

Summer 1992

Controversial World of Corporate Mergers and Acquisitions: A Critical Assessment, The

Perry V. Kalajian

Follow this and additional works at: <https://scholarship.law.missouri.edu/mlr>



Part of the [Law Commons](#)

Recommended Citation

Perry V. Kalajian, *Controversial World of Corporate Mergers and Acquisitions: A Critical Assessment, The*, 57 MO. L. REV. (1992)

Available at: <https://scholarship.law.missouri.edu/mlr/vol57/iss3/1>

This Article is brought to you for free and open access by the Law Journals at University of Missouri School of Law Scholarship Repository. It has been accepted for inclusion in Missouri Law Review by an authorized editor of University of Missouri School of Law Scholarship Repository. For more information, please contact bassettcw@missouri.edu.

MISSOURI LAW REVIEW

VOLUME 57

SUMMER 1992

NUMBER 3

The Controversial World of Corporate Mergers and Acquisitions: A Critical Assessment

*Perry V. Kalajian**

* Member of the New Jersey, New York, and District of Columbia Bars.
Copyright © 1992 Perry V. Kalajian.

MERGERS AND ACQUISITIONS

TABLE OF CONTENTS

I. Introduction	745
II. The Facts in <i>Interco</i>	749
III. The Delaware Court of Chancery Expresses Its Position on Topics in the Area of Corporate Mergers and Acquisitions	755
A. The Delaware Court of Chancery in <i>Interco</i> Has Misinterpreted and Misapplied the "Business Judgment Rule" and the " <i>Unocal</i> Test" to the Poison Pill	755
B. What Is an Excessive Response to a Particular Tender Offer Proposal?	765
C. An Inadequate All-Cash, All-Shares Tender Offer Constitutes a Substantial Threat	772
D. What Is the Standard for an "Adequate Offer?"	782
E. When Should a Board of Directors Be Required to Redeem a Poison Pill?	784
IV. The Delaware Court of Chancery Provides Further Insight into Its Position on Topics in the Area of Corporate Mergers and Acquisitions	789
A. The Delaware Court of Chancery Decisions that Have Followed <i>Interco</i> Have Created Greater Uncertainty as to the Court's Position with Respect to Poison Pills	789
B. The Delaware Court of Chancery's Opinion in <i>Pillsbury</i> Supports Its Holding in <i>Interco</i>	789
C. The Delaware Court of Chancery Has Failed to Directly Address and Rectify the Central Problem Before It in <i>Interco</i> and <i>Pillsbury</i> —Valuation	795
D. The Delaware Court of Chancery's Holding in <i>TW Services</i> May Show a Change in Direction for the Court	800
E. The Delaware Court of Chancery's Holding in <i>Paramount</i> Further Supports the Reasoning of the Court in <i>TW Services</i>	804
V. The Delaware Supreme Court in Its <i>Paramount</i> Opinion Responded to the Delaware Court of Chancery's Series of Decisions Starting with <i>Interco</i>	806
VI. The Holdings in <i>Interco</i> and <i>Pillsbury</i> May Be More Easily Justified When Analyzed from an Economic Perspective	819
VII. Conclusion	827

I. INTRODUCTION

The last decade has proven to be a landmark era in the area of corporate mergers and acquisitions.¹ Perhaps the most rapid development in this area has been in the growth of antitakeover devices to defend against unwanted, hostile takeover attempts. The most noteworthy of the devices developed has been the share purchase rights plan.² Since its inception in 1983, the use of

1. See, e.g., CRTF Corp. v. Federated Dep't Stores, Inc., 683 F. Supp. 422 (S.D.N.Y. 1988); Mills Acquisition Co. v. Macmillan, Inc., 559 A.2d 1261 (Del. 1989); Ivanhoe Partners v. Newmont Mining Corp. (*In re* Newmont Mining Corp. Shareholders Litigation), 535 A.2d 1334 (Del. 1987); Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1986); Moran v. Household Int'l, Inc., 500 A.2d 1346 (Del. 1985); Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985); Smith v. Van Gorkom, 488 A.2d 858 (Del. 1985); Aronson v. Lewis, 473 A.2d 805 (Del. 1984); Weinberger v. UOP, Inc., 457 A.2d 701 (Del. 1983); Paramount Communications, Inc. v. Time, Inc., [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,514 (Del. Ch. July 14, 1989), *aff'd*, 571 A.2d 1140 (Del. 1990); TW Servs., Inc. v. SWT Acquisition Corp., Nos. 10427, 10298, 1989 WL 20290 (Del. Ch. Mar. 2, 1989); Shamrock Holdings, Inc. v. Polaroid Corp. (*In re* Polaroid Shareholders Litigation), 559 A.2d 278 (Del. Ch. 1989); Grand Metro. Pub. Ltd. Co. v. Pillsbury Co. (*In re* Pillsbury Co. Shareholders Litigation), 558 A.2d 1049 (Del. Ch. 1988); City Capital Assocs. Ltd. Partnership v. Interco Inc., 551 A.2d 787 (Del. Ch.), *appeal dismissed*, 556 A.2d 1070 (Del. 1988); West Point-Pepperell, Inc. v. J.P. Stevens & Co. (*In re* J.P. Stevens & Co. Shareholders Litigation), 542 A.2d 770 (Del. Ch. 1988).

2. A share purchase rights plan is an antitakeover device that, depending on its structure, generally allows shareholders other than a hostile bidder to acquire shares at a price below market. A share purchase rights plan or "poison pill" is triggered when a hostile bidder acquires a specified percentage of a company's stock. See *Moran*, 500 A.2d at 1348-49; Sutton Holding Corp. v. DeSoto, Inc., Nos. 11221, 11222, 1990 WL 13476, at *5 (Del. Ch. Feb. 5, 1990); Robert M. Bass Group, Inc. v. Evans (*In re* Macmillan, Inc. Shareholders Litigation), 552 A.2d 1227, 1230-31 (Del. Ch.), *appeal dismissed*, 548 A.2d 498 (Del. 1988); RONALD J. GILSON, THE LAW AND FINANCE OF CORPORATE ACQUISITIONS 636-39 (1986); Robert Comment & Gregg A. Jarrell, *Two-Tier and Negotiated Tender Offers: The Imprisonment of the Free-Riding Shareholder*, 19 J. FIN. ECON. 283, 284 n.1 (1987); Jennifer J. Johnson & Mary Siegel, *Corporate Mergers: Redefining the Role of Target Directors*, 136 U. PA. L. REV. 315, 408 n.360 (1987); Martin Lipton & Andrew R. Brownstein, *Takeover Responses and Directors' Responsibili-*

the share purchase rights plan, or "poison pill" as it is more commonly known, as a defensive mechanism against hostile tender offers has generated much controversy and debate in the legal and business communities.³

ties-An Update, 40 BUS. LAW. 1403, 1422-25 (1985); Georgeson & Co., *Poison Pill Impact Study* (Mar. 31, 1988) (concluding that companies with poison pills received substantially higher takeover premiums than companies without poison pills); Georgeson & Co., *Poison Pill Impact Study II* (Oct. 31, 1988) (concluding that, on the average, the stocks of companies with poison pills outperformed companies without poison pills); Kidder, Peabody & Co., *Impact of Adoption of Stockholder Rights Plans on Stock Prices* (1986) (concluding that the implementation of poison pills generally increased the price of the stock of a company); *A Study on the Economics of Poison Pills*, [1985-1986 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,971 (Mar. 5, 1986) (conducted by SEC economists and concluding that the adoption of poison pills by companies subject to takeover speculation decreased stock prices); see generally A. GILCHRIST SPARKS, III ET AL., *Delaware Law Considerations in Undertaking Acquisitions*, in ACQUISITIONS AND MERGERS 1989, at 9, 19-31 (PLI 1989).

3. See GILSON, *supra* note 2, at 738-39; Dennis J. Block & Jonathan M. Hoff, *The Duties of Boards To Redeem Poison Pills*, N.Y. L.J., Dec. 15, 1988, at 5; Comment & Jarrell, *supra* note 2, at 284 n.1; Johnson & Siegel, *supra* note 2, at 408 n.360; Martin Lipton, *Corporate Governance in the Age of Finance Corporatism*, 136 U. PA. L. REV. 1, 30-31 (1987); William Meyers, *Showdown in Delaware: The Battle to Shape Takeover Law*, INSTITUTIONAL INVESTOR, Feb. 1989, at 64; Michael W. Schwartz, *Chancery Court Ignores Del. Supreme Court Precedents*, N.Y. L.J., June 5, 1989, at 45; Georgeson & Co., *Poison Pill Impact Study* (Mar. 31, 1988) (concluding that companies with poison pills received substantially higher takeover premiums than companies without poison pills); Georgeson & Co., *Poison Pill Impact Study II* (Oct. 31, 1988) (concluding that, on the average, the stocks of companies with poison pills outperformed companies without poison pills); Kidder, Peabody & Co., *Impact of Adoption of Stockholder Rights Plans on Stock Prices* (1986) (concluding that the implementation of poison pills generally increased the price of the stock of a company); *A Study on the Economics of Poison Pills*, *supra* note 2 (conducted by SEC economists and concluding that the adoption of poison pills by companies subject to takeover speculation decreased stock prices); see generally SPARKS ET AL., *supra* note 2, at 19-31.

In June of 1983, Lenox, Inc. introduced what many regard to be the original poison pill plan in response to a takeover attempt by Brown-Forman Distillers Corporation. Lenox, Inc. responded to a takeover attempt by Brown-Forman Distillers Corporation by issuing convertible preferred stock

In recent years, the Delaware courts, and in particular the Delaware Court of Chancery, have been very active in expressing their opinions with respect to many of the practices currently being used in the area of corporate mergers and acquisitions. The Delaware Court of Chancery has been particularly active in addressing the use of poison pills.⁴ The court has expressed its opinion in

as a dividend to its shareholders. The preferred stock was designed so that upon a follow-up business combination, the preferred stock was convertible into shares of the acquiror's voting common stock. In an effort to inhibit takeover attempts, the preferred stock was structured so that if it was fully converted upon a business combination, the holders of existing control blocks of the acquiror would suffer considerable dilution. Further, the conversion price guaranteed that the target's shareholders would receive a price not less than that paid in the first stage of the tender offer. See Robert C. Micheletto, Comment, *The Poison Pill: A Panacea For The Hostile Corporate Raider*, 21 J. Marshall L. Rev. 107, 112 n.32 (1987); see also David A. Rosenzweig, Note, *Poison Pill Rights: Toward a Two-Step Analysis of Directors' Fidelity to Their Fiduciary Duties*, 56 GEO. WASH. L. REV. 373, 373 n.2 (1988); *A Study on the Economics of Poison Pills*, *supra* note 2, at 88,044.

Martin Lipton has supported the use of defensive takeover measures in the current environment. See Martin Lipton, *Takeover Bids in the Target's Boardroom*, 35 BUS. LAW. 101 (1979). More recently he has stated that, "[w]ith limitations on abusive takeovers in place, there no longer will be a justification for structural defenses that treat common shareholders unequally or are triggered by a change of control, such as poison pills, lock-up options, and fair price provisions." Lipton, *Corporate Governance in the Age of Finance Corporatism*, *supra*, at 60 n.280, 65. See also Lipton & Brownstein, *supra* note 2, at 1422-25. See generally *Compounding the Headache*, MERGERS & ACQUISITIONS, Jan./Feb. 1990, at 21; Alan Schwartz, *Search Theory and the Tender Offer Auction*, 2 J.L., ECON., & ORG. 229, 245 (1986).

With respect to poison pills and companies that are for sale, Professors Johnson and Siegel have stated:

The proposal, therefore, specifically requires directors of targets that are for sale to give all bidders a fair opportunity to compete. The proposal accomplishes this by (1) prohibiting the use of defensive tactics or the implementation of state statutes designed to deter a competing bid, and (2) requiring target directors to waive uniformly any pre existing repellent measures such as poison pills or state legislative protections that remain under their control.

Johnson & Siegel, *supra* note 2, at 408.

4. See *Paramount*, [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,514; *TW Servs.*, 1989 WL 20290; *Pillsbury*, 558 A.2d 1049; *Interco*, 551 A.2d 787.

this area of the law predominantly through a series of decisions starting with *City Capital Associates Ltd. Partnership v. Interco Inc.*⁵

The purpose of this Article is to analyze the poison pill and use it as a vehicle to examine other important topics in the area of corporate mergers and acquisitions, all as reviewed by the Delaware Court of Chancery and, where pertinent, by the Delaware Supreme Court. In addition to the poison pill, this Article examines such topics in the area of corporate mergers and acquisitions as the tender offer process, antitakeover devices, valuation, and economics, as well as other significant topics. These topics are analyzed by examining the *Interco* decision, which is most illustrative of issues in this area, and by comparing it to the applicable line of decisions that have followed in the Delaware Court of Chancery, as well as certain holdings of the Delaware Supreme Court.

In Part II of this Article, I discuss the facts and holding in the *Interco* case. A detailed discussion of the facts and holding in this case helps to clearly present the issues that are analyzed in this Article.

In Part III, I review the *Interco* decision, as well as relevant decisions of the Delaware Supreme Court. I undertake my analysis in this section from a purely legal perspective.

In Part IV, I discuss the series of pertinent decisions of the Delaware Court of Chancery that followed *Interco*. My analysis in this section is still of a purely legal nature.

In Part V, I analyze the *Paramount* decision of the Delaware Supreme Court, again from a legal perspective. The impact of the Delaware Supreme Court's decision will be considered both in general terms, and as it applies to the decisions of the Delaware Court of Chancery.

In Part VI, I take two decisions of the Delaware Court of Chancery discussed in previous sections of this Article from a legal perspective, but this time analyze them from an economic perspective. I consider whether it is possible to make the argument that the holdings are justified when viewed solely from an economic perspective.

Part VII consists of a summary and a conclusion. Throughout this Article, I comment on the merits and shortcomings of the various positions taken and arguments stated. I also make recommendations on the issues discussed.

5. 551 A.2d 787 (Del. Ch. 1988), *appeal dismissed*, 556 A.2d 1070 (Del. 1988).

II. THE FACTS IN *INTERCO*

Interco Incorporated is a diversified Delaware holding company with its principal offices located in St. Louis, Missouri.⁶ In late 1985, Interco adopted a poison pill with a "flip-in" provision.⁷ Management claimed that it adopted this poison pill because it viewed the company as susceptible to a highly leveraged "bust-up" takeover.⁸ Management attributed Interco's susceptibility to such a takeover to a lack of integration in the company's corporate structure.⁹

In response to trading activity that began in May 1988, and that was caused by the acquisition of Interco stock by Steven and Mitchell Rales through City Capital Associates Limited Partnership ("City Capital"), the Interco board met on July 11, 1988,¹⁰ at which time they redeemed the rights issued as part of a 1985 rights plan and issued a new rights plan that contained both "flip-in" and "flip-over" rights.¹¹

6. *Id.* at 791. Interco has 21 subsidiary companies in four major business areas: furniture and home furnishings, footwear, apparel and general merchandizing. Interco owns such nationally recognized brands as London Fog raincoats; Ethan Allen, Lane, and Broyhill furniture; Converse All-Star athletic shoes; and Le Tigre and Christian Dior sportswear. *Id.*

7. *Id.* A poison pill with a flip-in provision allows the current shareholders of a company, other than the hostile bidder, to acquire additional shares in the company at a price below market. See JOY M. BRYAN, CORPORATE ANTI-TAKEOVER DEFENSES: THE POISON PILL DEVICE at xx (Charles E. Simon & Co. 1990); Harold S. Bloomenthal, *Introduction: Tender Offer Defenses—The Poison Pill; State Takeover Statutes* in BRYAN, *supra*, at Intro.-1 to -3; Ronald A. Brown, Jr., Note, *An Examination of a Board of Directors' Duty to Redeem the Rights Issued Pursuant to a Stockholder Rights Plan*, 14 DEL. J. CORP. L. 537, 542 n.29 (1989); Micheletto, *supra* note 3, at 116-18.

8. *Interco*, 551 A.2d at 791. A "bust-up" takeover occurs when a company is acquired and its various divisions/business units/pieces are separately sold off. See Lipton & Brownstein, *supra* note 2, at 1411-12; see generally Reinier Kraakman, *Taking Discounts Seriously: The Implications of "Discounted" Share Prices as an Acquisition Motive*, 88 COLUM. L. REV. 891, 901, 908 (1988).

9. *Interco*, 551 A.2d at 791. Interco is structured so its subsidiaries function as autonomous units and are not viewed by management as part of a large integrated unit. *Id.*

10. *Id.* at 791.

11. *Id.* A poison pill with a "flip-over" provision allows the current shareholders of a company, other than a hostile bidder, to acquire additional

The flip-in provision of the new rights plan provided that if an entity acquired 30% of Interco's common stock, each rights holder could exercise his right to purchase that number of Interco shares per right which, at that time, would have a market value of twice the exercise price of each right.¹² The "flip-over" provision provided that in the event of a merger of Interco or upon the acquisition of 50% or more of Interco's assets or earning power, "the rights may be exercised to acquire common stock of the acquiring company having a value of twice the exercise price of the right."¹³

On July 15, 1988, the Chairman of Interco's board, Mr. Harvey Saligman, issued a press release announcing his intention to recommend a major restructuring of the company to Interco's board.¹⁴

On July 27, City Capital made an offer to Interco to acquire the company by merger for a price of \$64 per share in cash, contingent upon the availability of financing.¹⁵ On August 8, City Capital increased its offering price to \$70 per share, still conditioned upon securing the required financing.¹⁶

On August 8, at Interco's regularly scheduled board meeting, Wasserstein Perella & Co., Inc. ("Wasserstein Perella"), Interco's investment banker, informed Interco's board that it viewed City Capital's \$70 offer as inadequate.¹⁷ Wasserstein Perella also analyzed the possibility of selling certain

shares in a hostile bidder for a price below market. BRYAN, *supra* note 7, at xx; Bloomenthal, *supra* note 7, at Intro.-1 to -3. See also STANLEY F. REED & LANE AND EDSON, P.C., *THE ART OF M&A: A MERGER ACQUISITION BUYOUT GUIDE* 772-73 (1989); 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, 299-310 (1984); Edward F. Greene & James J. Junewicz, *A Reappraisal of Current Regulations of Mergers and Acquisitions*, 132 U. PA. L. REV. 647, 705 (1984); Johnson & Siegel, *supra* note 2, at 333 n.65; Brown, *supra* note 7, at 541-43, 541 n.24; Micheletto, *supra* note 3, at 114-16; A *Study on the Economics of Poison Pills*, *supra* note 2, at 88,044-45.

12. *Interco*, 551 A.2d at 791.

13. *Id.* at 791-92.

14. *Id.* at 792.

15. *Id.* On July 27, 1988, the Rales brothers disclosed through the filing of a Schedule 13D with the Securities and Exchange Commission that, as of July 11, they owned 3,140,300 shares, or 8.7% of Interco's common stock. *Id.*

16. *Id.* The \$70 per share offer was made prior to any response by the Interco board to City Capital's previous \$64 per share offer. *Id.*

17. *Id.* Discounted cash flow analysis, and an analysis of premiums paid over existing stock prices for specific tender offers during early 1988, as well

Interco businesses while retaining others.¹⁸ Through this analysis Wasserstein Perella arrived at a value "reference range" of \$68 to \$80 per share for Interco.¹⁹ At this same meeting, "the board voted to decrease the threshold percentage needed to trigger the flip-in provision of the rights plan from 30% to 15% and elected to explore a restructuring plan for the [c]ompany."²⁰

The Rales brothers, on August 15, announced a public tender offer at \$70 cash per share for all of the outstanding stock of Interco. The court explained, "The offer was conditioned upon (1) receipt of financing, (2) the tender of sufficient shares to give the offeror a total holding of at least 75% of the [c]ompany's common stock on a fully diluted basis at the close of the offer, (3) the redemption of the rights plan, and (4) a determination as to the inapplicability of 8 *Del. C.* § 203."²¹

On August 22, the board held a special meeting to consider the Rales brothers' \$70 per share tender offer.²² The Interco board decided to recommend against the tender offer.²³ The board based its recommendation, in part, on a revised value "reference range" of \$74 to \$87 for Interco in its entirety.²⁴ The board also decided at this meeting to keep the rights plan in place and not to render Delaware Code Annotated title 8, section 203²⁵ inapplicable to the tender offer.²⁶ Further, the board decided not to disclose

as other forms of analysis were used by Wasserstein Perella to arrive at their opinion. *Id.*

18. *Id.*

19. *Id.*

20. *Id.*

21. *Id.* City Capital was unsuccessful in its legal proceedings against Interco. It attempted to secure a determination from a federal district court that Delaware Code Annotated title 8, § 203 was invalid on constitutional grounds. *See City Capital Assocs. Ltd. Partnership v. Interco Inc.*, 696 F. Supp. 1551 (D. Del.), *aff'd*, 860 F.2d 60 (3d Cir. 1988).

22. *Interco*, 551 A.2d at 792.

23. *Id.*

24. *Id.*

25. The statute states in part, "Notwithstanding any other provisions of this chapter, a corporation shall not engage in any business combination with any interested stockholder for a period of 3 years following the date that such stockholder became an interested stockholder." DEL. CODE ANN. tit. 8, § 203 (1991). The *Interco* court cites the version of § 203 in place in 1988. The statute has not been amended since then.

26. *Interco*, 551 A.2d at 792.

confidential information²⁷ related to the tender offer unless City Capital agreed to enter into a confidentiality agreement²⁸ and a standstill agreement²⁹ with Interco.³⁰

At this meeting, the board went on to examine alternatives to the City Capital offer.³¹ This included a resolution by the board empowering management ". . . to explore all appropriate alternatives to the [City Capital] offer, including, without limitation, the recapitalization, restructuring or other reorganization of the company, the sale of assets of the company in addition to the Apparel Manufacturing Group, and other extraordinary transactions, to maximize the value of the company to the stockholders. . . ."³²

On August 23, Interco informed City Capital by letter³³ that it had decided to explore alternatives to the City Capital offer.³⁴ Interco also

27. City Capital had requested confidential information from Interco. *Id.*

28. *Id.* A confidentiality agreement states that a company (usually the target) agrees to release confidential information about itself to a second company (usually a tender offeror) and the second company agrees not to disclose that information to any other entity.

29. *Id.* "A standstill agreement pledges a bidder to cease acquiring further shares of the target, typically for a defined period unless further acquisitions are approved by the target's management. In return, the bidder is typically given access to confidential information from the target." John C. Coffee, Jr., *Regulating the Market for Corporate Control: A Critical Assessment of the Tender Offer's Role in Corporate Governance*, 84 COLUM. L. REV. 1145, 1261 (1984).

30. Under the proposed standstill agreement, City Capital could not make any tender offer for Interco for a period of three years unless a tender offer was approved by Interco. There did not appear to be a provision in the agreement that would allow City Capital to make an offer for all of Interco's shares at a price higher than an offer supported by the Interco board. *Interco*, 551 A.2d at 792 n.5.

31. *Id.* at 793. Wasserstein Perella performed a valuation of each of Interco's operating components and presented its findings to the Interco board. *Id.*

32. *Id.* (quoting Minutes of Meeting, August 22, 1988) (ellipses in original).

33. *Id.* This exchange of letters was the only communication between Interco and City Capital during the period between August 22, when the \$70 offer was made, and September 10, when a higher offer of \$72 per share was made by City Capital. *Id.* Both sides claimed unsuccessful attempts to contact the other by telephone during this period. *Id.*

34. *Id.* Interco did inform City Capital that it intended to disclose

informed City Capital that it would not release information to City Capital unless City Capital entered into a confidentiality agreement and a standstill agreement.³⁵ On August 26, City Capital responded to Interco's proposal by suggesting that the two parties enter into a confidentiality agreement without a standstill provision.³⁶

On September 10, the Rales brothers increased their offer for Interco to \$72 per share.³⁷ On September 19, the Interco board considered the \$72 offer and rejected it on grounds of financial inadequacy.³⁸ Instead, the board agreed to adopt a restructuring proposal as presented by Wasserstein Perella.³⁹ The court in *Interco* described the proposed restructuring as follows:

Under the terms of the restructuring designed by Wasserstein Perella, Interco would sell assets that generated approximately one-half of its gross sales and would borrow \$2.025 billion. It would make very substantial distributions to shareholders, by means of a dividend, amounting to a stated aggregate value of \$66 per share. The \$66 amount would consist of (1) a \$25 dividend payable November 7 to shareholders of record on October 13, consisting of \$14 in cash and \$11 in face amount of senior subordinated debentures, and (2) a second dividend (declared on October 19 and payable no earlier than November 29) of (a) \$24.15 in cash, (b) \$6.80 principal amount of subordinated discount debentures, (c) \$5.44 principal amount of junior subordinated debentures, (d) convertible preferred stock with a liquidation value of \$4.76, and (e) a remaining equity interest or stub that Wasserstein Perella estimated (based on projected earnings of the then remaining business) would trade at a price of at least \$10 per share. Thus, the total value of the restructuring to shareholders would, in the opinion of Wasserstein Perella, be at least \$76 per share on a fully distributed basis.⁴⁰

confidential information to other entities in the course of exploring alternative options. *Id.*

35. *Id.* See *supra* note 29 and accompanying text.

