, and *Unocal* is starkly inconsistent with the rest of corporate law.

C. Revlon and Nonshareholder Constituencies

Once the board decides to sell the company, the board is disabled entirely from considering the interests of nonshareholder constituencies. *Revlon's* purported justification for distinguishing between the ability of a board to consider the interests of nonshareholder constituencies in the pre-sale and sale contexts is that a board may consider the interests of such groups only to the extent that "there are rationally related benefits accruing to the stockholders."[257] This interpretation of *Revlon* implies that the board never has the ability to consider the interests of nonshareholder constituencies.[258]

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corporate conduct. *See id.* at 1371. Given the shareholders' primacy, and the large agency costs involved in giving directors unreviewable discretion to act on behalf of nonshareholder constituencies, a per se rule prohibiting the consideration of nonshareholder entitlements would seem preferable were a per se rule desired. *See* Ribstein, *supra* note 215, at 148 (arguing that "the case for [nonshareholder] duties founders on the considerable conceptual and practical problems of permitting directors to consider stakeholder interests when resisting takeovers").

256. Both defenders and attackers of the shareholder primacy notion agree on this point. *Compare* Macey, *supra* note 235, at 175 (defending shareholder primacy and arguing that "[d]islocations to nonshareholder constituencies ... can best be remedied by side payments, made through intrafirm contracts"), *with* Coffee, *supra* note 127, at 105 (defending nonshareholder interests and arguing that shareholders should "bribe" other constituencies to allow profitable offers to proceed).

257. *Revlon,* 506 A.2d at 182; *see* TW Services, Inc. Shareholders Litig., [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,334, at 92,179 (Del. Ch. Mar. 2, 1989) (noting that "[w]hen a corporation is in a 'Revlon mode,' legitimate concerns relating to the claims of [nonshareholder] constituencies are absent").

258. *See* Andrew G.T. Moore, II, *The 1980s—Did We Save the Stockholders While the Corporation Burned?,* 70 WASH. U. L.Q. 277, 285 (1992) (arguing that if directors advance the interests of nonshareholder constituencies at the expense of shareholders, they "violate their duties of loyalty and care"); *see also* Buckhorn, Inc. v. Ropak Corp., 656 F. Supp. 209, 231 (S.D. Ohio) (holding in a non-*Revlon* takeover setting that a target company's board may consider nonshareholder constituencies only to the extent shareholders benefit), *aff'd,* 815 F.2d 76 (6th Cir. 1987); Bainbridge, *supra* note 188, at 982 (noting that *Revlon* forecloses the view that *Unocal* "allowed target boards to trade off a decrease in shareholder wealth for an increase in stakeholder wealth"); Gilson & Kraakman, *supra* note 10, at 267 (arguing that "[t]arget management may take other corporate constituencies into account in framing defensive plans, but only to the extent it benefits shareholders by doing so"); Alexander C. Gavis, *A Framework for Satisfying Corporate Directors' Responsibilities Under State Nonshareholder Constituency Statutes: The Use of Explicit Contracts,* 138 U. PA. L. REV. 1451, 1467–68 (1990) (concluding

As noted above, most corporate philanthropy in fact benefits shareholders.[259] However, to the extent that furthering the interests of nonshareholder constituencies benefits shareholders, the board can always justify such conduct on shareholder value grounds alone.[260] Giving legitimacy to the interests of nonshareholder groups requires that the board be able to consider such groups even at the shareholders' expense. For example, just as the board should be entitled to reject a bid to protect employees to a reasonable extent even though a bidder offers more than the target company's going concern value, the board should have the opportunity to accept a bid that is lower than the highest auction bid to protect employees as long as the cost to shareholders is not excessive.[261]

Moreover, if *Revlon* requires a shareholder value justification for all board conduct, *Revlon* has overruled sub silentio a well accepted body of general corporate law.[262] Some have tried to avoid this result by arguing that *Revlon* allows the board to consider the intrinsic interests of nonshareholder constituencies prior to but not after the time of sale.[263] If this view of *Revlon* is correct, it is hard to understand why the fact of sale cuts off the ability to consider the interests of nonshareholder constituencies.[264] If the board has the ability to further the interests of nonshareholder constituencies at the expense of shareholders prior to a sale, there is no reason why this ability should not continue in a sale transaction. If the board is not entitled to consider the interests of nonshareholder constituencies in the sale context, there is no reason why the board should be able to make charitable donations that do not benefit shareholders or preserve a company's independence for the benefit of nonshareholder constituencies.

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that, in the takeover context, "any decision related to consideration of nonshareholders must result in some benefit to stockholders"); Oesterle, *supra* note 17, at 142 n.106 (noting that, unless *Revlon* is limited to the auction context, *Revlon* "suggests that the Unocal standard was too broad, and that target managers are responsible in all cases for maximizing share price"); Ribstein, *supra* note 215, at 142–47 (arguing that, in responding to takeovers, directors should not have the ability to represent bondholders, employees, or society at large); David S. White, Note, *Auctioning the Corporate Bastion: Delaware Readjusts the Business Judgment Rule in* Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 40 SW. L.J. 1117, 1131 (1986) (noting that *Revlon* "seems to nullify that part of the Unocal decision permitting consideration of nonstockholder constituencies").

259. *See supra* text accompanying notes 198–99.

260. For example, a board may decide to give employees benefits to which they are not contractually entitled in the interest of improving morale and increasing efficiency. It is hardly surprising that this decision, and most other action taken for the benefit of nonshareholder groups, can be justified purely on shareholder value grounds. *See* A.L.I., *supra* note 196, § 2.01, cmt. f.