36. *Interco*, 551 A.2d at 793.

37. *Id.*

38. *Id.*

39. *Id.*

40. *Id.* Wasserstein Perella's compensation arrangement with Interco awarded the firm substantial contingency pay upon the completion of a restructuring. *Id.* With respect to this compensation arrangement, the court viewed Wasserstein Perella as having a conflict of interest in opining that the value of the restructuring was greater than City Capital's all cash offer. *Id.*

The market, as well as City Capital's investment banker, Drexel Lambert Burnham Incorporated valued Interco at \$70 per share.⁴¹

On September 15, Interco started its restructuring by announcing its plans to sell the Ethan Allen furniture division, citing that Ethan Allen could not be integrated into its other furniture divisions and was not suitable for the cost cutting required by the restructuring.⁴² City Capital viewed Ethan Allen as Interco's "crown jewel."⁴³

On September 20, Interco announced the initial terms of its restructuring.⁴⁴ These terms were revised on September 27 in that "the dividend declared on October 13, 1988 would accrue interest at 12% per annum from that date to the payment date; and second, that the second phase dividend would similarly accrue interest (currently expected to be at a rate of 13 3/4% per annum) from the date of its declaration."⁴⁵

On October 18, City Capital raised its offer for Interco to \$74 per share.⁴⁶ This proposal, like the preceding bid, was an all cash offer for all the shares of Interco.⁴⁷

On October 19, the Interco board rejected City Capital's \$74 offer.⁴⁸ The board based its decision to reject the offer on its position that the price of \$74 was inadequate and that the proposed restructuring would yield a value of at least \$76 per share.⁴⁹

41. *Id.* at 793-94. Interco believes that the risks involved with this litigation, as well as other associated factors, account for the market's \$70 per share valuation. *Id.* at 794 n.6.

42. *Id.* at 794.

43. *Id.* A "crown jewel" is usually considered to be the most desirable part/division of a company. See Coffee, *supra* note 29, at 1261; Green & Junewicz, *supra* note 11, at 701; Dale A. Oesterle, *Target Managers as Negotiating Agents for Target Shareholders in Tender Offers: A Reply to the Passivity Thesis*, 71 CORNELL L. REV. 53, 92, 92 n.131 (1985).

44. *Interco*, 551 A.2d at 794.

45. *Id.*

46. *Id.* This, like the previous offers, was "an all cash offer for all shares with a contemplated back-end merger for the same consideration." *Id.*

47. *Id.*

48. *Id.*

49. *Id.*

III. THE DELAWARE COURT OF CHANCERY EXPRESSES ITS POSITION ON TOPICS IN THE AREA OF CORPORATE MERGERS AND ACQUISITIONS

A. *The Delaware Court of Chancery in Interco Has Misinterpreted and Misapplied the "Business Judgment Rule" and the "Unocal Test" to the Poison Pill*

Under Delaware Code Annotated title 8, section 141(a), the board of directors has the responsibility and power to manage the "business and affairs" of a corporation.⁵⁰ The "business judgment rule" articulates limited guidelines which must be followed by directors.⁵¹ The rule is a "presumption that in making a business decision, the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company."⁵²

50. DEL. CODE ANN. tit. 8, § 141(a) (1991) states:

The business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors, except as may be otherwise provided in this chapter or in its certificate of incorporation. If any such provision is made in the certificate of incorporation, the powers and duties conferred or imposed upon the board of directors by this chapter shall be exercised or performed to such extent and by such person or persons as shall be provided in the certificate of incorporation.

The 1991 version of § 141 is identical to the version in place at the time of the *Interco* case.

51. In *Pogostin v. Rice*, 480 A.2d 619, 627 (Del. 1984), the Delaware Supreme Court held that the business judgment rule, including the standards for the judgment of director conduct, applied to takeover situations. *See also Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 954 (Del. 1985).

52. *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984). *See also Ivanhoe Partners v. Newmont Mining Corp.* (*In re Newmont Mining Corp. Shareholders Litigation*), 535 A.2d 1334, 1341 (Del. 1987); *Moran v. Household Int'l, Inc.*, 500 A.2d 1346, 1356 (Del. 1985); *Unocal*, 493 A.2d at 954; *Robert M. Bass Group, Inc. v. Evans* (*In re Macmillan, Inc. Shareholders Litigation*), 552 A.2d 1227, 1239 (Del. Ch.), *appeal dismissed*, 548 A.2d 498 (Del. 1988); *West Point-Pepperell, Inc. v. J.P. Stevens & Co.* (*In re J.P. Stevens & Co. Shareholders Litigation*), 542 A.2d 770 (Del. Ch. 1988); Frederick W. Kanner, *Management-Led LBOs: Directors Have Heightened Duties When Involved in Takeover Battles*, N.Y. L.J., June 5, 1989, at 44.; Louis Lowenstein, *Pruning Deadwood in Hostile Takeovers: A Proposal for Legislation*, 83

In *Unocal Corp. v. Mesa Petroleum Co.*,⁵³ the Delaware Supreme Court recognized that directors were faced with a conflict between their own interests and the interests of the corporation and shareholders when confronted with a threat to corporate control.⁵⁴ The court in *Unocal* noted that these situations required an additional step prior to the conference of the protection

COLUM. L. REV. 249, 314-15 (1983); Edward E. Shea, *Obligations of Directors When a Bid is on the Table*, MERGERS & ACQUISITIONS, July/Aug. 1988, at 49; SPARKS ET AL., *supra* note 2, at 9-60

Martin Lipton has been a supporter of the business judgment rule. See Martin Lipton, *Takeover Bids in the Target's Boardroom; An Update After One Year*, 36 Bus. Law. 1017 (1981); Lipton, *Takeover Bids in the Target's Boardroom*, *supra* note 3; see also Ronald J. Gilson & Reinier Kraakman, *Delaware's Intermediate Standard for Defensive Tactics: Is There Substance to Proportionality Review?*, 44 BUS. LAW. 247, 247 n.1 (1989).

Judge (formerly Professor) Easterbrook and Professor Fischel have argued that the business judgment rule should not be used to support a decision to reject a tender offer. 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, 1194-1204 (1981). See also Frank H. Easterbrook & Daniel R. Fischel, *The Corporate Contract*, 89 COLUM. L. REV. 1416, 1417 (1989); see generally Victor Brudney, *Corporate Governance, Agency Costs, and the Rhetoric of Contract*, 85 COLUM. L. REV. 1403, 1419 n.37 (1985).

Edward F. Greene and James J. Junewicz have argued that the business judgment rule "fails to provide adequate legal standards for evaluating defensive tactics," "fails to provide the analytical framework necessary to give officers and directors adequate guidance" and does not adequately protect shareholder interests. Greene & Junewicz, *supra* note 11, at 701, 714. See also *id.* at 700-20, 726.

Professor Oesterle has argued that "courts should stop applying the business judgment doctrine or rule . . . in evaluating a target management's conduct when responding to a hostile tender offer." Oesterle, *supra* note 43, at 83. He has stated that "state courts or legislatures should define and enforce standards of fiduciary misconduct for target management based on their role as negotiating agents for shareholders." *Id.* at 82.

53. 493 A.2d 946 (Del. 1985).

54. *Unocal*, 493 A.2d at 954. See also *Shamrock Holdings, Inc. v. Polaroid Corp. (In re Polaroid Shareholders Litigation)*, 559 A.2d 278, 286 (Del. Ch. 1989); *City Capital Assocs. Ltd. Partnership v. Interco Inc.*, 551 A.2d 787, 796 (Del. Ch.), *appeal dismissed*, 556 A.2d 1070 (Del. 1988); Kanner, *supra* note 52; Shea, *supra* note 52, at 49-50; SPARKS ET AL., *supra* note 2, at 16-18.

of the business judgment rule.⁵⁵ The court stated that an "enhanced duty [is required] which calls for judicial examination at the threshold."⁵⁶

Unocal considered the business judgment rule in the context of the adoption of antitakeover measures and formed a two-part test.⁵⁷ The first part of this test requires that "directors must show that they had reasonable grounds for believing that a danger to corporate policy and effectiveness

55. *Unocal*, 493 A.2d at 954. See also *Moran v. Household Int'l, Inc.*, 500 A.2d 1346, 1356 (Del. 1985); *MAI Basic Four, Inc. v. Prime Computer, Inc.*, No. 10428, 1988 WL 140221, at *3 (Del. Ch. Dec. 20, 1988), *Interco*, 551 A.2d at 796; Kanner, *supra* note 52; SPARKS ET AL., *supra* note 2, at 16-18.

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

57. *Unocal*, 493 A.2d at 955. See also *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 180 (Del. 1986); *Moran*, 500 A.2d at 1355-57; *Polaroid*, 559 A.2d at 286-87; *Robert M. Bass Group, Inc. v. Evans (In re Macmillan, Inc. Shareholders Litigation)*, 552 A.2d 1227, 1239 (Del. Ch.), *appeal dismissed*, 548 A.2d 498 (Del. 1988); *Interco*, 551 A.2d at 796; *AC Acquisitions Corp. v. Anderson, Clayton & Co.*, 519 A.2d 103, 111 (Del. Ch. 1986); *Gilson & Kraakman*, *supra* note 52; Kanner, *supra* note 52; SPARKS ET AL., *supra* note 2, at 16-18. This is called the "proportionality test." *Interco*, 551 A.2d at 796.

Professors Johnson and Siegel have argued that the *Unocal* requirements are "inconsequential." Johnson & Siegel, *supra* note 2, at 329-39. I disagree with this position. First, the *Unocal* test may not be as stringent as Professors Johnson and Siegel would prefer, but it is more demanding than they characterize it to be. Also, it is more rigorous than the previous business judgment rule standard. Second, the transfer of the initial burden of proof from the plaintiff to the target's board presents a threshold standard that target boards must satisfy. Third, the Delaware Supreme Court has demonstrated that the *Unocal* test is not an "inconsequential" standard, in its holdings in *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986) and in *Mills Acquisition Co. v. Macmillan, Inc.*, 551 A.2d 1261 (Del. 1989). Also, the Delaware Court of Chancery has attempted to use the *Unocal* test to support its holdings against target boards in *City Capital Associates Ltd. Partnership v. Interco Inc.*, 551 A.2d 787 (Del. Ch.), *appeal dismissed*, 556 A.2d 1070 (Del. 1988) and *Grand Metropolitan Public Ltd. Co. v. Pillsbury Co. (In re Pillsbury Co. Shareholders Litigation)*, 558 A.2d 1049 (Del. Ch. 1988). I have argued elsewhere in this Article that the Delaware Court of Chancery misunderstood and/or failed to apply or misapplied the *Unocal* test in *Interco* and *Pillsbury*. See also Johnson & Siegel, *supra* note 2, at 329-39.

existed because of another person's stock ownership."⁵⁸ *Unocal* places the initial burden on directors to justify their position in the adoption of antitakeover measures in order to come under the control of the business judgment rule.⁵⁹ The *Unocal* court recognized that directors could satisfy this burden by a showing of "good faith and reasonable investigation."⁶⁰ The second part of this test requires that directors show that their actions were "reasonable in relation to the threat posed."⁶¹ If the directors satisfy this

58. *Unocal*, 493 A.2d at 955. See also *Paramount Communications, Inc. v. Time, Inc.*, 571 A.2d 1140, 1152 (Del. 1990); *Johnson & Siegel*, *supra* note 2, at 329-39; *Kanner*, *supra* note 52; *SPARKS ET AL.*, *supra* note 2, at 16-18.

59. *Unocal*, 493 A.2d at 954. See also *Paramount*, 571 A.2d at 1152; *Moran*, 500 A.2d at 1356; *Bass*, 552 A.2d at 1239; *Johnson & Siegel*, *supra* note 2, at 329-39; Kirk R. Crowder, Note, *Recent Developments in the Use of the Poison Pill Antitakeover Defense: Limiting the Business Judgment Rule*, 31 ST. LOUIS U. L.J. 1083, 1090 (1987).

60. *Unocal*, 493 A.2d at 955 (quoting *Cheff v. Mathes*, 199 A.2d 548, 555 (Del. 1964)). See also *Paramount*, 571 A.2d at 1152; *Moran*, 500 A.2d at 1356; *Interco*, 551 A.2d at 796; *MAI Basic Four, Inc. v. Prime Computer, Inc.*, No. 10428, 1988 WL 140221, at *3 (Del. Ch. Dec. 20, 1988); *Bass*, 552 A.2d at 1239; *Shea*, *supra* note 52, at 49; *SPARKS ET AL.*, *supra* note 2, at 16-18; *Crowder*, *supra* note 59, at 1090 n.39.

61. *Unocal*, 493 A.2d at 955. See also *Paramount*, 571 A.2d at 1152; *Moran*, 500 A.2d at 1356; *In re Holly Farms Corp. Shareholders Litigation*, 564 A.2d 342, 348-49, 350-52 (Del. Ch. 1989); *Polaroid*, 559 A.2d at 286-87; *MAI Basic Four*, 1988 WL 140221, at *3; *Bass*, 552 A.2d at 1239; *Interco*, 551 A.2d at 796; *AC Acquisitions*, 519 A.2d at 111; *Gilson & Kraakman*, *supra* note 52, at 251.

Professors *Gilson* and *Kraakman* referred to *AC Acquisitions Corp. v. Anderson, Clayton & Co.* to support their contention that "an effective proportionality test must be more than a threshold test," *id.* at 266, and that "[d]efensive tactics must be justified in relationship to particular terms of hostile offers." *Id.* at 256. They did recognize that the application of the proportionality standard was still open to the interpretation of the Delaware courts. *Id.* at 252-54.

An indication of the Delaware Court of Chancery's and Delaware Supreme Court's current interpretation of this standard can be found in *Paramount*. The respective courts' *Paramount* decisions generally recognize and approve of a target board's reliance on a long-term corporate strategy argument to defeat a tender offer, and also recognize other factors. The opinions indicate that the Delaware courts are interpreting the proportionality standard as being more of a threshold test and less of a substantive test. This

two-part test, the burden shifts back to the plaintiffs to show that the directors breached their fiduciary duty.⁶² The *Unocal* court noted that a "corporation does not have unbridled discretion to defeat any perceived threat by any Draconian means available."⁶³ The *Unocal* court also noted that the preceding process carries increased weight when properly carried out and approved by a board consisting of a majority of outside directors.⁶⁴

The Delaware Court of Chancery in *Interco*, separating the issue of the poison pill and speaking apart from it, found that the Interco board had acted in good faith and on an informed basis.⁶⁵ Why the *Interco* court did not apply this analysis, which relies on a standard of good faith and informed judgment, to the question of whether the poison pill should be redeemed is unclear, but creates an issue in the court's analysis.⁶⁶ If the *Interco* court had applied such an analysis to the question of the poison pill and had concluded that the board had acted in good faith and in an informed manner (or that the board had conducted a reasonable investigation), this determination would have been sufficient to satisfy the first part of the *Unocal* test.⁶⁷ The court gave no reason for its failure to make this analysis.

represents a move away from the standard supported by Gilson and Kraakman. See *id.*; Kanner, *supra* note 52; Jonathan J. Lerner, *Did the Time Decision Torpedo the Hostile Bid?*, MERGERS & ACQUISITIONS, Jan./Feb. 1990, at 41, 42; Shea, *supra* note 52, at 50; SPARKS ET AL., *supra* note 2, at 16-18, Crowder, *supra* note 59, at 1090 n.39.

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

63. *Unocal*, 493 A.2d at 955. See also *Grand Metro. Pub. Ltd. Co. v. Pillsbury Co. (In re Pillsbury Co. Shareholders Litigation)*, 558 A.2d 1049, 1058 (Del. Ch. 1988).

64. *Unocal*, 493 A.2d at 955. See also *Johnson & Siegel*, *supra* note 2, at 320.

65. *Interco*, 551 A.2d at 802-03.

66. Instead of applying a standard based on good faith and informed judgment, the court in *Interco* used a two-part standard it identified as "[t]hreats to voluntariness" and "[t]hreats from 'inadequate' but noncoercive offers." *Id.* at 797-800.

67. *Unocal*, 493 A.2d at 955. See also *Moran v. Household Int'l, Inc.*, 500 A.2d 1346, 1356 (Del. 1985); *Cheff v. Mathes*, 199 A.2d 548, 554-55 (Del. 1964); *Interco*, 551 A.2d at 796. The first part of the *Unocal* test requires that "directors must show that they had reasonable grounds for believing that a danger to corporate policy and effectiveness existed because of another person's stock ownership." *Unocal*, 493 A.2d at 955. See also *Moran*, 500 A.2d at 1356; *Interco*, 551 A.2d at 796.

The court in *Interco* also did not adequately consider whether the Interco board satisfied the second part of the *Unocal* test,⁶⁸ the standard of a reasonable response.⁶⁹ The court recognized that a board could respond to a tender offer with a "restructuring" which is the response that the Interco board had given to the City Capital tender offer.⁷⁰ As noted previously, the court recognized that, apart from the poison pill issue, the board had been appropriately informed and "did explore with expert third parties [Interco's] value in an LBO transaction."⁷¹ It is difficult to see how after recognizing that a restructuring is a possible response to a tender offer and the fact that this restructuring was done on an informed basis, that the *Interco* court did not recognize that the board had satisfied the second requirement of the *Unocal* test and thus both parts of the *Unocal* standard.

It is also difficult to understand how the court could justify separating its evaluation of the restructuring from that of the redemption of the poison pill. The board's good faith and informed conclusion, as recognized by the *Interco* court,⁷² that the restructuring had a value of at least \$76 per share provided the board with a standard of value for the company.⁷³ In judging the adequacy of all other alternatives, a board has to compare them against the value of a restructuring. Adequacy of price is probably the most critical issue in a board's determination as to whether it should redeem a poison pill.⁷⁴

68. Although the *Interco* court stated that it did not find the poison pill reasonable in relation to the threat posed by the offer, *Interco*, 551 A.2d at 790-91, it did not adequately explain its underlying reasoning. The court concentrated on applying its own two-part analysis, which it unconvincingly classified as coming under part one of the *Unocal* test. See *infra* note 76. From this misapplied analysis it arrived at the conclusion that the poison pill was not reasonable in relation to the threat posed.

69. The second part of the *Unocal* test requires that directors must show that their actions were "reasonable in relation to the threat posed." *Unocal*, 493 A.2d at 955. See also *Moran*, 500 A.2d at 1356; *Interco*, 551 A.2d at 796; Crowder, *supra* note 59.

70. *Interco*, 551 A.2d at 798. See also *The Short M & A Casualty List, MERGERS & ACQUISITIONS*, May/June 1989, at 17.

71. *Interco*, 551 A.2d at 803.

72. See *supra* notes 60, 61 and accompanying text.

73. *Interco*, 551 A.2d at 795.

74. See *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 180-81 (Del. 1986); *Moran v. Household Int'l, Inc.*, 500 A.2d 1346 (Del. 1985); *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946 (Del. 1985). Adequacy of price is not the only issue that should be considered. *Paramount Communications, Inc. v. Time, Inc.*, 571 A.2d 1140, 1153 (Del. 1990).

It seems inconceivable that a court could find that the board had acted in good faith and in an informed manner with regard to the restructuring, yet avoid this conclusion with respect to the issue of redemption of the poison pill, when one considers the intertwined nature of the two issues.

Instead of applying the business judgment rule and the *Unocal* test,⁷⁵ the *Interco* court applied a two-part analysis of its own⁷⁶ and followed that with a review of Wasserstein Perella's valuation.⁷⁷ The *Interco* court identified part one of its two-part test as "[t]hreats to voluntariness."⁷⁸ The argument that the court attempted to make was that shareholders ought to be able to voluntarily decide upon an offer or choose between competing alternatives.⁷⁹ The court concluded that the *Interco* board had used the poison pill to "preclude shareholder choice."⁸⁰

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

76. *Interco*, 551 A.2d at 797-98. The *Interco* court unconvincingly tried to classify its two-part test as coming under the first element of the *Unocal* test. *Id.* at 797. This reasoning shows a misunderstanding of the *Unocal* standard. When the *Interco* court's analysis is viewed in its most favorable light, it is at best a misapplication of the *Unocal* test. *Unocal*, 493 A.2d at 955. As argued above, *supra* part III(A), a proper application of the *Unocal* test should lead to conclusions which differ from those arrived at by the *Interco* court.

77. *Interco*, 551 A.2d at 798-800.

78. *Id.* at 797. The *Interco* court identifies part two as, "[t]hreats from 'inadequate' but noncoercive offers." *Id.*

79. *Id.*

80. *Id.* at 799. The *Interco* court did refer to the holding in *Unocal* in its reasoning process, but misinterpreted and misapplied the *Unocal* holding. *Id.* at 796-801. See *supra* note 66 and accompanying text.

In addressing the issue of shareholder choice the court in *Interco* stated:

Perhaps there is a case in which it is appropriate for a board of directors to in effect permanently foreclose their shareholders from accepting a noncoercive offer for their stock by utilization of the recent innovation of "poison pill" rights. . . .

. . . .

Yet, recognizing the relative closeness of the values and the impossibility of knowing what the stub share will trade at, the board, having arranged a value maximizing restructuring, elected to preclude shareholder choice. It did so not to buy time in order to negotiate or arrange possible alternatives, but asserting in effect a right and duty to save shareholders from the consequences of the choice they might make, if permitted to choose.

The *Interco* court, when discussing the issue of voluntary shareholder choice, failed to consider the role of a board of directors in the corporate decision-making process. The *Interco* court failed to recognize that the basic premise upon which the General Corporation Law of the State of Delaware is based "is that directors, rather than shareholders manage the business and affairs of [a] corporation."⁸¹ Delaware Code Annotated title 8, section 141(a) states in part: "The business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors, except as may be otherwise provided in this chapter or in its certificate of incorporation."⁸²

....

Our corporation law exists, not as an isolated body of rules and principles, but rather in a historical setting and as a part of a larger body of law premised upon shared values. To acknowledge that directors may employ the recent innovation of "poison pills" to deprive shareholders of the ability effectively to choose to accept a noncoercive offer, after the board has had a reasonable opportunity to explore or create alternatives, or attempt to negotiate on the shareholders' behalf, would, it seems to me, be so inconsistent with widely shared notions of appropriate corporate governance as to threaten to diminish the legitimacy and authority of our corporation law.

Id. at 798-800.

Judge Easterbrook and Professor Fischel have argued that with respect to the decision of "whether to accept or reject a tender offer, managers enjoy no particular comparative advantage over shareholders." Easterbrook & Fischel, *The Proper Role of a Target's Management in Responding to a Tender Offer*, *supra* note 52, at 1198. This position does not consider that managers spend a lot of time getting to know their companies. Also, they have current and ready access to information that shareholders do not have access to. Further, they are better informed about current negotiations, strategic business and legal positions on matters, and other issues, than are shareholders.

81. *Aronson v. Lewis*, 473 A.2d 805, 811 (Del. 1984). See also DEL. CODE ANN. tit. 8, § 141(a) (1991); *Paramount Communications, Inc. v. Time, Inc.*, 571 A.2d 1140 (Del. 1990); *Johnson & Siegel*, *supra* note 2, at 320, 320 n.15; *The Time Case: Breathing Room for Increasing Values*, MERGERS & ACQUISITIONS, Sept./Oct. 1989, at 7.

82. DEL. CODE ANN. tit. 8, § 141(a) (1991). See also *Paramount*, 571 A.2d 1140; *Aronson*, 473 A.2d at 811; *MAI Basic Four, Inc. v. Prime Computer, Inc.*, No. 10428, 1988 WL 140221, at *2 (Del. Ch. Dec. 20, 1988); *The Time Case: Breathing Room for Increasing Values*, *supra* note 81, at 7; *Johnson & Siegel*, *supra* note 2, at 320, 320 n.15.

The Delaware Supreme Court in *Unocal* recognized that the management function of directors includes extraordinary corporate transactions when it stated: "Even in the traditional areas of fundamental corporate change, i.e., charter amendments [8 *Del.C.* § 242(b)], mergers [8 *Del.C.* §§ 251(b), 252(c), 253(a), and 254(d)], sale of assets [8 *Del.C.* § 271(a)], and dissolution [8 *Del.C.* § 275(a)], director action is a prerequisite to the ultimate disposition of such matters."⁸³

Although the *Interco* court referred to *Unocal* to support its shareholder-choice contention, it failed to recognize that neither *Unocal*, which has a fact pattern similar to *Interco's*, nor Delaware law in general, requires that shareholders be given the opportunity to vote to accept an inadequate offer.⁸⁴

The Delaware Court of Chancery in *Interco* also did not recognize the applicability of the decision of the Delaware Supreme Court in *Moran v.*

83. *Unocal*, 493 A.2d at 954 n.8 (brackets in original). See also *Smith v. Van Gorkom*, 488 A.2d 858, 888 (Del. 1985).

84. *Unocal*, 493 A.2d 946. See also *Ivanhoe Partners v. Newmont Mining Corp.* (*In re Newmont Mining Corp. Shareholders Litigation*), 535 A.2d 1334 (Del. 1987). These are important cases to consider in analyzing shareholder choice with respect to *Interco*. In both these cases, as in *Interco*, the bidder made a tender offer at a price that the respective target boards decided was inadequate. The respective target boards responded to the inadequate offers by restructuring or recapitalizing their companies. Newmont issued a large cash dividend and made use of a street sweep. *Ivanhoe Partners*, 535 A.2d at 1336-37. *Unocal* issued debt securities in exchange for stock. *Unocal*, 493 A.2d at 950-51. The shareholders were not given the opportunity to vote on the tender offer in either *Unocal*, 493 A.2d 946, or *Ivanhoe Partners*, 535 A.2d 1334.

The question of the inadequacy of the City Capital offer will be analyzed later in this Article. See *infra* part III(C).

Martin Lipton has argued that directors and not shareholders should make the decision as to whether to accept or reject a takeover bid and that shareholders can voice their opinions by voting for or against directors. He has stated, "If the shareholders are dissatisfied with the directors' rejection of a takeover bid, they have the right, through the normal proxy machinery, to replace the directors or to instruct the directors to accept a takeover bid." Lipton, *Takeover Bids in the Target's Boardroom*, *supra* note 3, at 116.

Lipton has also stated, "If the shareholders do not like the directors' decisions, they have the right and power to change the directors." *Id.* at 120.

I agree with the arguments made by Lipton that shareholders can express their opinions on directors' decisions through the voting process.

*Household International, Inc.*⁸⁵ The court in *Moran* based its decision on *Unocal* and held that a rights plan could be adopted without a shareholder vote.⁸⁶ The Delaware Supreme Court in *Moran* also determined that, subject to the *Unocal* standard, the board, and not the shareholders by way of voting, was responsible for deciding whether or not to redeem a poison pill.⁸⁷ The court in *Moran* held that shareholders could assert their power by exercising their control over the members of the board.⁸⁸

The Delaware Court of Chancery's holding in *Interco* effectively takes the decision-making process out of the hands of the directors and puts it almost entirely in the hands of the shareholders. The court in *Interco* fails to acknowledge the powers granted to directors under Delaware Code Annotated title 8, section 141(a), as well as by the holdings in *Unocal* and *Moran*.

The holding in *TW Services, Inc. v. SWT Acquisition Corp.*⁸⁹ further clouds the Delaware Court of Chancery's position on the role of shareholder voting with respect to management of the business and affairs of a corporation. In discussing the Delaware model of corporate governance, Chancellor Allen⁹⁰ wrote in *TW Services*:

"Shareholder democracy" is an appealing phrase, and the notion of shareholders as the ultimate voting constituency of the board has obvious pertinence, but that phrase would not constitute the only element in a well articulated model. While corporate democracy is a pertinent concept, a corporation is not a New England town meeting; directors, not shareholders, have responsibilities to manage the business and affairs of a corporation, subject however to a fiduciary obligation.⁹¹

Chancellor Allen's opinion in *TW Services*, which supports the position that directors should manage the business and affairs of a corporation, seems like a retreat from his decision in *Interco*, which supported shareholder voting with respect to the management of a corporation. The inconsistencies of the Delaware Court of Chancery on this issue make it difficult to determine where the position of the court ultimately lies. However, the later *TW Services*

85. 500 A.2d 1346 (Del. 1985).

86. *Id.* at 1353, 1355. See also *Unocal*, 493 A.2d at 953.

87. *Moran*, 500 A.2d at 1353-54. Professors Gilson and Kraakman recognized and commented on the application of the *Unocal* two-part test to the poison pill in *Moran*. Gilson & Kraakman, *supra* note 52, at 252-53. See also Lipton & Brownstein, *supra* note 2, at 1408-10.

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

89. Nos. 10427, 10298, 1989 WL 20290 (Del. Ch. March 2, 1989).

90. Chancellor Allen also wrote the *Interco* decision.

91. *TW Servs.*, 1989 WL 20290 at *12 n.14.

decision, which is more in line with the position of the Delaware Supreme Court, may signal support in the Delaware Court of Chancery for the position of directors managing the business and affairs of corporations.⁹²

B. What is an Excessive Response to a Particular Tender Offer Proposal?

The Delaware Supreme Court in *Unocal* established that a response to a takeover proposal must be balanced and "reasonable in relation to the threat posed"⁹³ in order to come under the guidelines of the business judgment rule.⁹⁴ The court in *Unocal* stated:

*A further aspect is the element of balance. If a defensive measure is to come within the ambit of the business judgment rule, it must be reasonable in relation to the threat posed. This entails an analysis by the directors of the nature of the takeover bid and its effect on the corporate enterprise. Examples of such concerns may include: inadequacy of the price offered, nature and timing of the offer, questions of illegality, the impact on "constituencies" other than shareholders (i.e., creditors, customers, employees, and perhaps even the community generally), the risk of nonconsummation, and the quality of the securities being offered in the exchange.*⁹⁵

92. See *Moran*, 500 A.2d 1346; *Unocal*, 493 A.2d 946; MAI Basic Four, Inc. v. Prime Computer, Inc., No. 10428, 1988 WL 140221 (Del. Ch. Dec. 20, 1988); Meyers, *supra* note 3; see also *infra* part IV(E) for a discussion of Paramount Communications, Inc. v. Time, Inc., [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,514 (Del. Ch. July 14, 1989), *aff'd*, 571 A.2d 1140 (Del. 1990).

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

94. The court in *Unocal*, in limiting the response a corporation can make to a takeover proposal, stated that "[a] corporation does not have unbridled discretion to defeat any perceived threat by any Draconian means available." *Id.*

The "Draconian" response limitation was considered in *MacAndrews & Forbes Holdings, Inc. v. Revlon, Inc.*, 501 A.2d 1239, 1247 (Del. Ch. 1985), *aff'd*, 506 A.2d 173 (Del. 1986) and recognized in Schwartz, *Chancery Court Ignores Del. Supreme Court Precedents*, *supra* note 3.

95. *Unocal*, 493 A.2d at 955 (emphasis added). See also Lipton & Brownstein, *supra* note 2.

In *Moran*, the Delaware Supreme Court affirmed its *Unocal* "reasonable response" position when it stated the following: "In addition, the directors must show that the defensive mechanism was 'reasonable in relation to the

In *Unocal*, the Unocal Corporation responded to Mesa Petroleum Co.'s tender offer, which it determined to be inadequate, with a self-tender.⁹⁶ The Delaware Supreme Court found Unocal's self-tender a reasonable response to Mesa's tender offer.⁹⁷ In reviewing the *Unocal* holding, it is difficult to see

threat posed." *Moran*, 500 A.2d at 1356 (citing *Unocal*, 493 A.2d at 955).

See also *Ivanhoe Partners v. Newmont Mining Corp. (In re Newmont Mining Corp. Shareholders Litigation)*, 535 A.2d 1334, 1343 (Del. 1987).

96. *Unocal*, 493 A.2d at 956-57.

97. *Id.* at 955-59. Judge Easterbrook and Professor Fischel have argued that "resistance by a corporation's managers to premium tender offers, even if it triggers a bidding contest, ultimately decreases shareholder welfare." Easterbrook & Fischel, *The Proper Role of a Target's Management in Responding to a Tender Offer*, *supra* note 52, at 1161. They have also argued that "the wealth of both investors and society is increased if the managers of tender offer targets neither resist takeover bids nor seek competing offers for the targets' securities." Frank H. Easterbrook & Daniel R. Fischel, *Auctions and Sunk Costs in Tender Offers*, 35 STAN. L. REV. 1, 1 (1982). This is known as the "passivity argument." See Lucian A. Bebchuk, *The Case for Facilitating Competing Tender Offers: A Reply and Extension*, 35 STAN. L. REV. 23 (1982); Easterbrook & Fischel, *supra*; Ronald J. Gilson, *Seeking Competitive Bids Versus Pure Passivity in Tender Offer Defense*, 35 STAN. L. REV. 51, 66 (1982).

I do not find this argument convincing because it neglects to properly consider that when looking at each tender offer individually, as opposed to tender offers as a group, it is difficult to argue that a target's board should not be allowed to use defensive measures, see Oesterle, *supra* note 43, at 68-70, the solicitation of competing offers, see Bebchuk, *supra*, at 38-39, and/or other means, see Lipton, *Takeover Bids in the Target's Boardroom*, *supra* note 3, at 112-24, to attempt to force an offeror (or offerors) to increase the value of its offer. See also Gregg A. Jarrell, *The Wealth Effects of Litigation by Targets: Do Interests Diverge in a Merge*, 28 J.L. & ECON. 151 (1985). Although defensive measures should not be so strong as to allow a target's board to defeat favorable tender offers, nevertheless, this is a long way from the Easterbrook and Fischel argument of passivity.

Professor Bebchuk has responded to the Easterbrook and Fischel position by arguing that competing bids are desirable for both target shareholders and society and that a target's management should be supported in its efforts to secure competing bids. See generally Lucian A. Bebchuk, *The Case for Facilitating Competing Tender Offers*, 95 HARV. L. REV. 1028 (1982); Bebchuk, *The Case for Facilitating Competing Tender Offers: A Reply and Extension*, *supra*. He has argued that "auctioneering increases premiums in

all acquisitions, unfriendly or negotiated, through merger or takeover, whether management is loyal or self-serving." Bebachuk, *The Case for Facilitating Competing Tender Offers*, *supra*, at 1045. See Bebachuk, *The Case for Facilitating Competing Tender Offers: A Reply and Extension*, *supra*; Coffee, *supra* note 29, at 1161-99; Gilson, *supra*; Oesterle, *supra* note 43, at 69-70. But see Easterbrook & Fischel, *supra*; Schwartz, *Search Theory and the Tender Offer Auction*, *supra* note 3. See generally Kraakman, *supra* note 8, at 933-36.

In studying the effects of auctions on takeover premiums Gregg A. Jarrell concluded:

Over 75 percent of the one hundred litigious targets are acquired, and their eventual acquisition is, on average, at a significantly higher takeover premium. Nearly 80 percent of the acquired targets benefit from lively auctions involving competing bidders or from substantially sweetened offers from the sole suitors. The typical auction provides an additional 17 percentage points to the already large initial takeover premium. Moreover, the frequency of auctions among litigious targets is much larger than that for nonlitigious targets.

Jarrell, *supra*, at 174.

Jarrell also concluded that when considering both successful and unsuccessful takeover attempts, the auction process was still beneficial to target shareholders, on average. *Id.*

Easterbrook and Fischel have argued that even resistance that elicits a higher offer is wasteful because all this does is transfer wealth from the offeror's shareholders to the target's shareholders. Easterbrook & Fischel, *supra* note 52, at 1175. I would argue that a target management's responsibility is to maximize wealth for its shareholders. It should not be concerned with the welfare of the bidder's shareholders.

In support of their passivity argument, Easterbrook and Fischel have argued that bidders invest heavily in research to identify underpriced corporations and that later bidders take a "free ride" on the first bidders' research investment. *Id.* at 1178-79. See also Easterbrook & Fischel, *supra* at 3-7; Schwartz, *Bebchuk on Minimum Offer Periods*, 2 J.L. ECON. & ORG. 271 (1986); Schwartz, *Search Theory and the Tender Offer Auction*, *supra* note 3.

Bebchuk has argued that while "bidding contests have some adverse effect on the amount of search done by prospective offerors," there are still significant rewards for searchers. Bebachuk, *The Case for Facilitating Competing Tender Offers*, *supra*, at 1035-38. See also Lucian A. Bebachuk, *Toward Undistorted Choice and Equal Treatment in Tender Offers*, 98 HARV. L. REV. 1693, 1776-78 (1985); Ronald J. Gilson, *A Structural Approach to*

Corporations: The Case Against Defensive Tactics in Tender Offers, 33 STAN. L. REV. 819, 870-72 (1981); Oesterle, *supra* note 43, at 80-83.

Professor Gilson has argued that competitive bidding may result in increased allocational efficiencies (As to allocational efficiencies, Bebchuk has stated that "the auctioneering rule in all likelihood minimizes the friction involved in moving target assets to their best possible uses." Bebchuk, *The Case for Facilitating Competing Tender Offers: A Reply and Extension*, *supra*, at 39-42. See also Bebchuk, *The Case for Facilitating Competing Tender Offers*, *supra*, at 264-68; Oesterle, *supra*, note 43, at 80-81, 80 n.87.), and that "for certain kinds of information producers, auctions [may] actually increase the return on investment in search." Gilson, *Seeking Competitive Bids Versus Pure Passivity in Tender Offer Defense*, *supra*, at 51-64; Gilson, *A Structural Approach to Corporations: The Case Against Defensive Tactics in Tender Offers*, *supra*, at 872. He suggests that an increase in return on investment in search can be achieved because "a successful acquisition requires two different sets of attributes: one involving information production skills and not very much capital, the other involving the operating skills required for implementing the takeover and substantially more capital." Gilson, *Seeking Competitive Bids Versus Pure Passivity in Tender Offer Defense*, *supra*, at 54. But see Easterbrook & Fischel, *supra*, at 13-15, 17-21. Gilson disagrees with Easterbrook's and Fischel's position that "a series of independent sales can cause assets to be shifted to their most productive users as efficiently as competitive bidding in connection with a single sale." Gilson, *Seeking Competitive Bids Versus Pure Passivity in Tender Offer Defense*, *supra*, at 62-64; Gilson, *A Structural Approach to Corporations: The Case Against Defensive Tactics in Tender Offers*, *supra*, at 872. But see Easterbrook & Fischel, *supra* at 13-15; Schwartz, *Search Theory and the Tender Offer Auction*, *supra* note 3, at 242-44, 249.

I would argue that the large number of tender offers put forth in the 1980's, appears to indicate that the research expense involved in attempting a tender offer is not much of an obstacle in making an actual tender offer. The potential gains for a bidder far outweigh the research costs involved. See Bebchuk, *The Case for Facilitating Competing Tender Offers*, *supra*, at 1036-37; Lucian A. Bebchuk, *The Case for Facilitating Competing Tender Offers: A Last (?) Reply*, 2 J.L. & ECON. & ORG. 253, 255-56 (1986). The best indicator of the likelihood of a wave of tender offers is probably the availability of financing. Financing was plentiful for much of the 1980's and so were the number of tender offers. See Kraakman, *supra* note 8, at 928-29, 928 n.129.

Easterbrook and Fischel base their position on the idea that investors cannot identify potential targets prior to the initiation of actual offers. Easterbrook & Fischel, *supra*, at 7-9. I disagree with this position. While

how the *Unocal* fact pattern differs substantially from that of *Interco*. *Interco* was faced with a tender offer which it determined to be inadequate.⁹⁸ *Interco*'s board responded to City Capital's inadequate tender offer with a restructuring.⁹⁹ Although the *Interco* restructuring differed somewhat from *Unocal*'s self-tender, they were similar in that they both were internal responses to an inadequate tender offer, as opposed to an external response, such as a sale to another bidder.¹⁰⁰

Courts must exercise some judgment in determining what is a "reasonable response" to a tender offer, but the essence of the *Unocal* holding is that courts should not overturn the judgment of a board, except in extreme cases.¹⁰¹ This is essentially an extension of the business judgment rule.

investors cannot predict potential targets with certainty, investors can identify companies possessing attributes which may make them more attractive candidates to a potential bidder. See Bebchuk, *The Case for Facilitating Competing Tender Offers: A Reply and Extension*, *supra*, at 27-29, 28 nn.13-15, 43. Bebchuk has argued that "[t]here are characteristics that make companies less likely to be targets or more likely to be acquirers" and that investors "can identify companies as being more likely than average to be targets." *Id.* at 27-29, 43.

Easterbrook and Fischel have argued that when a target's management is faced with a tender offer, it does not have a duty to prevent violations of the law, such as possible antitrust violations. Easterbrook & Fischel, *The Proper Role of a Target's Management in Responding to Tender Offers*, *supra* note 52, at 1192-94. Their reasoning is that target shareholders are not hurt by these violations. *Id.* at 1192-94.

This view does not properly consider potential problems. Treble damages associated with an antitrust violation could heavily burden target shareholders. Also, if an approved merger is cancelled due to antitrust violations, this may signify that the company is for sale and trigger *Revlon* duties. Further, violations of Section 13(d) of the Williams Act could have an adverse impact upon the judgment of target shareholders with respect to tender offers.

98. *City Capital Assocs. Ltd. Partnership v. Interco Inc.*, 551 A.2d 787, 792-94 (Del. Ch.), *appeal dismissed*, 556 A.2d 1070 (Del. 1988). The issue of the adequacy of City Capital's tender offer is discussed *infra* part III(C).

99. *Interco*, 551 A.2d at 793-94.

100. It is interesting to note that *Unocal* recognized that corporate funds could be used to fight off a raider. *Unocal*, 493 A.2d at 957.

101. *Id.* at 954. See also *Sinclair Oil Corp. v. Levien*, 280 A.2d 717, 720 (Del. 1971). The Delaware Supreme Court rejected the approach of the Delaware Court of Chancery in *Interco* regarding the Court of Chancery's action of substituting its judgment for that of the *Interco* board. Paramount

The Delaware Court of Chancery in *Interco* reviewed and overturned the judgment of the Interco board, replacing the judgment of the board with that of its own.¹⁰² Although the court in *Interco* did not enjoin the restructuring,¹⁰³ it condemned it to defeat by ordering the redemption of the poison pill.¹⁰⁴

The Delaware Court of Chancery in *Interco* failed to recognize or consider the Delaware Supreme Court's "element of balance" standard in *Unocal* for reviewing defensive responses.¹⁰⁵ Faced with an offer judged to be inadequate by its investment banker, the board responded in the proper manner by protecting the company.¹⁰⁶ The board's response consisted of a restructuring which involved making short-term cash and securities distributions, as well as the adoption of a poison pill to protect the value of the company.¹⁰⁷ These measures do not preclude the success of a future offer that is adequate in value.¹⁰⁸ Further, the response of the board is similar to

Communications, Inc. v. Time, Inc., 571 A.2d 1140, 1153 (Del. 1990).

102. *Interco*, 551 A.2d at 799-800. See also *Paramount*, 571 A.2d at 1153; *Unocal*, 493 A.2d at 954; *Sinclair*, 280 A.2d at 720. Professors Johnson and Siegel have argued that courts have generally refused to second-guess the decision(s) of a board. Johnson & Siegel, *supra* note 2, at 350. The Delaware Court of Chancery has shown that it will overturn the decision(s) of a board of directors. See *Grand Metro. Pub. Ltd. Co. v. Pillsbury Co.*, 558 A.2d 1049 (Del. Ch. 1988); *Interco*, 551 A.2d 787.

103. *Interco*, 551 A.2d at 800-04.

104. *Id.* at 799-800.

105. See *Unocal*, 493 A.2d at 955.

106. *Interco*, 551 A.2d 791-97.

107. *Id.* at 793-94. Aware of unusual trading activity in Interco's stock, often a prelude to a tender offer, Interco's board adopted a poison pill on July 11, 1988. *Id.* at 791. Although the pill was adopted prior to the July 27, 1988 announcement by City Capital of its tender offer, the Interco board anticipated a possible tender offer, effectively making the adoption of the pill a response to City Capital's offer. *Id.* at 792.

108. The poison pill is not a "show stopper," meaning that a poison pill does not preclude all hostile takeovers. Micheletto, *supra* note 3, at 113 ("Although the preferred dividend plan effectively deters partial, two-tiered and bootstrap takeover attempts, it is not a 'show stopper.'"). See also *Moran v. Household Int'l, Inc.*, 500 A.2d 1346, 1356 (Del. 1985) ("the Rights Plan will not have a severe impact upon proxy contests and it will not preclude all hostile acquisitions. . ."); Block & Hoff, *supra* note 3 ("The 'pill' has not prevented all tender offers, but it was not intended to do so."); Lipton, *Corporate Governance in the Age of Finance Corporatism*, *supra* note 3, at

the positions taken by other boards when faced with an inadequate offer.¹⁰⁹ The response would protect Interco from City Capital's inadequate offer and give both short and long-term benefits to Interco's shareholders, while keeping open the possibility that the board would accept an adequate offer.¹¹⁰ The response of the Interco board to City Capital's offer was clearly a "balanced" response within the standards articulated by the *Unocal* court.¹¹¹ Neverthe-

69-71 ("The flip-over, however, does nothing to deter raiders able to acquire majority control and willing to forego a second-step merger."); Rosenzweig, *supra* note 3, at 380 n.49, 381-82. The target was forced to remove its poison pill when the auction was over and the target's board was faced with two bids that were deemed fair in price by its investment bankers in *Mills Acquisition Co., v. Macmillan, Inc.*, No. 10168, 1988 WL 108332, at *10, 18-19 (Del. Ch. Oct. 18, 1988), *rev'd*, 559 A.2d 1261 (Del. 1989). *See also* *TW Servs., Inc. v. SWT Acquisition Corp.*, Nos. 10427, 10298, 1989 WL 20290, at *2 (Del. Ch. Mar. 2, 1989).

Judge Easterbrook and Professor Fischel have argued that a poison pill could "be used to defeat any bid." Easterbrook & Fischel, *The Corporate Contract*, *supra* note 52, at 1438. This position seems to overlook the fact that a poison pill cannot stop an adequate offer.

109. For cases in which the target company's board was faced with an inadequate tender offer which it correctly rejected, see *BNS Inc. v. Koppers Co.*, 683 F. Supp. 458 (D. Del. 1988); *Ivanhoe Partners v. Newmont Mining Corp.* (*In re* Newmont Mining Corp. Shareholders Litigation), 535 A.2d 1334 (Del. 1987); *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946 (Del. 1985); *Pogostin v. Rice*, 480 A.2d 619 (Del. 1984); *TW Servs.*, 1989 WL 20290. The various boards used several methods to defend against the inadequate tender offers including, but not limited to, a self-tender for a corporation's own shares, *Unocal*, 493 A.2d at 950, a refusal to redeem a poison pill, *BNS*, 683 F. Supp. at 462, *TW Servs.*, 1989 WL 20290, at *1, 5, 11, and dividends, *Ivanhoe Partners*, 535 A.2d at 1336-37.

110. A board of directors of a company under attack can consider the long-term effects and implications of their decisions on the target company. Further, their decisions "are expected to promote corporate (and shareholder) long run interests, even if short run share value can be expected to be negatively affected." *TW Servs.*, 1989 WL 20290 at *6-7, 10-11.

111. The "element of balance" in a defensive response to a hostile tender offer was considered by the court in *Unocal*, 493 A.2d at 955-56. In discussing the issue of "balance," the *Unocal* court stated that "[i]f a defensive measure is to come within the ambit of the business judgment rule, it must be reasonable in relation to the threat posed." *Id.* at 955. The standard of "balance" as determined by the "reasonableness" of a response has also been

less, the court in *Interco* did not recognize the "balance" standard of *Unocal*, nor the satisfaction of that standard by the Interco board. The *Interco* court failed to see the balance in the board's overall response. It labeled the restructuring an "alternative" transaction and tried to apply its test of voluntariness instead of the standards articulated by the Delaware Supreme Court in *Unocal*.¹¹² The *Interco* court's application of a voluntariness standard is misplaced and shows a disregard for the Delaware Supreme Court's standard of "balance" as articulated in *Unocal*.¹¹³

*C. An Inadequate All-Cash, All-Shares Tender Offer
Constitutes a Substantial Threat*

The *Interco* court viewed the City Capital offer of \$74 per share as a "mild threat."¹¹⁴ To attempt to determine whether a tender offer is or is not a threat¹¹⁵ and the degree of threat seems to fly in the face of reality. Tender offers¹¹⁶ are made by parties to maximize their positions in an effort to gain control of companies at the most economical price.¹¹⁷ They are not made with the intention of benefitting shareholders, although in fact shareholders often do benefit from tender offers.¹¹⁸ Tender offers are not

followed by other courts. See, e.g., *BNS*, 683 F. Supp. at 473-74; *Ivanhoe Partners*, 535 A.2d at 1341-43; *TW Servs.*, 1989 WL 20290 at *10.