261. *See* Coffee, *supra* note 96, at 449 (criticizing *Revlon* because it "see[s] the board's role (at least once a takeover is inevitable) as only that of a 'fair auctioneer'"). A recent article cites approvingly a case in which a board accepted an $18.75 bid in preference to a $20.85 bid to avoid massive lay-offs. *See* Johnson & Millon, *supra* note 34, at 2119 n.61.

262. *See supra* part III.A.1.

263. *See, e.g.,* Lipton, *supra* note 129, at 40–41.

264. *See* Coffee, *supra* note 127, at 85–86 (arguing that "[r]ather than focus on the time at which the board's decision is made (i.e., before or after the moment at which a corporate sale becomes inevitable), the sounder rule would accord equivalent capacity to the board but review the reasonableness of its efforts in either case to provide for nonshareholder constituencies"); Johnson & Millon, *supra* note 34, at 2118 (noting that "shareholder desires for current wealth are subordinated to other considerations when the corporation is outside the Revlon mode" and that the Delaware Supreme Court has never identified any "authoritative principle that differentiates" the sale context).

Revlon's attack on the interests of nonshareholder constituencies in the sale context sparked a vigorous response from other states. A majority of states have passed statutes designed to overrule this aspect of *Revlon*.[265] The most common form of these statutes provides that the board is entitled to consider the interests of nonshareholder constituencies in all corporate contexts.[266] These statutes allow the board to consider the interests of nonshareholder constituencies after the board decides to sell the company in response to a takeover bid.

IV. CONCLUSION

In conclusion, there is no reason to continue to distinguish between the duties of a target company's board in those cases in which the board's goal is to maintain the independence of the target company and those cases in which the board's goal is to sell the target company. To the extent that the board is focusing on the interests of shareholders, the board should be required to demonstrate that it has reasonable grounds to believe that any takeover defense will increase shareholder value. Whatever the context, the board should have the power to protect the interests of nonshareholder constituencies but should be required to demonstrate that any negative impact on shareholders due to such action is not excessive. In this way, the gap between *Unocal* and *Revlon* would be eliminated and a unitary standard would apply to all takeover defense questions.

Subsequent to *Revlon*, the Delaware Supreme Court has narrowed that case to the greatest possible extent. Currently, one can be confident in predicting the triggering of enhanced *Revlon* duties only when the board makes a conscious decision to sell 100% of a company. The ever-decreasing scope of *Revlon* may be some indication that the Delaware Supreme Court is less than comfortable with either or both of the enhanced *Revlon* duties. To the extent *Paramount* suggests that the court is attempting to limit the scope of the shareholder wealth maximization principle, the court has made an error. The better approach would be to extend this principle to all takeover cases. To the extent the court is attempting to preserve the board's ability to consider the interests of nonshareholder constituencies, the court is correct and would do well to eliminate this aspect of *Revlon*.

Although there is a substantial gap between *Unocal* and *Revlon* under current practice, this gap has never been accepted by the Delaware Supreme Court in theory. In *Macmillan*, the Delaware Supreme Court conceived of *Revlon* as a specific application, rather than a stark departure, from *Unocal*:

> As we held in *Revlon*, when management of a target company determines that the company is for sale, the board's *responsibilities* under the enhanced *Unocal* standards are significantly altered. Although the board's *responsibilities* under *Unocal* are far different, the enhanced *duties* of the directors in responding to a potential shift in control, recognized in *Unocal*, remain unchanged. This principle pervades *Revlon*, and when directors conclude that an auction is

265. *See* Bainbridge, *supra* note 188, at 994–95 (arguing that the nonshareholder constituency statutes permit directors to disadvantage shareholders for the benefit of nonshareholders and do not codify *Revlon*); Orts, *supra* note 204, at 104–05 (arguing that the nonshareholder constituency statutes overrule rather than codify *Revlon*).

266. *See* Matheson & Olson, *supra* note 167, at 1540–44 (collecting and summarizing the twenty-nine nonshareholder constituency statutes that had been passed as of 1991).

> appropriate, the standard by which their ensuing actions will be judged continues to be the enhanced duty imposed by this court in *Unocal*.[267]

The *Macmillan* court made this statement in the context of rejecting a suggestion flowing from several Delaware Chancery Court cases that the traditional business judgment rule governed board conduct once a decision to sell the target company had been made.[268] In other words, the *Macmillan* court was defending the *Revlon* standard against the suggestion that it was more lax than *Unocal*. The problem with modern takeover law involves the converse: *Unocal* as applied by the Delaware Supreme Court is too lax and *Revlon* is too strict. However, to the extent the Delaware Supreme Court believes that *Unocal* and *Revlon* represent different articulations of a unitary concept, there is no reason these cases cannot be merged to provide a single takeover defense standard for the future. This merger would be well worth accomplishing.

267. Mills Acquisition Co. v. Macmillan, Inc., 559 A.2d 1261, 1287 (Del. 1988) (citations omitted); *see also Gilbert*, 575 A.2d at 1146 (noting that *Revlon*'s "change in focus ... [does] not alter the Board's continued duties of care and loyalty under Unocal"); City Capital Associates v. Interco, Inc., 551 A.2d 787, 802 (Del. Ch. 1988) (arguing that "Revlon should not ... be interpreted as representing a sharp turn in [Delaware] law"). Evidence that *Revlon* is not meant as a stark departure from *Unocal* also lies in the Delaware Supreme Court's retroactive application of *Revlon*. *See* Barkan v. Amsted Indus., Inc., 567 A.2d 1279, 1286 n.2 (Del. 1989) (applying *Revlon* retroactively because it is "derived from fundamental principles of corporate law and flows directly from such precedents as Unocal").

268. *See Macmillan*, 559 A.2d at 1287–88.