112. *Interco*, 551 A.2d at 797-98.

113. Schwartz, *supra* note 3.

114. In referring to the use of the poison pill by the Interco board to defend against the City Capital offer, the *Interco* court stated that "[t]he 'threat' here, when viewed with particularity, is far too mild to justify such a step in this instance." *Interco*, 551 A.2d at 798.

The *Interco* court also stated that "the proposed sale of Ethan Allen Company is a defensive step that is reasonable in relation to the mild threat posed by this noncoercive \$74 cash offer." *Id.* at 801.

115. See Gilson & Kraakman, *supra* note 52, at 256-60.

116. Greene & Junewicz, *supra* note 11, at 662-67.

117. One should also consider that some tender offers are made with the intent of extracting "greenmail" payment from a company. See generally Note, *Greenmail: Targeted Stock Repurchases and the Management-Entrenchment Hypothesis*, 98 HARV. L. REV. 1045 (1985). The payment of greenmail is a cost to a company and, therefore, hurts rather than helps shareholders. *Id.* at 1045-56.

118. Tender offers usually increase the market price of a stock, giving shareholders an opportunity to sell their shares on the open market at a price greater than the price they would have received prior to the tender offer.

negotiated offers for the purchase of a company, but rather unilateral offers. Often tender offers are made when a negotiated transaction is not possible. Therefore, generally tender offers cannot be viewed as "friendly" and must be viewed as hostile acts.¹¹⁹ Tender offers usually threaten the structure and existence of a target company.¹²⁰ Any threat to the structure or existence of a company must be viewed as a "serious threat."¹²¹

Also, since tender offers are made for prices above the market price, accepted tender offers give shareholders the opportunity to receive more for their shares than they would have received on the open market prior to the tender offer. See John R. Wilke & John J. Keller, *NCR Agrees to AT&T Takeover for \$110 a Share, or \$7.48 Billion*, WALL ST. J., May 7, 1991 at A3; Randall Smith, *NCR's Holdout Boosted AT&T's Bid by 22%, Yet Opinion Is Split on Tactics*, WALL ST. J., May 7, 1991, at A3.

119. It may be argued that some tender offers are welcome, such as a competing offer from a party deemed more favorable than a party making the original offer. Michael Bradley et al., *Synergistic Gains from Corporate Acquisitions and Their Division Between the Stockholders of Target and Acquiring Firms*, 21 J. FIN. ECON. 3, 20-25, 31 (1988). These offers can only be viewed as favorable in light of the original offer. If the original offer did not exist, these offers would generally not be welcomed by the target company. The only tender offer that should be viewed as friendly is one that is negotiated and/or requested by the company to be acquired and which takes place in an environment without duress. Most tender offers are not of this type.

120. Professor Lowenstein has put forth a proposal that calls for all hostile tender offers to remain open for six months and any response to a hostile tender offer that entails structural changes to the target to require shareholder approval. Professor Lowenstein argues that this will allow for a more rational and efficient auction, and will allow management sufficient time to properly consider and analyze the situation and make the proper decision(s). Lowenstein, *supra* note 52, at 255-57, 317-34.

My chief objection to Professor Lowenstein's proposal is that a waiting period of six months is excessively long. This makes arranging the financing of a tender offer more difficult and expensive. Further, it creates much uncertainty for the future of the target, as well as the bidder, which hampers corporate planning and is inefficient from an overall perspective. If implemented, Professor Lowenstein's proposal will probably have the undesirable effect of decreasing the number of tender offers made. See Jarrell, *supra* note 97, at 162-64 (Jarrell found a high incidence of bidders dropping their bids after one hundred days from the date of their first bid).

121. Martin Lipton has stated that "there is an element of coercion in every tender offer." Lipton, *Corporate Governance in the Age of Finance*

Boards and courts should not concern themselves with determining whether a tender offer is a threat or in assessing the degree of threat. Tenders offers are generally hostile acts and so they must be threatening to a company. What boards and courts should concentrate on, in the tender offer process, is adequacy of price.¹²² If the tender offer is fair in value, it should generally be accepted as favorable to a company.¹²³ This may be the case even if it means that the structure and existence of a company may be affected because shareholders are getting a fair price in return for their acceptance of a change in a company's structure or threat to its existence. When the issue of whether a tender offer is threatening is viewed in this manner, it is incorporated into the issue of adequacy of price.

A determination as to whether or not a threat is "serious" often involves a determination as to whether or not a threat is "coercive."¹²⁴ The determina-

Corporatism, *supra* note 3, at 62. See also Bebchuk, *Toward Undistorted Choice and Equal Treatment in Corporate Takeovers*, *supra* note 97, at 1717-33; Greene & Junewicz, *supra* note 11, at 679-80; Lowenstein, *supra* note 52, at 267; Note, *Protecting Shareholders Against Partial and Two-Tiered Takeovers: The "Poison Pill" Preferred*, 97 HARV. L. REV. 1964, 1966 (1984); Rosenzweig, *supra* note 3, at 378.

The SEC has stated that "any tender offer, and particularly any partial tender offer, involves an element of coercion or pressure." *Two-Tier Tender Offer Pricing and Non-Tender Offer Purchase Programs—Advance Notice of Possible Commission Action*, [1984 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,637, at 86,917 (June 21, 1984).

122. See *The Forces Driving the M & A Market in 1989*, MERGERS & ACQUISITIONS, May/June 1989, at 34, 45.

123. *Id.*

124. For cases in which the court determined whether a tender offer was coercive, see *Ivanhoe Partners v. Newmont Mining Corp. (In re Newmont Mining Corp. Shareholders Litigation)*, 535 A.2d 1334, 1342-43 (Del. 1987); *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 956, 958 (Del. 1985); *TW Servs., Inc. v. SWT Acquisition Corp.*, Nos. 10427, 10298, 1989 WL 20290, *3-4, 8-9 (Del. Ch. Mar. 2, 1989); see also Bebchuk, *Toward Undistorted Choice and Equal Treatment in Corporate Takeovers*, *supra* note 97, at 1747-54; Gilson & Kraakman, *supra* note 52; Lowenstein, *supra* note 52, at 267.

Edward F. Greene and James J. Junewicz have argued that, "[a]ny offer to purchase stock that involves payment of a premium over the market price results in pressure on shareholders to tender their shares." Greene & Junewicz, *supra* note 11, at 679. To support their position, Greene and Junewicz cited *Radol v. Thomas* which determined that "any tender offer is

determination as to coerciveness is often made on the basis of whether a tender offer is or is not two-tier in nature.¹²⁵ The coerciveness attributed to

likely to be coercive to some degree" "and that such coercion is" "inherent" "in the tender offer process." *Id.* (citing *Radol v. Thomas*, 534 F. Supp. 1302, 1312 (S.D. Ohio 1982)). They also cited Professors Brudney and Chirelstein as supporters of the position that two-step acquisitions with a price differential are coercive, and Brudney's and Chirelstein's recommendation that equivalent compensation be paid in both steps of a tender offer. *Id.* at 679-81 (citing Victor Brudney & Marvin A. Chirelstein, *A Restatement of Corporate Freezeouts*, 87 *YALE L.J.* 1354, 1361-62 (1978)).

125. A two-tier tender offer contains two parts. In the first part, or "front-end," the bidder pays a high price, usually in cash, for a substantial portion of the target's stock. In the second part, or "back-end," the bidder offers cash or securities having a value that is lower than the amount offered in the first part. When the value of the front-end exceeds the value of the back-end, which is usually the case in a two-tier tender offer, the offer is called a "two-tier, front-end loaded" tender offer. *See* Comment & Jarrell, *supra* note 2, at 286; Greene & Junewicz, *supra* note 11, at 676-77; Lipton, *Corporate Governance in the Age of Finance Corporatism*, *supra* note 3, at 18-20; Lipton & Brownstein, *supra* note 2, at 1412-13; Oesterle, *supra* note 43, at 60-61.

See Two-Tier Tender Offer Pricing and Non-Tender Offer Purchase Programs—Advance Notice of Possible Commission Action, *supra* note 121, at 86,915 n.1, 86,922. The two-tier tender offer was a factor in the determination of coerciveness in *Unocal*, 493 A.2d at 956, 958; *Ivanhoe Partners*, 535 A.2d at 1342-43; and *TW Services*, 1989 WL at *3-4, 8-9. *See also* Block & Hoff, *supra* note 3; Comment & Jarrell, *supra* note 2, at 286; Lipton & Brownstein, *supra* note 2, at 1412-13.

Edward F. Greene and James J. Junewicz determined that two-tier and partial tender offers are unfair, coercive and provide successful bidders with the opportunity to loot a corporation. Greene & Junewicz, *supra* note 11, at 676-84. They called for regulation of partial and two-tier tender offers. *Id.* at 684-93. Such regulation should give shareholders adequate time to make informed decisions, and also would prohibit two-tier bids "unless equivalent value is offered in each tier." *Id.* at 692. They believe that current defensive measures and other options available to management today are adequate to prevent looting and overreaching in partial bids. *Id.* at 691-93. Martin Lipton has also called for a limit on partial bids and has suggested a prohibition on "acquisitions above the ten percent level unless the purchaser offers to purchase all remaining shares at the highest price paid by the purchaser in the prior twelve months." *Id.* at 691. *See also* Lipton, *Corporate Governance in the Age of Finance Corporatism*, *supra* note 3, at 60 n.280, 61. Lipton's

two-tier offers is based on the argument that shareholders are coerced into tendering for fear that if they do not tender, they will receive the second tier of the offer which is usually substantially less than the value of the first tier.¹²⁶ In such instances, a shareholder is not getting adequate and fair value for all of his shares. If a board encourages shareholders to tender their shares to an inadequate offer, those shareholders will also not be getting adequate and fair value for their shares. Further, the position of a non-tendering shareholder can be analogized to that of the shareholder in the two-tier scenario. If a shareholder does not tender into the offer (or any second stage follow-up offer at the same or a lower price), he will be forced to sell his shares on the open market.¹²⁷ After the tender offer is completed, the

proposal would prevent partial and two-tier tender offers.

Robert Comment and Gregg A. Jarrell argue that their study indicated that two-tier tender offers do not adversely effect shareholder wealth or tendering behavior when compared against any-or-all offers. Comment & Jarrell, *supra* note 2, at 298-99. They found that the mean premium was 56.6% when an any-or-all offer was executed and 55.9% when a two-tier offer was executed. The mean premium for partial offers dropped to 22.8%. *Id.*

A study by the SEC found that the average premium for any-or-all tender offers was 63.4%, while the average blended premium was 55.1% for two-tier offers and 31.3% for partial tender offers. *Two-Tier Tender Offer Pricing and Non-Tender Offer Purchase Programs—Advance Notice of Possible Commission Action*, *supra* note 121, at 86,916, 86,926.

126. *Unocal*, 493 A.2d at 956. For a discussion of the coercive nature of two-tier tender offers, see Victor Brudney & Marvin A. Chirelstein, *Fair Shares in Corporate Mergers and Takeovers*, 88 HARV. L. REV. 297, 337 (1974); Finkelstein, *supra* note 11, at 293; Greene & Junewicz, *supra* note 11, at 676-93; Oesterle, *supra* note 43, at 56-63; Lipton, *Takeover Bids in the Target's Boardroom*, *supra* note 3, at 113-14; Note, *supra* note 121, at 1966.

Martin Lipton has argued that two-tier tender offers are abusive. See Lipton, *Corporate Governance in the Age of Finance Corporatism*, *supra* note 3, at 15-20. He has called for the elimination of two-tier, front-end loaded tender offers. *Id.* at 60 n.280. See also Lipton, *Corporate Governance in the Age of Finance Corporatism*, *supra* note 3 (discussing the coercive nature of two-tier tender offers).

In *Interco*, the Delaware Court of Chancery, in concluding that the City Capital tender offer was not coercive, observed that the bid was for all the shares and not a partial offer. *Interco*, 551 A.2d at 795-96. Partial tender offers are similar to two-tier tender offers in that all shareholders are not given the opportunity to receive the highest price for all of their shares.

127. See Gilson & Kraakman, *supra* note 52, 255 n.29.

price of the target's stock usually drops substantially.¹²⁸ Therefore, a non-tendering shareholder selling on the open market will get substantially less than the tender price for his shares. If a shareholder thinks that the board-endorsed tender offer has a chance of being successful, he is essentially being coerced into tendering for fear of ending up with an open market price.¹²⁹ The result is similar to that which is achieved by the two-tier offer in that a shareholder is coerced into tendering, even if he feels he is not getting fair and adequate compensation for his shares, for fear of ultimately receiving less for his shares later.¹³⁰

My position assumes that appraisal is not a desirable option. See generally Lucian A. Bebchuk, *Limiting Contractual Freedom in Corporate Law: The Desirable Constraints on Charter Amendments*, 102 HARV. L. REV. 1820, 1852-56 (1989); Bebchuk, *Toward Undisputed Choice and Equal Treatment in Tender Offers*, *supra* note 97, at 1706-08; Greene & Junewicz, *supra* note 11, at 687 n.186; Johnson & Siegel, *supra* note 2, at 339-40.

128. See Greene & Junewicz, *supra* note 11, at 681.

129. This assumes that a shareholder does not want to go through an appraisal proceeding.

130. Judge Easterbrook and Professor Fischel have argued that managers should be guided by a fiduciary principle that calls for managers to accept corporate control transactions that permit "unequal division of gains . . . subject to the constraint that no investor be made worse off by the transaction." Frank H. Easterbrook & Daniel R. Fischel, *Corporate Control Transactions*, 91 YALE L.J. 698, 698, 703-04, 715 (1982). Their reasoning is that such a standard maximizes investor welfare. *Id.* But see Oesterle, *supra* note 43, at 73-75. This is basically a "Pareto optimality" argument. Coffee, *supra* note 29, at 1174 n.76. The position articulated by Easterbrook and Fischel shares a similarity with the results of a two-tier tender offer in that in both cases some shareholders will receive more for their shares than others while generally, it can be argued that no shareholders will be made worse off by the transaction.

Martin Lipton has argued that all shareholders should be treated in a fair and equal manner. Lipton, *Corporate Governance in the Age of Finance Corporatism*, *supra* note 3, at 60 n.280. See generally Bebchuk, *Toward Undistorted Choice and Equal Treatment in Corporate Takeovers*, *supra* note 97; Victor Brudney, *Equal Treatment of Shareholders in Corporate Distributions and Reorganizations*, 71 CAL. L. REV. 1072 (1983). The Easterbrook and Fischel position of "unequal division of gains" conflicts with Lipton's position. I agree with Lipton's position because it is equitable and allows less room for coercive tactics by corporate raiders.

The Easterbrook and Fischel argument fails to consider and underestimates the power that large institutional investors, incumbent management, and insiders have, and could utilize to manipulate corporate control transactions to their advantage at the expense of smaller investors. *See Coffee, supra* note 29, at 1230-31 (noting that insiders generally have superior information and outperform the market). If manipulation of this nature is taken to an extreme, small investors may or may not be hurt by such corporate control transactions, but they will never benefit substantially. This could lead to fewer small investors investing in stocks. *See Oesterle, supra* note 43, at 80.

The Easterbrook and Fischel argument seems to assume that most investors are willing to invest on the basis that they may have no more than a 50% chance of gain on their investment. This seems a presumptive position. I would argue that most investors invest on the premise that their chance for gain is greater than 50%. Admittedly some investors may accept a lower chance for gain if the potential gains are greater, but these are not the majority of investors.

Easterbrook and Fischel argue that investors can diversify their portfolios to adjust for risk. Easterbrook & Fischel, *The Corporate Contract, supra* note 52, at 1439-41. This assumes that most investors take the time, have the background and have sufficient information to diversify their portfolios on a continual basis to adjust for risk. While this assumption may hold for large institutional investors, it most likely does not hold for the majority of small investors. *See Bebchuk, The Case for Facilitating Competing Tender Offers: A Reply and Extension, supra* note 97, at 29-30; *Coffee, supra* note 29, at 1216-21 (Bebchuk and Coffee disagree with the Easterbrook and Fischel position on shareholder portfolio diversification):

Easterbrook and Fischel support their position by arguing the validity of efficient capital market theory. While arguments can be made for and against efficient capital market theory, *see generally* RICHARD A. BREALEY & STEWART C. MYERS, *PRINCIPLES OF CORPORATE FINANCE* (3d ed. 1988); GILSON, *supra* note 2, at 156-204; Schwartz, *Search Theory and the Tender Offer Auction, supra* note 3, their argument fails to recognize the position that this theory holds in the long run more so than in the short run. An argument based on efficient capital market theory may be less useful when applied to the usually short-term environment of an attempted corporate control transaction. *See* BREALEY & MYERS, *supra*; THOMAS E. COPELAND & J. FRED WESTON, *FINANCIAL THEORY AND CORPORATE POLICY* (3d ed. 1988); *see also* *Coffee, supra* note 29, at 1206-11; Lowenstein, *supra* note 52, at 269-309.

While in theory, the Easterbrook and Fischel position may appear plausible to some, in practice it most likely would be difficult to employ. Evidence of this is that in the mid-1980s corporate raiders tried to use two-

I agree with the decisions handed down by the courts that have made it clear that tender offers should be accepted or rejected predominantly on the issue of adequacy of price.¹³¹ The position that should follow from the argument of "acceptance based on adequacy of price" is that any price that is determined to be inadequate should be considered coercive and should therefore be rejected. This position melds the issue of coercion into the issue of adequacy of price and results in one question to be answered by boards of directors and courts, instead of two. When viewed in this manner, the issue of determining whether or not an offer is coercive, as well as the degree of coercion, in essence becomes moot.

With respect to guarding against two-tier, front-end loaded tender offers, the elimination of the requirement of a review as to threat and coercion presents little difficulty. A bid that does not provide an adequate price to be offered to all shareholders cannot be considered adequate in nature when viewed from a broad perspective. Boards are representatives of all the shareholders and must try to maximize the price received by all shareholders.¹³² Therefore, two-tier, front-end loaded tender offers would not satisfy my definition as to adequacy of price.

Partial pro rata tender offers¹³³ present a slightly different situation.¹³⁴

tier, front-end loaded tender offers in their takeover attempts. Most often the back end of these offers gave shareholders junk bonds. It can be argued that these bonds in certain cases put some parties in a position where they were worse off after the transaction. Indeed, the value of many junk bond offerings were probably overestimated at their issuance in the 1980s, and many failed shortly thereafter. The two-tier, front-end loaded tender offer, though, shows the potential for abuse of a standard such as the one articulated by Easterbrook and Fischel.

In sum, the Easterbrook and Fischel position does not seem to be practical in that it offers too much opportunity for abuse and fails to recognize certain considerations as outlined above. Also, the idea of unequal distribution may seem unconscionable to most and a standard that a majority of stockholders do not want to adopt. Easterbrook & Fischel, *supra*.

131. See *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946 (Del. 1985); *Smith v. Van Gorkom*, 488 A.2d 858 (Del. 1985); *TW Servs., Inc. v. SWT Acquisition Corp.*, Nos. 10427, 10298, 1989 WL 20290 (Del. Ch. Mar. 2, 1989); *Grand Metro. Pub. Ltd. Co. v. Pillsbury Co. (In re Pillsbury Co. Shareholders Litigation)*, 558 A.2d 1049 (Del. Ch. 1988).

132. See generally *Bebchuk, Toward Undisputed Choice and Equal Treatment in Tender Offers*, *supra* note 97; *Brudney*, *supra* note 130, at 1115-22, 1131-33.

133. A partial pro rata tender offer is an offer for less than all the shares of a company where the offeror buys stock from all of the shareholders

Partial pro rata tender offers should be held to a higher standard of acceptability than all-shares offers. Boards must assess the adequacy of the offer, and determine whether acceptance of the offer is favorable to shareholders (and the company) from an overall (i.e. strategic) perspective.¹³⁵ Partial non-pro rata tender offers¹³⁶ possess most of the shortcomings of two-tier, front-end loaded tender offers and should be reviewed in a similar manner.¹³⁷

There is support for my position in the Delaware Supreme Court. In *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*,¹³⁸ the raider, Pantry

equally, instead of on a "first come, first served" basis. See Comment & Jarrell, *supra* note 2, at 286; Greene & Junewicz, *supra* note 11, at 676, 684; Lipton, *Corporate Governance in the Age of Finance Corporatism*, *supra* note 3, at 17-18.

134. See Comment & Jarrell, *supra* note 2, at 286; see also *supra* note 125 and accompanying text. Edward F. Greene and James J. Junewicz have suggested that the response of directors to a partial tender offer be limited to trying to find an offer for all shares, or to trying to find a more favorable partial offer for a greater percentage, or to taking action to frustrate the initial offer. They argue that directors should respond to full tender offers by recommending acceptance of the offer or attempting to find a more favorable offer. Directors should not try to frustrate the initial bid without shareholder approval. Further, they argue that greenmail repurchases should be prohibited unless approved by shareholders. Greene & Junewicz, *supra* note 11, at 730-32, 738. Cf. Bebchuk, *Toward Undistorted Choice and Equal Treatment in Corporate Takeovers*, *supra* note 97.

135. Martin Lipton has called for restrictions on partial offers. Lipton, *Corporate Governance in the Age of Finance Corporatism*, *supra* note 3, at 61. See also Greene & Junewicz, *supra* note 11, at 676-93.

136. Because the Williams Act requires that shares be taken pro rata in a partial tender offer, this point was raised and addressed in order to present a complete discussion of the topic. 15 U.S.C. § 78n(d)(6) (1988). See also Bebchuk, *Toward Undistorted Choice and Equal Treatment in Corporate Takeovers*, *supra* note 97, at 1714-15; Greene & Junewicz, *supra* note 11, at 684.

137. Professor Coffee has stated that in the auction process partial bids should be severely restricted. Coffee, *supra* note 29, at 1191, 1295. Martin Lipton has argued that partial tender offers are abusive. Lipton has suggested that tender offers should be required to be made for all of a company's common stock. Lipton, *Corporate Governance in the Age of Finance Corporatism*, *supra* note 3, at 15-20, 61.

138. 506 A.2d 173 (Del. 1986).

Pride, Inc., made an all-cash, all-shares offer for the target, Revlon, Inc.¹³⁹ The court held that the Revlon board was correct in adopting a poison pill to protect the company and its shareholders against an inadequate tender offer.¹⁴⁰ The court in *Revlon* did not try to determine the degree of threat that the inadequate offer posed. Nor did it try to determine whether the offer was coercive or noncoercive.¹⁴¹ The court in *Revlon* focused its attention on the issue of adequacy of the price offered.¹⁴² In determining that the offer was inadequate, it held that the Revlon board was correct in adopting a poison pill.¹⁴³

It is interesting to note that the Delaware Court of Chancery opinion in *Interco* did not discuss the Delaware Supreme Court's opinion in *Revlon* regarding poison pills.¹⁴⁴ Considering the importance of the *Revlon* holding, this has to be viewed as a gross omission on the part of the Delaware Court of Chancery in *Interco*.

There is also precedent in the Delaware Supreme Court in opinions before *Revlon*, to support the position that coercion should not enter into the tender offer review equation for boards or courts.¹⁴⁵ The case of *Smith v. Van Gorkom*¹⁴⁶ involved a target company, Trans Union, faced with an all-cash, all-shares offer. The court concentrated its analysis on whether the target's board reached an informed business judgment in evaluating the offer and whether the board came within the protection of the business judgment rule.¹⁴⁷ The court addressed the process by which the adequacy of the bid was determined and concluded that the board did not make its decision on an informed basis.¹⁴⁸ It is important to note that the court did not discuss or try to determine the degree of threat or coercion represented by the offer.¹⁴⁹

139. *Id.* at 177. See generally Kanner, *supra* note 52.

140. *Revlon*, 506 A.2d at 180-81.

141. It is important to note that the *Revlon* court did not say that the Pantry Pride all-cash, all-shares tender offer was noncoercive.

142. *Revlon*, 506 A.2d at 180-81.

143. *Id.* See also Gilson & Kraakman, *supra* note 52, at 261.

144. See Schwartz, *Chancery Court Ignores Del. Supreme Court Precedents*, *supra* note 3.

145. *Id.*

146. 488 A.2d 858 (Del. 1985).

147. *Id.* at 874-88. See also Lipton & Brownstein, *supra* note 2, at 1409-10.

148. *Van Gorkom*, 488 A.2d at 893. See Johnson & Siegel, *supra* note 2, at 393.

149. See Schwartz, *Chancery Court Ignores Del. Supreme Court Precedents*, *supra* note 3.

These factors were not important to the court. The court correctly based its decision on the process used to review the offer.¹⁵⁰

Some may argue that *Van Gorkom* is distinguishable from the *Interco* scenario and similar scenarios "because it relied on duty of care, rather than duty of loyalty grounds."¹⁵¹ The implication derived from the *Van Gorkom* holding is that most issues, including duty of care and duty of loyalty, are of minor importance compared to adequacy of price when we consider the broad picture in the corporate setting.¹⁵²

Further, the argument that *Van Gorkom* is distinguishable from *Interco* (and similar cases), because *Van Gorkom* involved a board responding to a merger proposal rather than a tender offer as in *Interco*, has little merit.¹⁵³ The common thread between these and many other cases is that an offer is being made for a company and a determination must be made as to whether the price offered is adequate. The form of the proposal is not as important as the value of the offer.

D. What Is the Standard for an "Adequate Offer?"

In *Interco*, City Capital made a \$74 per share bid for Interco.¹⁵⁴ This offer was \$2 per share below the value of the Interco board's restructuring of \$76 per share.¹⁵⁵ In enjoining Interco's poison pill, the court basically condemned the restructuring and favored City Capital's \$74 per share offer.¹⁵⁶ In its review, the *Interco* court noted that the value of the two offers differed by only 3%.¹⁵⁷ As discussed in Part III(A) of this Article, the court's decision to enjoin the poison pill is difficult to justify when one considers that the court, in addressing the restructuring, concluded that the Interco board had properly informed itself as to the relevant issues involved,

150. *Van Gorkom*, 488 A.2d at 874-81, 893.

151. Schwartz, *Chancery Court Ignores Del. Supreme Court Precedents*, *supra* note 3. See also *Van Gorkom*, 488 A.2d at 872-73.

152. Schwartz, *Chancery Court Ignores Del. Supreme Court Precedents*, *supra* note 3. See also *Mills Acquisition Co. v. Macmillan, Inc.*, 559 A.2d 1261 (Del. 1989); *Van Gorkom*, 488 A.2d at 872-73.

153. See Schwartz, *Chancery Court Ignores Del. Supreme Court Precedents*, *supra* note 3.

154. *City Capital Assocs. Ltd. Partnership v. Interco Inc.*, 551 A.2d 787, 790 (Del. Ch.), *appeal dismissed*, 556 A.2d 1070 (Del. 1988).

155. *Id.* at 790, 799.

156. *Id.* at 798-800.

157. *Id.* at 799.

including the value of the company in a leveraged buy-out transaction.¹⁵⁸ It is also noteworthy that the court in *Interco* concluded that the Interco board had acted "prudently and in good faith" in deciding "to pursue the restructuring as an alternative to the [City Capital] [tender] offer."¹⁵⁹ The court recognized that the Interco board had satisfied the elements of the business judgment rule as expressed in *Unocal*, and yet, in its holding, the court put its judgment over that of the board.¹⁶⁰

Interco presents problems for boards of directors and those advising boards as to what constitutes an adequate price. Prior to *Interco*, boards and their advisors could generally conclude that if the business judgment rule was satisfied, they would be safe in the conclusions they reached as to valuations.¹⁶¹ The *Interco* decision clouds the issue. It seems to be saying that if an offer is made that is close to what the board believes to be the minimum value of a company, the board should accept the offer even if it believes the bid to be inadequate.

This raises the question as to what price differential is an acceptable threshold level. If we are to accept *Interco* at face value, it is obvious that a tender offer that is 3% below the value attributed to a company by its board will be closely scrutinized by the Delaware Court of Chancery and that the court will probably hold that such an offer should be accepted.¹⁶² It is uncertain if the *Interco* court would have held differently if the fact situation before it had involved, say, a 4% or 5% differential.¹⁶³ The current problem

158. *Id.* at 803.

159. *Id.* The court also concluded that the value of the restructuring was at least \$76 per share. *Id.* at 795.

160. The Delaware Court of Chancery in *Interco* concluded that the Interco board had acted in good faith and in an informed manner. *Id.* at 795, 803. It also concluded that a reasonable shareholder could prefer either the restructuring or the \$74 offer. *Id.* at 795-96, 799, 803. *See also* Shea, *supra* note 52.

161. In *Unocal*, the court stated, "A hallmark of the business judgment rule is that a court will not substitute its judgment for that of the board if the latter's decision can be 'attributed to any rational business purpose.'" *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 954 (Del. 1985) (citing *Sinclair Oil Corp. v. Levien*, 280 A.2d 717, 720 (Del. 1971)). *See generally* Shea, *supra* note 52.

162. *Interco*, 551 A.2d at 799.

163. The Delaware Court of Chancery held on one occasion that an 8% differential between a tender offer and a target board's strategic plan was insufficient to justify not redeeming its poison pill. *Grand Metro. Pub. Ltd. Co. v. Pillsbury Co.* (*In re Pillsbury Co. Shareholders Litigation*), 558 A.2d

for boards is to determine where the Delaware Court of Chancery places the line of demarcation between acceptance and rejection of an offer. The *Interco* decision creates a vagueness in this area of the law and much unnecessary guessing on the parts of future boards in similar situations. A strict application of the business judgment rule takes this vagueness out of the law and eliminates the need for guesswork on the part of boards of directors' and those advising boards.

*E. When Should a Board of Directors Be Required
to Redeem a Poison Pill?*

The point in time at which directors should be required to redeem a poison pill has been a difficult question for most courts.¹⁶⁴ The Delaware courts have generally made their determinations based on the facts in each particular case.¹⁶⁵

The Delaware courts, as well as some other courts, have indicated that they are willing to keep a poison pill in place when it is used by the board of a target company to promote the continuation of an auction in an attempt to receive the highest possible price for a company.¹⁶⁶ In *CRTF Corp. v.*

1049 (Del. Ch. 1988).

164. In addressing this issue, the Delaware Court of Chancery in *Macmillan* stated that this "is necessarily a fact specific determination." *Mills Acquisition Co. v. Macmillan, Inc.*, [1988-1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,071, at 91,024 (Del. Ch. Oct. 18, 1988), *rev'd*, 559 A.2d 1261 (Del. 1989).

165. *Id.* See also *Facet Enters., Inc. v. Prospect Group, Inc.*, No. 9746, 1988 WL 36140 (Del. Ch. Apr. 15, 1988).

166. See *CRTF Corp. v. Federated Dep't Stores, Inc.*, 683 F. Supp. 422 (S.D.N.Y. 1988); see also *In re Holly Farms Corp. Shareholders Litigation*, 564 A.2d 342, 350-52 (Del. Ch. 1989).

The court in *Doskocil Companies v. Griggy*, No. 10,095, 1988 WL 105751 (Del. Ch. Oct. 7, 1988) concluded that a poison pill could be kept in place to protect a company's shareholders from an inadequate offer. *Id.* at *3.

The court in *Nomad Acquisition Corp. v. Damon Corp.*, Nos. 10,173, 10,189, 1988 WL 96192 (Del. Ch. Sept. 16, 1988) stated that a court "should not order the redemption of rights where the effect of the redemption would negatively impact the shareholders' ability to realize full value for their shares. This is so even if the tender offer is for all cash." *Id.* at *5 (citations omitted).

In *Facet Enterprises, Inc. v. Prospect Group, Inc.*, No. 9746, 1988 WL 36140 (Del. Ch. Apr. 15, 1988), the court stated with respect to keeping a pill

Federated Department Stores, Inc.,¹⁶⁷ a target, Federated Department Stores, Inc., was faced with two competing two-tier tender offers.¹⁶⁸ After considering the advice of its investment bankers, the board of the target determined that although the offers were close in value, one was superior to the other.¹⁶⁹ The board redeemed the pill with respect to the more favorable offer, but not with respect to the less favorable offer.¹⁷⁰ The entity making the less favorable offer claimed that "the continued existence of a [r]ights [p]lan in the midst of such an auction usurps to management the prerogative

in place during an auction that an "auction may produce a bid or bids superior to Prospect's [the hostile raider] current \$27.50 per share offer—a result clearly in the shareholders' best interests. To grant Prospect injunctive relief at this time would create a significant risk that Prospect could acquire majority control of Facet [the target] at \$27.50 per share." *Id.* at *7.

Referring to a study by Gregg A. Jarrell on the effects of litigation on takeover premiums, Professor Oesterle stated that "[a]uctions therefore occurred more frequently for litigious than for nonlitigious targets, and these auctions increased takeover premiums by an average of seventeen percent." Oesterle, *supra* note 43, at 69-70. He argued that the use of reversible defensive tactics and the auction process allows a target's management to extract a higher premium. *Id.* See generally Jarrell, *supra* note 97.

167. 683 F. Supp. 422 (S.D.N.Y. 1988). Although *CRTF Corp. v. Federated Department Stores, Inc.* was decided by the United States District Court for the Southern District of New York and not a Delaware court, a review of this case is beneficial to my analysis.

168. The court found coercion to be the motivation for one of the offers being changed from a single-tier, all-cash, all shares offer to a two-tier, front-end loaded, all-cash offer. *Id.* at 440.

169. *Id.* at 434-35. Note that the court stated that a mid-\$60s offer that was lower than the later offers considered by the court was found by the board not to be "grossly inadequate." *Id.* at 434.

Although the court's opinion does not supply us with useful numbers as to the valuations performed by the target's investment bankers, it is interesting to note that only one of the three investment bankers hired by the target to value the offers could say that one offer was clearly superior to the other. The other two investment bankers valued the offers as "roughly comparable," although one of the investment bankers noted that one of the bids offered greater long-term value. *Id.* at 434-35.

Also, note that the offer found by the target's board to be superior was that of the "white knight." *Id.* at 437-43.

170. *Id.* at 433.

of deciding whether the [o]ffer may be considered by the shareholders."¹⁷¹ The court held that a poison pill could be selectively enforced to further the auction process and raise the bidding.¹⁷²

171. *Id.*

172. *Id.* at 437-43. Note that this was a *Revlon*-type auction, and that it was not clear that the final offer had been made by the party deemed to have the less favorable offer. *Id.* at 443.

The court also noted that if the poison pill were redeemed, the company would be "vulnerable to a street sweep; to this and other coercive, two-tiered, front-end loaded tender offers; to a decrease in existing offers; and possibly to other dangers." *Id.* at 442.

The court in *Facet Enterprises, Inc. v. Prospect Group, Inc.*, recognizing that in the case before it, the redemption of a pill would allow an entity to engage in a street sweep, stated:

a rights plan could benefit shareholders by deterring a street sweep or "front-end loaded offer" by a bidder or a third party that could otherwise end the auction. That same reasoning is persuasive here, at least at the present time, because even though Prospect disclaims any intent to engage in a street sweep or coercive offer, without the Rights Plan in place other interested third parties will remain free to do so.

Facet Enters., Inc. v. Prospect Group, Inc., No. 9746, 1988 WL 36140, at *6 (Del. Ch. Apr. 15, 1988) (citation omitted).

Professors Gilson and Kraakman have spoken out against giving management broad powers to use preclusive defensive tactics against takeovers and have stated:

Yet, substantive coercion is a slippery concept. To note abstractly that management *might* know shareholder interests better than shareholders themselves do cannot be a basis for rubber-stamping management's pro-forma claims in the face of market skepticism and the enormous opportunity losses that threaten target shareholders when hostile offers are defeated. Preclusive defensive tactics are gambles made on behalf of target shareholders by presumptively self-interested players. Although shareholders may win or lose in each transaction, they would almost certainly be better off on average if the gamble were never made in the absence of meaningful judicial review. By minimizing management's ability to further its self-interest in selecting its response to a hostile offer, an effective proportionality test can raise the odds that management resistance, when it does occur, will increase shareholder value.

Gilson & Kraakman, *supra* note 52, at 274.

It is interesting to compare the holding in *CRTF Corp.* with the holding

Professors Bebchuk, Gilson, Schwartz, Fischel, and Judge Easterbrook have supported the elimination of obstructive defensive tactics. See Bebchuk, *The Case for Facilitating Competing Tender Offers: A Reply and Extension*, *supra* note 97, at 47; Bebchuk, *Toward Undistorted Choice and Equal Treatment in Corporate Takeovers*, *supra* note 97, at 1706; Easterbrook & Fischel, *supra* note 97, at 2-3; Gilson, *Seeking Competitive Bids Versus Pure Passivity in Tender Offer Defense*, *supra* note 97, at 51-52, 66; Gilson, *A Structural Approach to Corporations: The Case Against Defensive Tactics in Tender Offers*, *supra* note 97; Schwartz, *Search Theory and the Tender Offer Auction*, *supra* note 3, at 238-39; see also Bebchuk, *The Case for Facilitating Competing Tender Offers: A Reply and Extension*, *supra* note 97, at 25 n.8; Johnson & Siegel, *supra* note 2, at 408; see generally Johnson & Siegel, *supra* note 2, at 336 n.70.

Martin Lipton has stated that if rules "are enacted to eliminate takeover abuses and impose needed long-term investment objectives on institutional investors, then the takeover defenses currently used to combat such abuses will no longer be justified." Lipton, *Corporate Governance in the Age of Finance Corporatism*, *supra* note 3, at 64-65.

Professor Oesterle has supported the use of defensive tactics that can quickly be undone if the target's board receives a favorable offer. He calls defensive tactics of this nature "reversible defensive tactics." Oesterle, *supra* note 43, at 68-70, 89. With respect to poison pills, Professor Oesterle stated that "if target management can negate the conversion or redemption features [of its poison pill] at its option, such plans may be legitimate reversible tactics, enabling target managers to negotiate on behalf of their shareholders." *Id.* at 90, 91 n.126. Most poison pills are structured so that target boards can redeem the rights at nominal cost. See, e.g., *Moran v. Household Int'l, Inc.*, 500 A.2d 1346 (Del. 1985).

While I realize that some management boards will act in their own self-interest, the view that calls for the elimination of defensive tactics seems to be an overreaction to the problem. This is especially true when one considers that target companies are increasingly using independent directors to make takeover decisions. Also, this position leaves management with less power and discretion to implement defensive tactics in order to protect a company from an inadequate offer.

In theory, Lipton's view seems plausible because it rests on the elimination of takeover abuses and protects institutional investors seeking long-term investments. However, it is debatable whether these goals are attainable as a practical matter. Under the current legal structure, Professor Oesterle's call for "reversible defensive tactics" may be the most practical position.

in *Interco*. In *Interco*, there was a difference in valuation between the offers being considered. Although the difference between the proposals was only 3%, the distinction in value was clear in the evaluation and in the minds of the *Interco* directors. Based on the opinions of the target's investment bankers in *CRTF Corp.*, the difference in value between the competing offers was less clear. Indeed, the offers were so close in value that two of the target's investment bankers found them to be "roughly comparable."¹⁷³ Yet, the *Interco* court struck down the poison pill before it, while the *CRTF Corp.* court upheld the poison pill under its consideration.¹⁷⁴ The case for support of the pill clearly appears stronger in *Interco* than in *CRTF Corp.*, but this is not supported by the respective court holdings.¹⁷⁵

There is a further problem related to the timing of the redemption of a poison pill. If a bidder is aware that he can force the redemption of a poison pill at any time prior to the end of a bidding process that culminates with the highest adequate offer, he is at an advantage. The bidder will try to force the redemption of a pill at the earliest possible opportunity so that he can acquire the company at the lowest possible price. There is no incentive or reason for him to put forth the highest price he is willing to pay for the shares. This will preclude the shareholders from receiving the highest possible price for their shares.¹⁷⁶

Also, if the poison pill is redeemed too early, there is the possibility that bidders will use street sweeps,¹⁷⁷ two-tier offers, and other tactics designed to acquire the shares of a company at a lesser price.¹⁷⁸ Without a poison

173. *CRTF Corp.*, 683 F. Supp. at 434, 435.

174. In *Interco*, if one accepts the valuation performed by Wasserstein Perella (*Interco*'s investment banker) as accurate, there was a clear difference of \$2 per share in value between the two choices before the *Interco* board.

175. This might be attributable to the fact that *Interco* was decided by the Delaware Court of Chancery and *CRTF Corp.* was decided by the United States District Court for the Southern District of New York.

176. In some cases, it will not even allow the shareholders to get an adequate price for their shares.

177. The term "[s]treet sweep" refers to the rapid acquisition of securities on the open market during and shortly after the pendency of a tender offer for the same class of securities. The shares are ordinarily purchased at a premium from arbitrageurs." *Ivanhoe Partners v. Newmont Mining Corp. (In re Newmont Mining Corp. Shareholders Litigation)*, 535 A.2d 1334, 1337 n.3 (Del. 1987).

178. See *supra* note 172 and accompanying text. See also *In re Holly Farms Corp. Shareholders Litigation*, 564 A.2d 342, 351 (Del. Ch. 1989).

pill in place, these tactics can be used by the primary hostile bidder, as well as by any interested third party.¹⁷⁹

IV. THE DELAWARE COURT OF CHANCERY PROVIDES FURTHER INSIGHT INTO ITS POSITION ON TOPICS IN THE AREA OF CORPORATE MERGERS AND ACQUISITIONS

A. *The Delaware Court of Chancery Decisions that Have Followed Interco Have Created Greater Uncertainty as to the Court's Position with Respect to Poison Pills*

In order to examine the Delaware Court of Chancery's position with respect to poison pills, it is necessary to undertake an analysis of the court's decisions beyond *Interco*.¹⁸⁰ A review of the Delaware Court of Chancery's holdings in *Grand Metropolitan Public Ltd. Co. v. Pillsbury Co.*,¹⁸¹ *T.W. Services, Inc. v. SWT Acquisition Corp.*,¹⁸² and *Paramount Communications, Inc. v. Time, Inc.*,¹⁸³ three cases that followed soon after *Interco*, is critical to gaining a greater understanding of the court's position in this area of the law. As *Interco* was the forerunner of these cases, it provides a backdrop from which to compare and contrast these opinions. While each case is decided on its own facts, a greater understanding of the Delaware Court of Chancery's position regarding poison pills is gained through analyzing these cases as a group or series in progression, rather than by considering each case in isolation.

B. *The Delaware Court of Chancery's Opinion in Pillsbury Supports Its Holding in Interco*

In *Grand Metropolitan Public Ltd. Co. v. Pillsbury Co.*,¹⁸⁴ a hostile raider, Grand Metropolitan Public Limited Company, made an all-cash, all-shares offer for The Pillsbury Company, a target, at \$63 per share.¹⁸⁵ Based

179. See *supra* note 172 and accompanying text.

180. 551 A.2d 787 (Del. Ch.), *appeal dismissed*, 556 A.2d 1070 (Del. 1988).

181. 558 A.2d 1049 (Del. Ch. 1988).

182. Nos. 10427, 10298, 1989 WL 20290 (Del. Ch. Mar. 2, 1989).

183. [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,514 (Del. Ch. July 14, 1989), *aff'd*, 571 A.2d 1140 (Del. 1990).

184. (*In re Pillsbury Co. Shareholders Litigation*), 558 A.2d 1049 (Del. Ch. 1988).

185. *Id.* at 1052. See also Schwartz, *Chancery Court Ignores Del.*

on the advice of its experts who valued the target at \$68 per share, the target company's board rejected the bid as inadequate and left the poison pill in place.¹⁸⁶ They further responded by proposing a plan that involved the spin-off and sale of some of the target's business units.¹⁸⁷ The intent of the proposed plan was to raise the company's value to \$68 per share.¹⁸⁸

The raider instituted an action to force the board to redeem the pill.¹⁸⁹ The Delaware Court of Chancery determined "that the [b]oard's decision to keep the [p]ill in place was not reasonable in relationship to any threat posed and, therefore, the [b]oard's decision [was] not protected by the business judgment rule."¹⁹⁰ The court ordered the target's board to redeem its pill.¹⁹¹

Unlike the *Interco* court, the *Pillsbury* court relied upon the *Unocal* decision of the Delaware Supreme Court in arriving at its holding.¹⁹² In applying the *Unocal* criteria to the facts in *Pillsbury*, the court found that the target's board had acted in good faith and had undertaken a reasonable investigation with respect to the tender offer.¹⁹³ The court also determined that a majority of the target's directors were outside, independent directors.¹⁹⁴

Supreme Court Precedents, supra note 3 (discussing *Grand Metro. Public Ltd. Co. v. Pillsbury Co. (In re Pillsbury Co. Shareholders Litigation)*, 558 A.2d 1049 (Del. Ch. 1988)).

186. *Pillsbury*, 558 A.2d at 1053-55, 1057-58.

187. *Id.* at 1057.

188. *Id.*

189. Interestingly, the raider as well as its co-plaintiffs, the shareholders wishing to sell to the raider, relied on the *Interco* decision to support their position that the pill should be redeemed. *Id.* at 1053-54.

190. *Id.* at 1060.

191. *Id.* at 1059-60.

192. As explained earlier in this Article, *supra* part III(A), the *Interco* court paid lip service to the *Unocal* holding and applied its own two-part test based on "threats to voluntariness" and "threats to economic interest." *City Capital Assocs. Ltd. Partnership v. Interco Inc.*, 551 A.2d 787, 797 (Del. Ch.), *appeal dismissed*, 556 A.2d 1070 (Del. 1988). Although I disagree in part with the Delaware Court of Chancery's application of the *Unocal* standard in *Pillsbury*, it is commendable that the court did recognize the applicability of the standard to the facts under its review.

193. *Pillsbury*, 558 A.2d at 1056.

194. The court concluded that twelve of the target's fourteen directors were independent. *Id.*

The *Pillsbury* court, nevertheless, concluded that the board failed to satisfy the requirements of the *Unocal* test.¹⁹⁵ The court based its conclusion on its determination that "no showing ha[d] been made that there would be a danger to policy or effectiveness of the . . . [target corporation] . . . if the [r]ights [preferred stock purchase rights associated with the poison pill] were redeemed and/or Grand Met succeed[ed] in its [t]ender [o]ffer."¹⁹⁶ The court went on to state that "[w]hatever danger there [was] relate[d] solely to shareholders and that concern[ed] price only."¹⁹⁷

I disagree with the court's determination in *Pillsbury* that redeeming the pill would not present a danger to the target corporation.¹⁹⁸ My objection to the court's determination is based largely on the court's consideration of the issue of price and failure to recognize the importance of this issue.¹⁹⁹ The court paid little attention to the fact that a \$5 or 8% per share spread existed between the alternatives presented to the target's board.²⁰⁰ This represents a significant amount. Inadequacy of price has generally been held by the Delaware courts to be a major reason to reject a tender offer.²⁰¹ Basically,

195. *Id.* at 1055.

196. *Id.* at 1056. This is basically the standard announced in *Unocal*, that a response "must be reasonable in relation to the threat posed." *Unocal*, 493 A.2d at 955.

197. *Pillsbury*, 558 A.2d at 1056.

198. The argument that the Delaware Court of Chancery's actions to force the redemption of the poison pill were simply intended to give the target's shareholders the opportunity to choose between the tender offer and the company's alternative offer, overlooks certain issues. *Id.* at 1057-58. First, the redemption of the pill ends the bidding process and forecloses the possibility of higher offers. Also, it is difficult to determine when the bidding process has actually ended. See *Mills Acquisition Co. v. Macmillan, Inc.*, 559 A.2d 1261 (Del. 1988). Therefore, any choice by shareholders at this time may be a choice between less than optimal offers. Second, the opinion, which states, among other facts that, "87% of the Pillsbury shares have been tendered into the [tender] [o]ffer," *Pillsbury*, 558 A.2d at 1058, indicates that the court knew that its actions favoring the redemption of the poison pill would lead to only one result, which was that the tender offer would be approved by the shareholders.

199. *Pillsbury*, 558 A.2d at 1056-58.

200. The court stated that "the real threat to shareholder value . . . is not the spread between \$63 and \$68 per share." *Id.* at 1058.

201. The Delaware courts have upheld a target board's rejection of an offer based predominantly on a determination of inadequacy of price in *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946 (Del. 1985); *Ivanhoe*

what the Delaware Court of Chancery did, was to accept as fact, the statements of the raider's investment bankers and other experts that the \$63 per share offer was a fair and possibly even generous offer.²⁰² The court did not seem to really believe the position of the board of the target that the company was really worth \$68 per share.²⁰³

The Delaware Court of Chancery took a similar position in *Interco* with respect to the valuation done by Wasserstein Perella, Interco's investment banker. The *Interco* court questioned the validity of Wasserstein Perella's valuation of Interco at \$76 per share.²⁰⁴

The court's conclusion in *Pillsbury*, questioning the target board's acceptance of the valuation carried out by the target's investment banker, is difficult to accept in light of its determination that the target's board acted in good faith, made a reasonable investigation of the situation, and was composed of a majority of outside, independent directors.²⁰⁵ If *Pillsbury* is read in isolation or along with *Interco*, one might believe that the issues of good faith, reasonable investigation, and outside, independent directors were of little importance. If this were true, the implications for boards of directors would be great. *Pillsbury* essentially strips the business judgment rule of its power to protect and shield boards. Boards of directors are left with little protection after *Pillsbury*. In *Pillsbury*, the Delaware Court of Chancery held against the target's board even though in the court's own judgment, the board substantially satisfied the elements of the business judgment rule.²⁰⁶ The *Pillsbury* decision could have a detrimental effect on the way boards act in the future. Boards may hesitate to reject any offer for fear of a lawsuit and

Partners v. Newmont Mining Corp. (*In re* Newmont Mining Corp. Shareholders Litigation), 535 A.2d 1334 (Del. 1987); and TW Services, Inc. v. SWT Acquisition Corp., Nos. 10427, 10298, 1989 WL 20290 (Del. Ch. Mar. 2, 1989).

202. *Pillsbury*, 558 A.2d at 1057-58. See *supra* note 198 and accompanying text.

203. *Pillsbury*, 558 A.2d at 1057-58.

204. The *Interco* court commented on the Wasserstein Perella valuation and called it "a highly debatable proposition." City Capital Assocs. Ltd. Partnership v. Interco Inc., 551 A.2d 787, 799 (Del. Ch.), *appeal dismissed*, 556 A.2d 1070 (Del. 1988).

205. *Pillsbury*, 558 A.2d at 1056.

206. *Id.* The court's main objection in *Pillsbury* was that the target board's response to the offer was not reasonable. *Id.* at 1055-56. My objection to this conclusion, as I have previously stated in this Article, is that the court did not properly consider the adequacy of price issue. See *supra* part III(C).

review by a court. Boards will be reluctant to push for the highest possible price in certain situations.²⁰⁷ Raiders, knowing that boards will be reluctant to pursue the highest possible price, will use this to their advantage and not bid as high as they would have when faced with a board that was confident in the protection afforded them by a stable business judgment rule. Generally, you will see boards redeeming pills earlier in the sales process, and accepting lower and often inadequate prices for the companies they represent.

Pillsbury also presents similar problems for those advising boards, such as attorneys and investment bankers. The protection afforded by the business judgment rule is highly questionable after *Pillsbury*. The Delaware Court of Chancery has shown that it will substitute its judgment for that of the board of a company.²⁰⁸

The Delaware Court of Chancery has also shown that while it has not struck down a valuation as totally false, it will question its validity.²⁰⁹ Alarmingly, the court questions the validity of valuations with almost no

207. Boards may be reluctant to wait for a higher price when there is the possibility that they may lose a bidder. The impact of this potentiality is even greater if a board has only one entity bidding for the company.

208. The court in *Pillsbury* recognized that a Delaware court is not supposed to substitute its judgment for that of a board when it stated that "a Delaware court will not substitute its judgment for that of the board, provided that the answer the Board gave can be 'attributed to any rational business purpose,' and, provided further, that it is determined that the standards required by *Unocal* have been met." *Pillsbury*, 558 A.2d at 1055 (citations omitted) (quoting *Sinclair Oil Corp. v. Levien*, 280 A.2d 717, 726 (Del. 1971)). Earlier in this part of the Article, I commented on the *Pillsbury* court's interpretation of the *Unocal* standard, and expressed my objections to aspects of the court's application of this standard.

The business purpose rule was described and discussed in *Singer v. Magnavox Co.*, 380 A.2d 969 (Del. 1977); *Tanzer v. International General Industries, Inc.*, 379 A.2d 1121 (Del. 1977); and *Roland International Corp. v. Najjar*, 407 A.2d 1032 (Del. 1979). With respect to the business purpose rule discussed in these three cases, the Delaware Supreme Court stated, "[W]e consider that the business purpose requirement of these cases is no longer the law of Delaware." *Weinberger v. UOP, Inc.*, 457 A.2d 701, 704 (Del. 1983). See also GILSON, *supra* note 2, at 904-07. Given that *Weinberger* did away with the business purpose standard, it is not clear why the Delaware Court of Chancery in *Pillsbury* tried to rely on a somewhat similar standard. See *Sinclair*, 280 A.2d at 720.

209. *Pillsbury*, 558 A.2d at 1057-58. See also *City Capital Assocs. Ltd. Partnership v. Interco Inc.*, 551 A.2d 787, 798-800. (Del. Ch.), *appeal dismissed*, 556 A.2d 1070 (Del. 1988).

mention as to why a valuation may be questionable. This means that even a valuation that conforms with generally accepted principles of valuation may be looked down upon by the court.²¹⁰

The issue of adequacy of price seems to be clouded. In *Interco* and *Pillsbury*, the Delaware Court of Chancery essentially told the boards of the target corporations that they should accept a price that, in their good faith judgment and based on reasonable investigation, was inadequate. This makes it difficult to advise boards in the future to turn down an offer that is lower in price than the type of offer that a board and its advisors may deem to be adequate.

Lastly, how close does an offer have to be to what a board sees as an adequate price, before a court will force a board to redeem its pill and accept an offer? In *Interco*, we saw that the Delaware Court of Chancery felt that 3% was close enough for the board to redeem the pill and accept the offer.²¹¹ In *Pillsbury*, 8% was deemed sufficient by the court for the board to redeem the pill and accept the offer.²¹² Exactly how far the Delaware Court of Chancery will go and what it views as acceptable is difficult to determine, but it helps raiders in their bids for companies. Knowing that they do not have to make offers that are considered adequate by target boards in order to get pills redeemed and offers accepted, raiders will make lower bids and take their chances on litigation. Ironically, the litigation will probably cost less than the amount they would have had to pay if they made offers viewed as adequate by the companies. This will result in shareholders receiving less for their shares. Part of the money saved by not paying shareholders a higher price for their shares will go to paying legal fees. The net result is that raiders will be able to acquire companies at lower overall costs.

The result of the *Interco* and *Pillsbury* holdings are that in the long run, the shareholders will be the real losers. Shareholders will generally receive

210. The Delaware Supreme Court, in addressing the issue of valuation, stated:

Accordingly, the standard "Delaware block" or weighted average method of valuation, formerly employed in appraisal and other stock valuation cases, shall no longer exclusively control such proceedings. We believe that a more liberal approach must include proof of value by any techniques or methods which are generally considered acceptable in the financial community and otherwise admissible in court, subject only to our interpretation of 8 *Del.C.* § 262(h).

Weinberger, 457 A.2d at 712-13.

211. *Interco*, 551 A.2d at 799.

212. *Pillsbury*, 558 A.2d at 1058.

less for their shares. Ironically, this is what the Delaware Court of Chancery was trying to prevent in *Interco* and *Pillsbury*. These holdings provide a dangerous precedent for the future and run counter to the intent of the Delaware Court of Chancery in *Interco* and *Pillsbury*.

C. *The Delaware Court of Chancery Has Failed to
Directly Address and Rectify the Central Problem
Before It in Interco and Pillsbury—Valuation*

The central problem before the Delaware Court of Chancery in *Interco* and *Pillsbury* is valuation. Indeed, this may be the central problem in most merger and acquisition transactions. It is a major issue with respect to redemption of poison pills.

Although valuation is of great importance, the Delaware Court of Chancery failed to adequately address the problem in both *Interco* and *Pillsbury*. The fact patterns and issues in both of these cases are such that they presented the Delaware Court of Chancery with a prime opportunity to address the valuation issue, but the court simply passed up the opportunity.

The problem with valuation is that the rules courts find acceptable for valuation by investment bankers and other advisors²¹³ are so broad that they allow the entity doing the valuation to easily arrive at a number that best suits its position.²¹⁴ This is done by using the valuation method which is most

213. Judge Easterbrook and Professor Fischel have noted that "[t]he advice of investment bankers or other experts is inexact and quite expensive." Easterbrook & Fischel, *The Proper Role of a Target's Management in Responding to a Tender Offer*, *supra* note 52, at 1200.

214. Professors Gilson and Kraakman have called for greater specificity and accountability by investment bankers in evaluating management plans and their potential for future value. Gilson & Kraakman, *supra* note 52, at 272-73. I support a position that calls for such a standard to be applied to all offers and plans of both offerors and target managements.

In *Interco*, the target company's investment banker analyzed the target company and arrived at what is referred to as a "reference range" for the company as a whole of \$68-\$80 per share. *Interco*, 551 A.2d at 792. Two weeks after this announcement, and after further study, the target company's investment banker revised its reference range to \$74-\$87 per share. *Id.* See also George Anders & Francine Schwadel, *Wall Streeters Helped Interco Defeat Raiders But at a Heavy Price*, WALL ST. J., July 11, 1990, at A1.

In *AC Acquisitions Corp. v. Anderson, Clayton & Co.*, 519 A.2d 103 (Del Ch. 1986), the target company's investment banker analyzed the target company with respect to recapitalization and arrived at an initial trading range

favorable to the advisor's position and by properly manipulating that method.²¹⁵ Prior to 1983, the Delaware courts recognized the "Delaware block" or weighted average method as the accepted method of valuation.²¹⁶ In 1983, the Delaware Supreme Court in *Weinberger v. UOP, Inc.*²¹⁷ asserted that other valuation techniques that were accepted in the financial community could be used to value a company.²¹⁸ In doing this, the court allowed investment bankers and others doing valuations almost unbridled discretion in choosing the valuation method that best supported their positions. This has resulted in the problem that we have today, which is that each side in a hostile takeover setting has experts who perform valuations that often differ sufficiently to lead one or both sides to pursue litigation.²¹⁹

This problem might be resolved if one supports the position that the courts are capable of listening to competing valuation arguments and making a final determination.²²⁰ This argument suffers from several shortcomings.

for the target's stock of \$6-\$10 per share and valued the recapitalization at \$43-\$47 per share. *Id.* at 106. Four months later these numbers were revised to \$13-\$18 per share for the trading range of the stock and a value of as high as \$55 per share for the recapitalization. *Id.* at 107. The revised values were attributed to a fall in interest rates and a general increase in the value of securities. *Id.*

Interestingly, in both *Interco* and *AC Acquisitions*, a tender offer was made after the initial valuation and prior to the follow-up valuation which fell within or exceeded the range of the initial valuation, but was arguably below the value arrived at in the follow-up valuation in *AC Acquisitions*, 519 A.2d at 106-07, and clearly below the value range arrived at in the follow-up valuation in *Interco*, 551 A.2d at 792-93.

215. See *supra* note 214 and accompanying text.

216. The Delaware block method of valuation determines value by three different methods: asset value, earnings value, and market value. Each of the three values are weighted and added to arrive at a value per share. See *Weinberger v. UOP, Inc.*, 457 A.2d 701, 712 (Del. 1983); GILSON, *supra* note 2, at 905-06.

217. 457 A.2d 701 (Del. 1983).

218. *Id.* at 712-13. See *supra* note 210 and accompanying text; see also *In re McLoon Oil Co.*, 565 A.2d 997, 1003 (Me. 1989); GILSON, *supra* note 2, at 905-06.

219. Judge Easterbrook and Professor Fischel have noted that a board of directors can set an "unrealistic" selling price for a corporation which will make a sale impossible. Easterbrook & Fischel, *The Corporate Contract*, *supra* note 52, at 1438.

220. This is what essentially happened in *Interco* and *Pillsbury*. The

First, this proposal does not help boards of directors at the critical time in the takeover process, which is when they have to decide on such issues as adequacy of price, acceptance of a tender offer, and whether to redeem a pill. A solution must help boards during this critical time period to address the many important issues before them.

Second, this solution may lead to more litigation. Since the parties have no standards by which to determine the validity of the valuations they are considering and the strength of their position vis-a-vis their opponents', there is less reason to try for an amicable settlement. They will simply let the courts decide.

Third, the courts in most cases do not possess the background required to review a valuation.²²¹ Courts will probably require expert third parties to assist them in analyzing valuations. This makes the litigation process more costly and time-consuming than it is in its present form. Also, the question of who is to pay the increased costs generated by a third party expert and other related costs raises another issue that will have to be resolved.²²²

Delaware Court of Chancery, in each case, listened to the respective valuations on both sides of the litigation, and although it tried to avoid making a determination, the court made a hesitant and reserved determination as to which valuation it felt was accurate. See *Grand Metro. Pub. Ltd. Co. v. Pillsbury Co.* (*In re Pillsbury Co. Shareholders Litigation*), 558 A.2d 1049, 1057 (Del. Ch. 1988); *City Capital Assocs. Ltd. Partnership v. Interco Inc.*, 551 A.2d 787, 799 (Del. Ch.), *appeal dismissed*, 556 A.2d 1070 (Del. 1988). The Delaware Court of Chancery in *Interco* and *Pillsbury* did not use definitive language in its holdings and did not set valuation guidelines or standards that could be followed in the future. The court, in both cases, largely passed on the valuation issue.

221. Professors Gilson and Kraakman take the position that courts are adequately equipped to review valuations and have stated, "Although courts are not better equipped to evaluate management's representations about future value than the market, the important point is that courts do not need to be more expert than the market to play a screening role." Gilson & Kraakman, *supra* note 52, at 273.

Valuations are a business function. They are actually performed by investment bankers or others that are trained in this specialty. Few judges possess the required background that would allow them to properly evaluate a valuation without the assistance of an expert third party. Forcing judges who do not possess the required background to make such evaluations will be doing an injustice in many cases to those parties that are adversely affected by a judge's often improper conclusion.

222. An argument can be made that the valuation problem might be solved by using arbitrators who have backgrounds in valuation to decide these

What is needed is a more formalized approach to valuation. We need an approach that is sufficiently clear to lead different parties to roughly the same price in valuing a company. We must do away with our current system which allows for a multitude of approaches that have few if any standards and that are often based on arbitrary projections of a firm's cash flow and growth.²²³

There are, at present, rules that govern conduct and acceptable practices for attorneys and accountants in their respective professions.²²⁴ Rules must be developed to govern investment bankers and others in the acceptable standards for the valuation process. If such rules are not followed by those parties conducting valuations, courts should hold the offending parties responsible and not place the blame on directors who generally do not possess training in the valuation area.

While standards for valuations is a topic in itself worthy of in-depth study, and beyond the scope of this Article, I generally envision a system that is based on concrete values and statistics currently in the market. A system

disputes. The use of such arbitrators suffers from most of the pitfalls that I have identified with respect to letting the courts decide upon valuations. In addition, the use of arbitrators may suffer from another problem which is that the losing party may look to the courts for a favorable decision. Unless the arbitrator's decision can be enforced as final, without appeal to a court, the arbitration process may only lengthen the existing process.

223. Many of the valuation methods used by investment bankers today are based on cash flow projections. One of the most frequently used methods of this type is the "discounted cash flow method." Basically, a company's cash flows are projected into the future and discounted back to the present to obtain a current value for the company under evaluation. By varying the growth of the cash flow projections, and using different discount rates, an investment banker can adjust an evaluation to suit his position. When one considers that the growth rate chosen for the cash flow projections and the discount rate are based predominantly on the opinion of the evaluator, and subject to few if any rules or limitations, it is easy to see how even two entities using the discounted cash flow method (or any other method similarly based on projected cash flow), can arrive at two very different valuations. See BREALEY & MYERS, *supra* note 130; COPELAND & WESTON, *supra* note 130; GILSON, *supra* note 2, at 85-155; see generally Kraakman, *supra* note 8.

224. Statutes and regulations such as the Internal Revenue Code, Tax Reform Act of 1976, Securities Act of 1933, Securities Exchange Act of 1934, and case law, as well as the American Bar Association Model Code of Professional Responsibility and the American Bar Association Model Rules of Professional Conduct, provide standards for attorneys. Accountants are subject to some of the same statutes such as the Tax Reform Act of 1976, as well as Financial Accounting Standards Board (FASB) rulings.

based on arbitrary projections, subject to few if any standards, will always lead to varying results. The system must be based more on process and less on personal choice.²²⁵

If the valuation process is regulated to produce the results I have described, the entire takeover process will be more clearly delineated. Target boards will not be able to rely on arbitrary and unrealistic valuations to reject tender offers, but will be able to defend companies against inadequate offers by using accurate and realistic valuations, as well as by relying on the business judgment rule and the *Unocal* test. Also, with more clearly delineated standards, offerors will have a more accurate idea of what it will truly cost to purchase a particular company. Further, the argument that management is rejecting an offer for its own interests will be more difficult to make. Lastly, a valuation which follows and is based on prescribed standards and regulations will assist those performing valuations in supporting and defending their work, and make them less vulnerable to attack. The final result will be a greater number of completed mergers because both offerors and target boards will be working under similar assumptions and valuations.

As applied to the *Interco* case, if my valuation proposal had been in place at the time of the takeover attempt, Interco's investment banker would have probably arrived at a different, and possibly lower, valuation price for the company.²²⁶ This would have put the Interco board in a position such that,

225. Two methods that are currently used to value companies are the "comparable transaction method" and the "comparable company method." These methods look at a transaction or a company that is comparable to the one under evaluation and adjust for differences that may exist between the comparable transaction or company and the one under evaluation. These methods suffer from the fact that there does not always exist a comparable transaction or company for analysis. Further, the adjustment process also allows for abuses.

In favor of these two methods is that they at least start on data presented by the market and are not driven by arbitrary projections. While far from being perfect, these methods may present a starting point from which to devise a usable and fair method for valuation. Such a method would have to greatly formalize the current process of both or either of these methods and develop standards that would eliminate the current abuses allowed by the two methods. See BREALEY & MYERS, *supra* note 130; COPELAND & WESTON *supra* note 130; Gilson, *supra* note 2, at 85-155; see generally Kraakman, *supra* note 8.

226. This is an assumption that is based on the parameters of my valuation proposal, the Delaware Court of Chancery opinion in *City Capital Associates Ltd. Partnership v. Interco Inc.*, 551 A.2d 787 (Del. Ch.), *appeal dismissed*, 556 A.2d 1070 (Del. 1988), and on an account of the *Interco* proceeding in the *Wall Street Journal*. See Anders & Schwadel, *supra* note

under the business judgment rule and the *Unocal* test, the board would probably have had to accept the Rales brothers' \$74 per share offer. While this result is the same as that achieved by the Delaware Court of Chancery holding, it would have been achieved without establishing the dangerous precedents that were put forth in the opinion and discussed earlier in this Article.²²⁷

*D. The Delaware Court of Chancery's Holding in
TW Services May Show a Change in Direction
for the Court*

In *TW Services, Inc. v. SWT Acquisition Corp.*,²²⁸ a hostile raider, SWT Acquisition Corp., sought a mandatory injunction that would require the target, TW Services, Inc., to redeem its poison pill.²²⁹ The target's board was faced with what it and its advisors determined to be an inadequate offer.²³⁰ The Delaware Court of Chancery held that the target did not have to redeem its poison pill.²³¹ This holding may have been surprising to some observers because the facts in *TW Services* were similar to those in *Interco* and *Pillsbury*. In *TW Services*, Chancellor Allen concluded that *Interco* and

214, at A1.

Note that *Interco's* investment banker supported and defended the advice and valuation they provided to *Interco's* board by saying that it "was based on *Interco* management's own budget data" and that "they assumed that management earnings projections were right." *Id.* See generally Babette Morgan, *Interco Wins \$18 Million from Advisers*, ST. LOUIS POST-DISPATCH, May 9, 1992, at 8C.

227. See *supra* parts III(A)-(E), IV(A)-(B). Without the adoption and application of the kinds of standards for valuation that I have articulated and under the state of the law at the time of the *Interco* takeover setting, the decision of the Delaware Court of Chancery is difficult to support in *Interco*, especially without a strong economic argument. Essentially, the court misunderstood and misapplied the *Unocal* standard which, if properly applied, should have resulted in a different holding. A better argument to support the Delaware Court of Chancery's holding under the then current law would have been an economic argument which the court did not adequately make. The court was very vague in this area and avoided the core of this argument. See *infra* part VI.

228. Nos. 10427, 10298, 1989 WL 20290 (Del. Ch. Mar. 2, 1989).

229. *Id.* at *1.

230. *Id.* at *3-4.

231. *Id.* at *11-12.

Pillsbury did not make a determination as to whether a target company's board could maintain its poison pill and pursue its long-term plan of corporate independence as a response to an inadequate tender offer.²³² He tried to distinguish *TW Services* from *Interco* and *Pillsbury*²³³ on the basis that in those cases the respective boards did not attempt to manage the companies on a long-term basis as did the board in *TW Services*.²³⁴ Chancellor Allen also tried to distinguish the *Interco* and *Pillsbury* cases from *TW Services* on the grounds that those cases involved a situation where the target's board formulated its own sale or restructuring alternative.²³⁵ He attempted to distinguish *TW Services* from *Interco* and *Pillsbury* by stating:

In few instances has this court issued an order requiring a board of directors to redeem a defensive stock rights plan. In those instances, the board itself had elected to pursue either an outright sale of the company and had completed an auction process, or had elected to pursue a defensive restructuring that in form and effect was (so far as the corporation itself was concerned) a close approximation of and an alternative to a pending all cash tender offer for all shares. . . . Those cases did not involve circumstances in which a board had in good faith (which appears to exist here) elected to continue managing the enterprise in long term mode and not to actively consider an extraordinary transaction of any type. Thus, I must disagree that the issue posed by this case at this juncture is the same issue as was presented in those cases.²³⁶

When closely studied, Chancellor Allen's effort to distinguish *TW Services* from *Interco* and *Pillsbury* appears to have the effect of greatly limiting the Delaware Court of Chancery's decisions in *Interco* and *Pillsbury*, possibly to the point that they are almost useless as legal precedent. Chancellor Allen's recognition that a firm may pursue long-term company plans even at the expense of short-term gains is a major point in the *TW Services* opinion, but is unconvincing as a characteristic upon which to distinguish *TW Services* from *Interco* and *Pillsbury*.²³⁷ Although *Interco*

232. *Id.* at *9. See also Schwartz, *Chancery Court Ignores Del. Supreme Court Precedents*, *supra* note 3 (discussing *TW Servs.*, 1989 WL 20290).

233. *TW Servs.*, 1989 WL 20290, at *9.

234. *Id.*

235. *Id.*

236. *Id.*

237. This is especially true with respect to trying to distinguish *Pillsbury* from *TW Services* since the Delaware Court of Chancery in *Pillsbury* stated that "[i]n response to the [t]ender [o]ffer, the Pillsbury [b]oard has developed a plan which, it says, provides better long-term value for its stockholders."

used a different approach than *TW Services*, its restructuring was intended to provide long-term growth.²³⁸ Pillsbury's plan to spin off and sell parts of its business can also be viewed as a decision based on long-term objectives.²³⁹ Chancellor Allen attempts to distinguish *Interco* and *Pillsbury* from *TW Services* on the grounds that the respective boards in *Interco* and *Pillsbury* took positive steps to obtain long-term objectives, whereas the board in *TW Services* determined to stay its course to best serve the long-term interests of the company. This is a difficult argument to support. Further, the court is questioning the respective boards' judgments as to what is best for each corporation in the long run.²⁴⁰ This is an extreme position for any court. This position presumes that a court is in a better position to know what is best for a company than a company's own board which is undoubtedly more familiar with the operations of that company and the industry in which it exists.

Also, based on the holdings in both *Interco* and *Pillsbury*, as well as on the court's comments in *TW Services*, it seems that the Delaware Court of Chancery takes the position that raiders are in a better position to manage a company than a company's own board. This again puts the court's judgment above that of the board of a company.²⁴¹

Grand Metro. Pub. Ltd. Co. v. Pillsbury Co. (*In re Pillsbury Co. Shareholders Litigation*), 558 A.2d 1049, 1057 (Del. Ch. 1988).

238. The *Interco* board proposed a restructuring. *City Capital Assocs. Ltd. Partnership v. Interco Inc.*, 551 A.2d 787, 793-94 (Del. Ch.), *appeal dismissed*, 556 A.2d 1070 (Del. 1988). The board of *TW Services* decided to stay with its long-term company plan. *TW Servs.*, 1989 WL 20290, at *6.

239. *Pillsbury*, 558 A.2d at 1057. It seems inconsistent and contradictory that the Delaware Court of Chancery enjoined a spin-off sale proposed by the target in *Pillsbury*, but allowed a similar sale under much the same circumstances by the target in *Interco*. See *Pillsbury*, 558 A.2d at 1060-61; *Interco*, 551 A.2d at 800-01. The Delaware Court of Chancery does not supply points of distinction or reasons for its contradictory conclusions with respect to this issue in *Interco*, *Pillsbury* or *TW Services*. *TW Servs.*, 1989 WL 20290.

240. See *supra* note 208 and accompanying text.

241. It is interesting to note that many in the legal community have openly questioned the judgment of the Delaware Court of Chancery in *Interco*, as well as in *Pillsbury*. Martin Lipton of Wachtell, Lipton, Rosen & Katz, counsel to *Interco*, stated that, "Delaware has misled corporate America." Lipton later said, "[Delaware] has breached its covenant. It lured companies in with the promise that the business-judgment rule would govern corporate law. It's obvious that the state has renegeged." Lipton went so far as to suggest that his clients pull out of Delaware and reincorporate in another state.

William Meyers, *Showdown in Delaware: The Battle to Shape Takeover Law*, INSTITUTIONAL INVESTOR, Feb. 1989, at 64, 75. Lipton's comments raise a point. If corporate America were to adopt the view that Delaware was no longer a favorable place to incorporate, it would have a negative economic impact on those industries and fields which have benefited from Delaware's position as a home for corporate America.

Bruce Wasserstein of Wasserstein Perella, questioned whether Chancellor Allen "had the ability to analyze a complex restructuring as well as an investment banker can." *Id.* at 75.

Probably most telling though is the fact that Delaware Supreme Court Justice Andrew G.T. Moore II was pleased that it appeared at the time that the *Interco* decision would be appealed to the Delaware Supreme Court. Justice Moore, a conservative who is a believer in the business judgment rule, the poison pill, and a supporter of management, was not scheduled to sit on the three-judge panel that would have heard the appeal, but many in the legal profession believed that since Justice Moore's "views on corporate law are held in such high esteem by his benchmates" that the Delaware Supreme Court would reverse the Delaware Court of Chancery opinion in *Interco*. *Id.* at 67-68, 72, 75.

The objections to the *Interco* decision may have been best summarized in an article by William Meyer entitled *Showdown in Delaware: The Battle to Shape Takeover Law*. *Id.* Interestingly, this article appeared in the February edition of *Institutional Investor*, which was after the *Interco* and *Pillsbury* holdings, but before the *TW Services* decision. Due to the fact that *Interco* and *Pillsbury* were not appealed to the Delaware Supreme Court, the Delaware Court of Chancery decisions did not come under the scrutiny of the upper court. If the Delaware Court of Chancery holding in *TW Services* was in line with its holdings in *Interco* and *Pillsbury*, and the case was appealed, the Delaware Supreme Court would have had a golden opportunity. The Delaware Supreme Court could have reversed the Delaware Court of Chancery's decision in *TW Services*, as well as undercut the significance of the *Interco* and *Pillsbury* holdings. By deciding *TW Services* in the manner they did, the Delaware Court of Chancery limited but preserved its opinions in *Interco* and *Pillsbury* and did not give the Delaware Supreme Court the opportunity to reverse its *TW Services* decision. While I am not saying that the Delaware Court of Chancery's holding was based on this reasoning and a result of Meyer's article, I am suggesting that these are possible factors that were considered by the Delaware Court of Chancery in *TW Services*.

*E. The Delaware Court of Chancery's Holding in
Paramount Further Supports the Reasoning of
the Court in TW Services*

In *Paramount Communications, Inc. v. Time, Inc.*,²⁴² the target company, Time, Inc., was considering a merger with another company, Warner Communications, Inc., when it was faced with a hostile tender offer from a third party, Paramount Communications, Inc.²⁴³ Knowing that the merger might not receive the necessary shareholder approval due to the existence of the tender offer, the board of the target company restructured the transaction in a way that would not require it to be put to a shareholder vote.²⁴⁴ The party making the tender offer brought suit, seeking a preliminary injunction to stop the target from going ahead with the restructured transaction.²⁴⁵ The court rejected the tender offeror's request for a preliminary injunction.²⁴⁶

The reasoning of the Delaware Court of Chancery in *Paramount* is particularly interesting. The court went to great lengths to stress that a board of directors can forego increases in current value if it has reason to believe that a long-term strategy will result in even greater value in the future.²⁴⁷ This reinforced the Delaware Court of Chancery's holding in *TW Services*, which earlier recognized that a board may decide that a company and its shareholders may best be served by a long-term business plan even if it has a negative effect on a company's short-term value.²⁴⁸ Prior to *TW Services*

242. [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,514 (Del. Ch. July 14, 1989), *aff'd*, 571 A.2d 1140 (Del. 1990).

243. *Paramount*, [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,514, at 93,265-75.

244. *Id.* at 93,265-66, 93,272. Note that although the target had a poison pill in place, the motion did not seek to force the target to redeem its pill. *Id.* at 93,265. The issues discussed though, are applicable to future cases involving the review of poison pills. See Lerner, *supra* note 61, at 43.

245. See *supra* note 244 and accompanying text.

246. *Paramount*, [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,514, at 93,284.

247. *Id.* at 93,276-77, 93,283-84. See also Lerner, *supra* note 61, at 41-43; *The Time Case: Breathing Room for Increasing Values*, *supra* note 81, at 7.

248. *TW Servs., Inc. v. SWT Acquisition Corp.*, Nos. 10427, 10298, 1989 WL 20290, *6-7, 11 (Del. Ch. Mar. 2, 1989). See also Lerner, *supra* note 61, at 41-42; *The Time Case: Breathing Room for Increasing Values*, *supra* note 81, at 7.

and *Paramount*, the argument of long-term gain over short-term value was not generally recognized by the Delaware Court of Chancery. These holdings show that future target companies can make this argument with some confidence that it will be successful.²⁴⁹

The court in *Paramount* recognized that directors, and not shareholders, are responsible for the management of a company.²⁵⁰ While the *Paramount* court's restatement of this position may not put an end to the argument that shareholders should manage a company, it lends further support to the recognized law in Delaware.²⁵¹

The holding in *Paramount* is also significant because the court held as it did, even though it recognized that the target board acted with respect to the recasting of the merger primarily to avoid having to gain shareholder approval for the transaction, which the board anticipated it would not be able to secure.²⁵² The court stated that a board of directors did not have to manage a company in compliance with the desires of those holding a majority of its shares.²⁵³ This is an extreme position. It helps to support management in its decision-making capacity. It also gives greater fortification to the business judgment rule and strengthens the protection it provides to boards that comply with its standards.²⁵⁴

249. The Delaware Court of Chancery in *Paramount* stressed that Time had a long-term strategic business plan in place prior to the takeover attempt and that the primary purpose of the plan was not to solidify management's control of the corporation. *Paramount*, [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,514, at 93,282-83. Corporations contemplating defensive measures should consider formulating a long-term strategic business plan. Such a plan should be periodically reviewed and revised. Also, the plan should be well documented, as director actions which affect the control of a company will probably come under much scrutiny by the courts. See Lerner, *supra* note 61, at 41-42.

250. *Paramount*, [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,514, at 93,284.

251. DEL. CODE ANN. tit. 8, § 141(a) (1991).

252. *Paramount*, [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,514, at 93,273, 93,284. See also Lerner, *supra* note 61, at 43.

253. *Paramount*, [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,514, at 93,284.

254. The *Paramount* court discussed the business judgment rule. *Id.* at 93,277, 93,282. The court found that the target's board had acted in good faith, that its response had been reasonable in relation to the threat posed, and presumably by its holding, that the board had acted in an informed manner. *Id.* at 93,276, 93,283-84, 93,272-73.

Although the primary issue considered by the *Paramount* court was the reformation of a merger,²⁵⁵ the successful arguments made by the target in *Paramount* and recognized by the court, could also be used by the board of a target that is trying to defend the validity of its poison pill.²⁵⁶ A board of directors could defend its poison pill by arguing that the poison pill is protecting and enhancing the firm's prospects of long-term growth at the possible expense of short-term value.²⁵⁷ Further, they could argue that it is a board's responsibility to manage a company and that determinations made by a board do not have to comply with the desires of shareholders who own a majority of a company's stock.²⁵⁸ The *Paramount* opinion, to some extent, helped to clarify what the Delaware Court of Chancery viewed as proper action by target boards in a tender offer situation.

The *Paramount* holding also shows that the trend in the Delaware Court of Chancery, as begun in *TW Services*, is toward supporting management, and away from the pro-shareholder position which was supported by the decisions in *Interco* and *Pillsbury*. While courts usually take the position that each case stands on its own merits, the *Paramount* decision must be viewed as further undercutting the opinions of the Delaware Court of Chancery in *Interco* and *Pillsbury*.

One might consider that the target company's transaction in *Paramount* in effect restructured the composition of the firm. The proposed actions by the target boards in *Interco* and *Pillsbury* would have had a similar effect with regard to their respective companies. If future courts were to recognize this view as valid, it would all but do away with any lasting vestiges of significance that remain in the *Interco* and *Pillsbury* opinions.

V. THE DELAWARE SUPREME COURT IN ITS *PARAMOUNT* OPINION RESPONDED TO THE DELAWARE COURT OF CHANCERY'S SERIES OF DECISIONS STARTING WITH *INTERCO*

The Delaware Supreme Court affirmed the decision of the Delaware Court of Chancery in *Paramount Communications, Inc. v. Time, Inc.*,²⁵⁹ but differed somewhat in its analysis and reasoning. In affirming the Delaware Court of Chancery's decision, the Delaware Supreme Court stated:

255. *Id.* at 93,265, 93,273-75.

256. *See* Lerner, *supra* note 61, at 41, 42, 44.

257. *See The Time Case: Breathing Room for Increasing Values*, *supra* note 81, at 7.

258. *Paramount*, [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,514, at 93,276-77, 93,283-84.

259. 571 A.2d 1140 (Del. 1990).

We find that Paramount's tender offer was reasonably perceived by Time's board to pose a threat to Time and that the Time board's "response" to that threat was, under the circumstances, reasonable and proportionate. Applying *Unocal*, we reject the argument that the only corporate threat posed by an all-shares, all-cash tender offer is the possibility of inadequate value.

We also find that Time's board did not by entering into its initial merger agreement with Warner come under a *Revlon* duty either to auction the company or to maximize short-term shareholder value, notwithstanding the unequal share exchange. Therefore, the Time board's original plan of merger with Warner was subject only to a business judgment rule analysis.²⁶⁰

The Supreme Court in *Paramount* applied the *Unocal* standard broadly and the *Revlon* standard narrowly.²⁶¹ The Delaware Supreme Court rejected the application of *Revlon* to the *Paramount* fact pattern.²⁶² The court determined that there was an "absence of any substantial evidence to conclude that Time's board, in negotiating with Warner, made the dissolution or break-up of the corporate entity inevitable, as was the case in *Revlon*."²⁶³

The Delaware Supreme Court in *Paramount* observed that *Revlon* duties²⁶⁴ may be triggered when a target responds to a tender offer by abandoning its long-term strategy, and substituting an alternative plan which involves the break-up of the company in a manner similar to the anticipated result of the tender offer.²⁶⁵ The court determined that *Revlon* duties are not

260. *Id.* at 1142.

261. *Id.* at 1142, 1149-55. See also *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986); *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946 (Del. 1985); *Johnson & Siegel*, *supra* note 2, at 340; *Kanner*, *supra* note 52.

262. *Paramount*, 571 A.2d at 1150-54.

263. *Id.* at 1150. See also *Johnson & Siegel*, *supra* note 2, at 340; *Kanner*, *supra* note 52.

264. *Revlon*, 506 A.2d at 184.

265. *Paramount*, 571 A.2d at 1150-51. Martin Lipton has argued that takeovers can negatively affect long-term planning and thereby adversely affect the economy. Lipton, *Takeover Bids in the Target's Boardroom*, *supra* note 3, at 104-05.

Judge Easterbrook and Professor Fischel have responded to Lipton's argument by stating that "[t]he threat of takeovers does not prevent managers from engaging in long-term planning. If the market perceives that management has developed a successful long-term strategy, this will be reflected in higher share prices that discourage takeovers." Easterbrook & Fischel, *The*

triggered if a board's reaction to an unwanted tender offer is a defensive response and "not an abandonment of the corporation's continued existence."²⁶⁶ In such cases *Unocal* duties apply.²⁶⁷ The Delaware Supreme Court concluded that "Time's recasting of its merger agreement with Warner from a share exchange to a share purchase [did not constitute, on the part of Time, either an abandonment of] its strategic plan or made a sale of Time inevitable."²⁶⁸

The Delaware Supreme Court concluded that the initial stock-for-stock merger between Time and Warner was "entitled to the protection of the business judgment rule."²⁶⁹ The Delaware Court of Chancery had found that the revised agreement between Time and Warner was defense motivated.²⁷⁰ Therefore, the Delaware Court of Chancery applied the *Unocal* standard, rather than the traditional business judgment rule to the revised agreement.²⁷¹ The Delaware Supreme Court agreed with the Delaware Court of Chancery's determination that *Unocal* applied to all defensive actions taken by Time's directors after they became aware of Paramount's hostile tender offer.²⁷²

The Delaware Supreme Court and the Delaware Court of Chancery recognized that a board of directors "is not under any *per se* duty to maximize shareholder value in the short term, even in the context of a takeover."²⁷³ This gives boards of directors some discretion and latitude in considering factors other than short-term, share-value maximization within a takeover context.

The Delaware Supreme Court differed on its position with respect to several stances taken by the Delaware Court of Chancery on various issues.²⁷⁴ While both courts were of the opinion that the facts in *Paramount*

Proper Role of a Target's Management in Responding to a Tender Offer, *supra* note 52, at 1183-84, 1183 n.60.

266. *Paramount*, 571 A.2d at 1150-51 ("The adoption of structural safety devices alone does not trigger Revlon."). *See also Revlon*, 506 A.2d at 182, 184.

267. *Paramount*, 571 A.2d at 1150-51. *See also Unocal*, 493 A.2d at 955.

268. *Paramount*, 571 A.2d at 1151.

269. *Id.* at 1152.

270. *Id.*

271. *Id.*

272. *Id.*

273. *Id.* at 1150; *Paramount*, [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,514, at 93,277-80.

274. *Paramount*, 571 A.2d at 1152-54.

did not trigger *Revlon* duties,²⁷⁵ they categorized the *Revlon* trigger in different ways.²⁷⁶ The Delaware Supreme Court concentrated on whether the actions of Time made the "dissolution or break-up of the corporate entity inevitable."²⁷⁷ The Delaware Court of Chancery concentrated on whether a "change in control" of the corporation had occurred.²⁷⁸ The Delaware Supreme Court viewed its position on *Revlon* claims in this case as based on "different grounds" than that of the Delaware Court of Chancery.²⁷⁹ There is some support for the Delaware Supreme Court's contention in that its analysis considers the abandonment of a company's long-term strategy²⁸⁰

275. *Id.* at 1150-51; *Paramount*, [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,514, at 93,278-80. *See also Revlon*, 506 A.2d at 182, 184.

276. *Paramount*, 571 A.2d at 1150-51, *Paramount*, [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,514, at 93,278-80.

277. *Id.* at 1150. *See also Revlon*, 506 A.2d at 182, 184.

278. The Delaware Court of Chancery did not state a test to determine when a change in control had occurred. The court indicated that a determination would have to be made based on the facts in each case. *Paramount*, [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,514, at 93,279. *See also Mills Acquisition Co. v. Macmillan, Inc.*, 559 A.2d 1261, 1285 n.35 (Del. 1989); *Ivanhoe Partners v. Newmont Mining Corp. (In re Newmont Mining Corp. Shareholders Litigation)*, 535 A.2d 1334, 1345 (Del. 1987); *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 182, 184 (Del. 1986); *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 954-56 (Del. 1985); *Smith v. Van Gorkom*, 488 A.2d 858, 872-78 (Del. 1985); *Pogostin v. Rice*, 480 A.2d 619, 627 (Del. 1984); *Aronson v. Lewis*, 473 A.2d 805, 812-16 (Del. 1984). Interestingly, with respect to the original stock-for-stock merger between Time and Warner, the Delaware Court of Chancery recognized that "62% of the equity of Time would be owned by former Warner shareholders after the merger," but concluded that this was "irrelevant for purposes of making" a *Revlon* determination. *Paramount*, [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,514, at 93,279.

279. *Paramount*, 571 A.2d at 1150.

280. Martin Lipton has stated:

the policy considerations are overwhelmingly in favor of specific recognition that the directors not only have the right to make takeover decisions based on their reasonable business judgment, but that macrosocioeconomic issues must be considered along with the long-term interests of the shareholders and the company as a business enterprise.

Lipton, *Takeover Bids in the Target's Boardroom*, *supra* note 3, at 115-16.

and any transaction that would lead to a bust-up of the corporation²⁸¹ in guiding the court to its determination with regard to whether *Revlon* duties have been triggered.²⁸² This position seems to differ somewhat from the change-in-control standard articulated by the Delaware Court of Chancery.²⁸³ While the Delaware Supreme Court's analysis appears to differ from the view expressed by the Delaware Court of Chancery, the application of these standards will be the only positive determination as to how these standards in fact differ from each other. Both standards leave much to the interpretation of a reviewing court.

In *Interco* and *Pillsbury*, the Delaware Court of Chancery rested on its previously stated position that "suggested that an all-cash, all-shares offer, falling within a range of values that a shareholder might reasonably prefer, cannot constitute a legally recognized 'threat' to shareholder interests sufficient to withstand a *Unocal* analysis."²⁸⁴ The Delaware Court of Chancery in *Interco* and *Pillsbury* concluded that any danger that existed was minimal, and limited to the shareholders and price, and not to the corporation.²⁸⁵ The Delaware Supreme Court in *Paramount* determined that the plaintiff's argument, which was based on the reasoning of the Delaware Court of Chancery, led to the conclusion that only two types of threats were posed by a hostile tender offer: (1) the threat of coercion from a two-tier offer; and (2) "the threat of inadequate value from an all-shares, all-cash offer at a price below" the present value of a company's shares.²⁸⁶

281. See generally Kraakman, *supra* note 8, at 913-14.

282. *Paramount*, 571 A.2d at 1150-51.

283. *Paramount*, [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,514, at 93,278-81.

284. *Paramount*, 571 A.2d at 1152. See *Grand Metro. Pub. Ltd. Co. v. Pillsbury Co. (In re Pillsbury Co. Shareholders Litigation)*, 558 A.2d 1049 (Del. Ch. 1988); *City Capital Assocs. Ltd. Partnership v. Interco Inc.*, 551 A.2d 787 (Del. Ch.), *appeal dismissed*, 556 A.2d 1070 (Del. 1988); see also *AC Acquisitions v. Anderson, Clayton & Co.*, 519 A.2d 103 (Del. Ch. 1986).

285. *Pillsbury*, 558 A.2d at 1056-58; *Interco*, 551 A.2d at 797-800. See also *Paramount*, 571 A.2d at 1152.

286. *Paramount*, 571 A.2d at 1152-53.

Professors Gilson and Kraakman have argued that hostile tender offers can pose three types of threats which they categorize as:

- (i) *opportunity loss*, or the *Anderson, Clayton* dilemma that a hostile offer might deprive target shareholders of the opportunity to select a superior alternative offered by target management; (ii) *structural coercion*, or the risk that disparate treatment of non-tendering shareholders might distort shareholders' tender decisions; and,

The Delaware Supreme Court rejected the Delaware Court of Chancery's narrow interpretation of *Unocal*.²⁸⁷ The Delaware Supreme Court interpreted *Unocal* broadly and in a manner which gave great support to directors under the business judgment rule and the *Unocal* test.²⁸⁸ The Delaware Supreme Court in *Paramount* stated:

The usefulness of *Unocal* as an analytical tool is precisely its flexibility in the face of a variety of fact scenarios. *Unocal* is not intended as an abstract standard; neither is it a structured and mechanistic procedure of appraisal. Thus, we have said that directors may consider, when evaluating the threat posed by a takeover bid, the "inadequacy of the price offered, nature and timing of the offer, questions of illegality, the impact on 'constituencies' other than shareholders²⁸⁹ . . . the risk of nonconsummation, and the quality of securities being offered in the exchange." The 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. Indeed, in our view, precepts underlying the business judgment rule militate against a court's engaging in the process of attempting to appraise and evaluate the relative merits of a long-term versus a short-term investment goal for shareholders. To engage in such an exercise is a distortion of the *Unocal* process and, in particular, the application of the second part of *Unocal's* test, discussed below.²⁹⁰

finally, (iii) *substantive coercion*, or the risk that shareholders will mistakenly accept an underpriced offer because they disbelieve management's representations of intrinsic value.

Gilson & Kraakman, *supra* note 52, at 267. See also *Paramount*, 571 A.2d at 1153 n.17.

287. *Paramount*, 571 A.2d at 1142, 1152-53.

288. *Id.* at 1152-55.

289. In *Revlon*, the Delaware Supreme Court limited a board's capacity to consider the interests of constituencies other than shareholders under the *Unocal* standard by stating that "[a] board may have regard for various constituencies in discharging its responsibilities, provided there are rationally related benefits accruing to the stockholders." *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 182 (Del. 1986). See also Johnson & Siegel, *supra* note 2, at 341 n.94. It appears that in *Paramount*, the Delaware Supreme Court unfortunately pulled back from its position in *Revlon* and reverted to its original position as articulated in *Unocal*. See *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 955 (Del. 1985); see also Gilson & Kraakman, *supra* note 52, at 259 n.41.

290. *Paramount*, 571 A.2d at 1153 (citation omitted). See *supra* note 61 and accompanying text.

The Delaware Supreme Court's interpretation of *Unocal* allows directors to consider many factors other than simply price/value in the takeover context.²⁹¹ The Delaware Supreme Court determined that the Delaware Court of Chancery's interpretation of *Unocal* was excessively mechanistic and price/value oriented.²⁹² The Delaware Supreme Court recognized that in recent cases, the Delaware Court of Chancery had substituted its judgment for that of the board of directors of a corporation in deciding as to the most favorable alternative for a corporation in a takeover context.²⁹³ The Delaware Supreme Court rejected such actions "as not in keeping with a proper *Unocal* analysis."²⁹⁴

The Delaware Supreme Court recognized that the duty to manage a corporation lies with a corporation's board of directors and not with its stockholders.²⁹⁵ The Delaware Court of Chancery seems to have forgotten this in *Interco* and *Pillsbury* where the court took the decision-making power away from the respective boards and placed it in the hands of the shareholders.²⁹⁶

The Delaware Supreme Court also disagreed with the Delaware Court of Chancery's review of the board's managerial function through a long-term versus short-term corporate strategy analysis.²⁹⁷ With respect to this issue, the court stated, "Thus, the question of 'long-term' versus 'short-term' values is largely irrelevant because directors, generally, are obliged to charter a course for a corporation which is in its best interests without regard to a fixed investment horizon."²⁹⁸

The Delaware Supreme Court's attempt to differentiate its approach from that of the Delaware Court of Chancery's may be more theoretical than practical.²⁹⁹ In *Paramount*, the Delaware Supreme Court did recognize and consider the issue of long-term versus short-term corporate strategy in its

291. *Paramount*, 571 A.2d at 1152-53.

292. *Id.*

293. *Id.* at 1153. See *Grand Metro. Pub. Ltd. Co. v. Pillsbury Co. (In re Pillsbury Co. Shareholders Litigation)*, 558 A.2d 1049 (Del. Ch. 1988); *City Capital Assocs. Ltd. Partnership v. Interco Inc.*, 551 A.2d 787 (Del. Ch.), *appeal dismissed*, 556 A.2d 1070 (Del. 1988). But see *TW Servs., Inc. v. SWT Acquisition Corp.*, Nos. 10427, 10298, 1989 WL 20290 (Del. Ch. Mar. 2, 1989).

294. *Paramount*, 571 A.2d at 1153.

295. *Id.* at 1150, 1154. See also DEL. CODE ANN. tit. 8, § 141(a) (1991).

296. See *Pillsbury*, 558 A.2d 1049; *Interco*, 551 A.2d 787.

297. *Paramount*, 571 A.2d at 1150.

298. *Id.*

299. *Id.* at 1147-51, 1154.

analysis.³⁰⁰ Further, since most valuations are based on projections, the issue of long-term versus short-term strategy/value is incorporated into the takeover methodology and into the facts reviewed by a court.³⁰¹ Therefore, it does not appear that the Delaware Supreme Court and Delaware Court of Chancery differed greatly on this point.³⁰²

I generally agree with the Delaware Supreme Court's ultimate decision in *Paramount*,³⁰³ especially on the issue of "threat" to shareholders³⁰⁴ and its assessment of *Interco*,³⁰⁵ but I do not agree with several of the positions taken by the Delaware Supreme Court.³⁰⁶ I am a supporter of the *Unocal* standard³⁰⁷ and the business judgment rule,³⁰⁸ but the Delaware Supreme Court's interpretation of this standard and rule in *Paramount* gives excessive support to directors.³⁰⁹ After *Paramount*, directors may be able to support their decisions by saying little more than that their "actions were part of a long-term corporate strategy."³¹⁰ While I agree with the Delaware Supreme Court that a mechanistic price valuation should not be the only factor considered by directors in a takeover context,³¹¹ I disagree with the broad range of factors that the Delaware Supreme Court indicated should be considered.³¹² I endorse a standard that requires a price valuation comparison, with a significantly lesser consideration of other factors, and a recognition of additional factors that are extreme or extraordinary in nature.³¹³ My

300. *Id.* at 1149-55.

301. *See* BREALEY & MYERS, *supra* note 130; COPELAND & WESTON, *supra* note 130; GILSON, *supra* note 2, at 85-155; *see generally* Kraakman, *supra* note 8.

302. *See Paramount*, 571 A.2d at 1149-55; *Paramount*, [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,514, at 93,267, 93,269, 93,272, 93,277, 93,278, 93,283, 93,284; *see also* BREALEY & MYERS, *supra* note 130; COPELAND & WESTON, *supra* note 130; GILSON, *supra* note 2, at 85-155.

303. *Paramount*, 571 A.2d at 1141-42, 1149-55.

304. *Id.* at 1152-53, 1153 n.17. *See also supra* note 286 and accompanying text.

305. *Paramount*, 571 A.2d at 1152-53.

306. *Id.* at 1149-55.

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

308. *Paramount*, 571 A.2d at 1152.

309. *Id.* at 1152.

310. *Id.* at 1149-55.

311. *Id.* at 1152-53.

312. *See supra* note 289 and accompanying text.

313. The Kodak judgment in *Shamrock Holdings, Inc. v. Polaroid Co. (In re Polaroid Shareholders Litigation)*, 559 A.2d 278 (Del. Ch. 1989) provides

standard may not be as different from the Delaware Supreme Court's standard³¹⁴ as may at first appear. The Delaware Supreme Court noted that directors should consider inadequacy of price, nature and timing of an offer, illegality, impact on stakeholders other than shareholders, risk of nonconsummation, and the quality of securities being offered.³¹⁵ Where the Delaware Supreme Court seems to consider these items as an issue of price and other separate factors,³¹⁶ I consider all except the issue of stakeholders other than shareholders to be factors that are interrelated and part of the issue of price. For example, if a board thought that an offer was illegal on antitrust grounds³¹⁷ or had little chance of consummation for other reasons,³¹⁸ then the price offered would be of little consequence. Similarly, the timing of an offer and the quality of the securities offered are factors considered in analyzing the value of an offer.³¹⁹ Where I differ most with the Delaware

an example of an extreme or extraordinary factor that must be considered by a target's board. In *Polaroid*, the target company expected a sizable future judgment against Kodak. *Id.* at 280. The court in *Polaroid* recognized that shareholders could not properly value the judgment at the time of the tender offer and that the dissemination of information would not cure this problem. *Id.* at 290. See also Oesterle, *supra* note 43, at 58 n.19. Also, the court noted that disclosure of certain information by the target board could hurt its bargaining position with respect to the continuing litigation. *Polaroid*, 559 A.2d at 290. Further, a hostile raider, especially if its intent was to break up the company, might want to settle the case expeditiously and might also be willing to accept a lesser judgment/offer than would incumbent management in order to quickly resolve the matter. This would not be in the best interests of the target's shareholders.

Generally, a target's board should not take any action on any factor in a takeover setting that will negatively affect shareholder interests.

314. *Paramount*, 571 A.2d at 1152-53.

315. *Id.* at 1153 (citing *Unocal Corp. v. Mesa Petroleum Corp.*, 493 A.2d 946, 955 (Del. 1985)). See also *West Point-Pepperell, Inc. v. J.P. Stevens & Co. (In re J.P. Stevens & Co. Shareholders Litigation)*, 542 A.2d 770, 781 n.6 (Del. Ch. 1988).

316. *Paramount*, 571 A.2d at 1153.

317. See *J.P. Stevens*, 542 A.2d at 778 (target board had to consider "significant legal uncertainties," including the offeror's cooperation with the Federal Trade Commission and the refusal of the offeror to divest assets that the Federal Trade Commission found to be problematic from an antitrust perspective).

318. *Id.* at 778, 781 n.6.

319. *Paramount*, 571 A.2d at 1153 (citing *Unocal*, 493 A.2d at 955).

Supreme Court is whether directors should consider stakeholders other than shareholders.³²⁰ Shareholders invest in corporations and take most of the risks.³²¹ Therefore, shareholders should be the primary parties considered in a takeover.³²²

This does not mean that I support a standard that requires directors to maximize short-term shareholder value at all costs and in all cases in a takeover context.³²³ If a board can show with a sufficiently high degree of certainty that its long-term strategy on a realistic discounted basis will produce

320. Martin Lipton has supported a position that directors should consider constituencies other than shareholders in the context of a takeover. Lipton, *Takeover Bids in the Target's Boardroom*, *supra* note 3, at 122, 130. *See also* Greene & Junewicz., *supra* note 11, at 717 n.342, 739; Lipton, *Corporate Governance in the Age of Finance Corporatism*, *supra* note 3, at 35-43; 59-60, 60 n.280.

Judge Easterbrook and Professor Fischel have argued that target management does not have a duty to consider the interests of groups other than the target's shareholders. Easterbrook & Fischel, *The Proper Role of a Target's Management in Responding to a Tender Offer*, *supra* note 52, at 1190-92. *See also* Easterbrook & Fischel, *The Corporate Contract*, *supra* note 52, at 1436; Easterbrook & Fischel, *supra* note 130, at 703 n.15.

321. *See supra* note 320 and accompanying text; *see also* Easterbrook & Fischel, *The Corporate Contract*, *supra* note 52, at 1425.

322. With respect to the issue of considering stakeholders other than shareholders, the court in *Revlon* stated:

The Revlon board argued that it acted in good faith in protecting the noteholders because *Unocal* permits consideration of other corporate constituencies. Although such considerations may be permissible, there are fundamental limitations upon that prerogative. A board may have regard for various constituencies in discharging its responsibilities, provided there are rationally related benefits accruing to the stockholders. However, such concern for non-stockholder interests is inappropriate when an auction among active bidders is in progress, and the object no longer is to protect or maintain the corporate enterprise but to sell it to the highest bidder.

Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 182 (Del. 1986) (citation omitted). *See also* Gilson & Kraakman, *supra* note 52, at 259 n.41, 267.

323. *See Paramount*, 571 A.2d at 1149-50, 1152-53.

Martin Lipton has argued that institutional investors focus on securing profits in the short-term. *See* Lipton, *Corporate Governance in the Age of Finance Corporatism*, *supra* note 3, at 7-9, 7-8 nn.23-26, 63-64.

greater shareholder value,³²⁴ then the directors should choose this alternative in a takeover setting.³²⁵ The problem with the Delaware Supreme Court's position is that it allows a board to choose a long-term corporate strategy even if it finds that such a strategy will produce less shareholder value than a current offer.³²⁶ Further, the court's position is sufficiently permissive to allow boards to successfully support almost any of their decisions.³²⁷

By applying the standard I have articulated, the Delaware Supreme Court could have still held in favor of Time, but would not have granted the apparent powers that it did to incumbent corporate management.³²⁸ Such a standard would guard against overly strong and possibly abusive and

324. This assumes that rules and regulations are instituted to make valuations based on projections more realistic than is currently the case, where valuations are performed under little or no regulations or guidelines. See *supra* part IV(C).

325. See BREALEY & MYERS, *supra* note 130; COPELAND & WESTON, *supra* note 130.

326. *Paramount*, 571 A.2d at 1152-53. For example, a board could justify favoring an offer that produces less shareholder value by arguing that its decision is based on grounds of consideration of constituencies other than shareholders.

Martin Lipton has argued that institutional investors are concerned about maximizing short-term profits and that this is detrimental to undervalued companies and shareholders that are interested in long-term investment. Lipton, *Corporate Governance in the Age of Finance Corporatism*, *supra* note 3, at 7-9, 8 n.26. My proposal is driven by maximization of profits and does not cater to the desires of any particular group of investors.

327. *Id.*

328. See *Paramount*, 571 A.2d at 1147-49. The Time board was told by its investment bankers that if it decided to sell Time, it would probably receive a price in excess of \$250 per share. Since this price is greater than Paramount's highest offer for Time which was \$200 per share, the Delaware Supreme Court could have justified a holding based purely on inadequacy of the offer. *Paramount*, [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,514, at 93,272.

inefficient management.³²⁹ It would also make entrenchment by management, especially inefficient management, more difficult.³³⁰

Whether the Delaware Supreme Court's *Paramount* decision will in reality grant boards as much power as it appears to have granted³³¹ is uncertain. One must consider that in *Paramount* there was a highly structured target board,³³² with a long-term strategic corporate plan,³³³ that had considered and attempted an acquisition prior to the emergence of the tender offer.³³⁴ This is a fact pattern that lends itself to a pro-management decision.³³⁵ Also, the proposed Time-Warner merger was analyzed by the target's investment bankers and found to yield more shareholder value than the tender offer.³³⁶ How strictly the Delaware courts apply the Delaware

329. See Carl C. Icahn, *The Case for Takeovers*, N.Y. TIMES MAG., Jan. 29, 1989, at 34; see also *Amanda Acquisition Corp. v. Universal Foods Corp.*, [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,436, at 92,812 (7th Cir. May 24, 1989); Coffee, *supra* note 29, at 1148 n.5, 1152 n.13, 1152-55. But see Robert B. Reich, *Leveraged Buyouts: America Pays the Price*, N.Y. TIMES MAG., Jan. 29, 1989, at 32.

Judge Easterbrook and Professor Fischel have argued that an active takeover market benefits society by giving management incentive to operate efficiently, and by providing a vehicle to displace inefficient managers. See Easterbrook & Fischel, *supra* note 130, at 705; Easterbrook & Fischel, *The Proper Role of a Target's Management in Responding to a Tender Offer*, *supra* note 52, at 1184.

330. See *supra* note 329 and accompanying text.

331. *Paramount*, 571 A.2d at 1151-55.

332. *Id.* at 1143-49. Twelve of Time's sixteen directors were outside, nonemployee directors and Time formulated a special committee of outside directors to oversee the Time-Warner merger. *Id.* at 1147-48. Further, Time's outside directors often acted independently of management directors with respect to the *Paramount* tender offer. *Id.* See also *Paramount*, [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,514, at 93,267-3, 93,270.

333. *Paramount*, 571 A.2d at 1144, 1149-51; *Paramount*, [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,514, at 93,267-68, 93,282, 93,283-84.

334. *Paramount*, 571 A.2d at 1144-47, 1154-55; *Paramount*, [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,514, at 93,267-71, 93,282, 93,284.

335. See generally *Paramount*, 571 A.2d at 1151-55.

336. See *supra* note 328 and accompanying text. Also, Time's advisors predicted trading ranges for the shares of the combined Time-Warner of \$106-\$188 for 1990, \$159-\$247 for 1991, \$230-\$332 for 1992 and \$208-\$402 for 1993. *Paramount*, [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,514,

Supreme Court's *Paramount* decision to future takeover situations will determine the true implications of the *Paramount* decision.

The strength of the Delaware Supreme Court's *Paramount* decision will have an impact upon the use of poison pills.³³⁷ If the decision is applied in its truest sense, boards may be able to use the holding to support the use of poison pills. Boards will claim that pills are part of their long-term corporate strategy or are protecting such a strategy. A similar argument might even be used to support more aggressive pills, with lower triggers.³³⁸ If the Delaware courts grant such power to boards regarding poison pills, boards will be allowed to use pills to preclude almost any takeover attempt.³³⁹ This is just what the court in *Moran* determined that a poison pill should not be able to accomplish.³⁴⁰ The general power to defend against takeovers becomes even greater when one considers that in addition to an enhanced poison pill, management can more often depend on state antitakeover statutes³⁴¹ and the "just say no" defense.³⁴²

at 93,273.

337. See *Moran v. Household Int'l, Inc.*, 500 A.2d 1346 (Del. 1985).

338. See *Mills Acquisition Co. v. Macmillan, Inc.*, 559 A.2d 1261, 1266-67 (Del. 1989); *Robert M. Bass Group, Inc. v. Evans (In re Macmillan, Inc. Shareholders Litigation)*, 552 A.2d 1227, 1230-32 (Del. Ch.), *appeal dismissed*, 548 A.2d 498 (Del. 1988); see also Claudia H. Deutsch, *Avon Keeps Ringing, but Wall Street Won't Answer*, N.Y. TIMES, July 15, 1990, § 3, at 7.

339. See *supra* note 108 and accompanying text.

340. *Moran*, 500 A.2d at 1356. See also *supra* note 108 and accompanying text.

341. When the poison pill is used in addition to the protection afforded corporations by state antitakeover statutes such as those recently enacted in Pennsylvania and Massachusetts, the possibility of a successful takeover attempt is almost completely precluded. See Dean Foust & Tim Smart, *The Merger Parade Runs Into A Brick Wall*, BUS. WK., May 14, 1990, at 38; Vindu P. Goel, *Many Pennsylvania Firms, Labor Groups Oppose Adoption of Anti-Takeover Bill*, WALL ST. J., Apr. 16, 1990, at A14; Vindu P. Goel, *Pennsylvania's New Anti-Takeover Law Fuels Controversy, Faces Fight in Court*, WALL ST. J., Apr. 30, 1990, at A16; Diana B. Henriques, *A Paradoxical Anti-Takeover Bill*, N.Y. TIMES, Apr. 8, 1990, § 3, at 15; see generally Greene & Junewicz, *supra* note 11, at 652-53, 652 n.21 (discussing first generation antitakeover statutes).

342. Corporate management can defend against unwanted takeovers by using the "just say no" defense which takes the position that a board of directors can decline to sell a company when faced with an offer. See

VI. THE HOLDINGS IN *INTERCO* AND *PILLSBURY* MAY BE MORE EASILY JUSTIFIED WHEN ANALYZED FROM AN ECONOMIC PERSPECTIVE

Earlier in this Article, I analyzed the holdings in *Interco* and *Pillsbury* from a purely legal perspective. The legal community has generally confined itself to this perspective. While purely legal analysis is the cornerstone of review in the legal profession, economic analysis can be a useful tool to broaden one's understanding.

In this part of the Article, I review *Interco* and *Pillsbury* from an economic perspective. This approach involves analyzing stock prices from the time that the target suspected that its stock was being purchased with the possible intent of a takeover attempt, to the close of the takeover process. I consider whether it is possible to make the argument that the respective holdings are justified when considered purely on economic grounds.

To better understand the economics involved with respect to these cases, a listing of critical dates and corresponding stock prices is essential. In the

Paramount, 571 A.2d at 1152; *Sutton Holdings Corp. v. DeSoto, Inc.*, Nos. 11221, 11222, 1990 WL 13476 (Del. Ch. Feb. 5, 1990); *Paramount*, [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,514 at 93,279; *TW Servs., Inc. v. SWT Acquisition Corp.*, Nos. 10427, 10298, 1989 WL 20290 (Del. Ch. Mar. 2, 1989); *Block & Hoff*, *supra* note 3; *see also* *Mills Acquisition v. Macmillan, Inc.*, 559 A.2d 1261, 1285 n.35 (Del. 1989); *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 954-56 (Del. 1985); *Smith v. Van Gorkom*, 488 A.2d 858, 872-78, 881 (Del. 1985); *Pogostin v. Rice*, 480 A.2d 619, 627 (Del. 1984); *Aronson v. Lewis*, 473 A.2d 805, 812-16 (Del. 1984). Whether the "just say no" defense is a valid position when a board is faced with an offer at an adequate price is unclear and not resolved by *Paramount*. *See supra* notes 328, 336 and accompanying text. Regardless, when corporate management uses an enhanced poison pill and takes the position of a "just say no" defense, this presents formidable obstacles for an offeror to overcome. Martin Lipton has stated:

A company need not have a perpetual "for sale" sign on its front lawn, *i.e.*, there is no requirement that the management or the directors engage in acquisition discussions at another person's initiative; on the contrary, a company may have an express policy of continuing as an independent business enterprise.

Lipton, *Takeover Bids in the Target's Boardroom*, *supra* note 3, at 112 (footnote omitted).

He also stated, "[D]irectors are not required when faced with a takeover bid to declare an auction and seek to sell the company to the highest bidder." *Id.*

case of *Interco*, Steven and Mitchell Rales started acquiring Interco stock through City Capital in May 1988.³⁴³ During May 1988, the closing price of Interco's stock ranged between \$40 1/4 and \$43 7/8 per share.³⁴⁴ The closing price of \$40 1/4 on May 2, 1988, was a low for Interco's stock during the period of the attempted takeover.³⁴⁵

On July 27, 1988, the Rales brothers filed a Schedule 13D³⁴⁶ with the Securities and Exchange Commission, which revealed that they owned 8.7% of Interco's common stock.³⁴⁷ On this same day, City Capital "offered to acquire . . . [Interco] by merger for a price of \$64 per share in cash, conditioned upon the availability of financing."³⁴⁸ On July 27, 1988, Interco's common stock closed at \$59 3/8.³⁴⁹

On August 8, prior to the response of the Interco board to the initial \$64 offer, City Capital increased its offering price to \$70 per share, still contingent on securing the required financing.³⁵⁰ Interco's stock closed at \$72 1/2 on August 8.³⁵¹

On August 15, the Rales brothers announced an all-cash, all-shares tender offer for the stock of Interco at \$70 per share.³⁵² Interco's stock closed at

343. *City Capital Assocs. Ltd. Partnership v. Interco Inc.*, 551 A.2d 787, 791 (Del. Ch.), *appeal dismissed*, 556 A.2d 1070 (Del. 1988).

344. Daily Stock Price Record New York Stock Exchange 229 (April, May, June 1988). For purposes of this analysis, I will use only closing prices unless otherwise specified. The Daily Stock Price Record New York Stock Exchange lists fractional share prices in eighths, but I have reduced fractional share prices where appropriate in this analysis.

345. Daily Stock Price Record New York Stock Exchange 229 (April, May, June 1988); Daily Stock Price Record New York Stock Exchange 227 (July, Aug., Sept. 1988); Daily Stock Price Record New York Stock Exchange 226 (Oct., Nov., Dec. 1988).

346. Under Section 13(d)(1)(a) of the Securities Exchange Act of 1934, any person who directly or indirectly acquires more than 5% of any equity security of a class specified in Section 13(d) must file a SEC Schedule 13D with the Securities and Exchange Commission disclosing that acquisition. 17 C.F.R. § 240.13d-1(a) (1990).

347. *Interco*, 551 A.2d at 792.

348. *Id.*

349. Daily Stock Price Record New York Stock Exchange 227 (July, Aug., Sept. 1988).

350. *Interco*, 551 A.2d at 792.

351. Daily Stock Price Record New York Stock Exchange 227 (July, Aug., Sept. 1988).

352. *Interco*, 551 A.2d at 792.

\$72 1/8 on this day.³⁵³ The Interco board recommended against the \$70 per share offer at its meeting on August 22.³⁵⁴

On August 29 and 30, Interco's common stock closed at \$73 1/2 per share.³⁵⁵ This was the highest price reached by the stock during the course of the takeover process.³⁵⁶

On September 10, the Rales brothers increased their offer to \$72 per share.³⁵⁷ On September 12, the next trading day, Interco's stock closed at \$71 3/4.³⁵⁸

On September 19, the Interco board adopted the restructuring proposal.³⁵⁹ The common stock of Interco closed at \$70 3/8 on this day.³⁶⁰

On October 18, City Capital further supplemented its offer by raising its bid to \$74 per share.³⁶¹ Interco's common stock closed at \$70 5/8 on this day.³⁶² This offer was rejected by the Interco board as inadequate at its meeting on October 19.³⁶³

The decision of the Delaware Court of Chancery came down on *Interco* on November 1.³⁶⁴ Interco's common stock closed at \$71 3/4 on this day.³⁶⁵

In analyzing Interco's stock over the course of the takeover process, it is clear that the stock rose roughly from \$40 1/4 per share to a high of \$73 1/2

353. Daily Stock Price Record New York Stock Exchange 227 (July, Aug., Sept. 1988).

354. *Interco*, 551 A.2d at 792.

355. Daily Stock Price Record New York Stock Exchange 227 (July, Aug., Sept. 1988).

356. Daily Stock Price Record New York Stock Exchange 229 (April, May, June 1988); Daily Stock Price Record New York Stock Exchange 227 (July, Aug., Sept. 1988); Daily Stock Price Record New York Stock Exchange 226 (Oct., Nov., Dec. 1988).

357. *Interco*, 551 A.2d at 793.

358. Daily Stock Price Record New York Stock Exchange 227 (July, Aug., Sept. 1988).

359. *Interco*, 551 A.2d at 793.

360. Daily Stock Price Record New York Stock Exchange 227 (July, Aug., Sept. 1988).

361. *Interco* 551 A.2d at 794.

362. Daily Stock Price Record New York Stock Exchange 226 (Oct., Nov., Dec. 1988).

363. *Interco*, 551 A.2d at 794.

364. *Id.* at 787.

365. Daily Stock Price Record New York Stock Exchange 226 (Oct., Nov., Dec. 1988).

per share.³⁶⁶ This is an increase in value of 83% over a period of several months.³⁶⁷

When comparing the value of the restructuring against City Capital's final offer, it is apparent that the two alternatives are close in value. The restructuring has a value of at least \$76 per share.³⁶⁸ City Capital's final offer was for \$74 per share.³⁶⁹ The difference between these offers is \$2 per share or 3%.³⁷⁰ Further, the \$74 tender offer is an all-cash offer, whereas the restructuring, with a value according to Wasserstein Perella of at least \$76, is not.³⁷¹

In studying the market's valuation of Interco's stock on October 18, the date of the \$74 per share bid by City Capital, and shortly thereafter, it can be seen that the stock traded at around \$70 and at no time rose above \$71 3/4.³⁷² The market price of roughly \$70 per share was below Wasserstein Perella's \$76 valuation for the restructuring.³⁷³ When one considers this, along with the opinion of Drexel Burnham Lambert Incorporated, which

366. *See supra* note 356.

367. A period of four or six months can be used, depending on whether one wants to look at a reference date keyed to the highest closing price of the stock or keyed to the decision of the Delaware Court of Chancery, to determine the increase in value of Interco's stock over the course of the takeover process. My figure of 83% is based on a four-month reference period, keyed to the highest closing price for the stock. A six-month reference period keyed to the decision of the Delaware Court of Chancery would yield an increase in value of 78%. Since the disparity in the two figures is small, either can be effectively used to make the point that Interco's stock rose sharply in value over the course of the takeover process.

368. *Interco*, 551 A.2d at 794. I am assuming that Wasserstein Perella's valuation of the restructuring is accurate.

369. *Id.*

370. *Id.* at 798-99.

371. *Id.* at 793-94. The court determined that the tender offer would result in value to the shareholders at an earlier date. *Id.* at 798. It is difficult to determine from the facts in the opinion, describing the timing of the realization of value of the restructuring, how much of a factor timing may have been in affecting the values of the two alternatives, when corrected for the time value of money. Since speculation on this matter will not add to this analysis, I will not consider the point beyond recognizing that it was mentioned by the court in *Interco*.

372. Daily Stock Price Record New York Stock Exchange 226 (Oct., Nov., Dec. 1988).

373. *Id.* *See also Interco*, 551 A.2d at 793-94.

valued the restructuring at between \$68.28 and \$70.37 per share, one might conclude that the prospects for Interco were not as favorable as were perceived by Wasserstein Perella, and that the stock of Interco, as well as the restructuring, could be fairly valued at approximately \$70 per share.³⁷⁴ If this is the conclusion one reaches, then City Capital's \$74 tender offer could be considered a fair offer and preferable to the proposed restructuring.³⁷⁵

In the *Pillsbury* case, Pillsbury first became aware that Grand Metropolitan had an interest in the company in May of 1988.³⁷⁶ During May 1988, the closing price for Pillsbury's common stock ranged between \$35 1/4 per share and \$40 1/2 per share.³⁷⁷

On July 19, Pillsbury's stock closed at \$33 5/8 per share.³⁷⁸ This was the lowest price reached by Pillsbury's stock during the period of this takeover.³⁷⁹

During or prior to September 1988, Pillsbury began communicating with State Alcoholic Beverage Commissions regarding Tied-House relationships.³⁸⁰ Pillsbury hoped to use the Tied-House Statutes as a defense if

374. *Interco*, 551 A.2d at 793-94, 798-800. Drexel Burnham Lambert, Incorporated was City Capital's investment banker for this transaction. *Id.* at 799.

375. Interco's board did ultimately institute the proposed restructuring. For information on the record of the restructuring and Interco in general, see Anders & Schwadel, *supra* note 214; Brian Bremner, *Interco: Another Day Older and \$1.4 Billion in Debt*, BUS. WK., Jan. 22, 1990, at 58; Larry Light, *The Junk Bond Time Bombs Could Go Off*, BUS. WK., Apr. 9, 1990, at 68; Francine Schwadel & George Anders, *Interco Bondholders and Banks Agree to Restructuring of \$1.9 Billion Debt*, WALL ST. J., Aug. 1, 1990, at A4; Francine Schwadel & George Anders, *Interco and its Banks and Bondholders Tentatively Agree on Debt Restructuring*, WALL ST. J., Aug. 21, 1990, at A7.

376. *Grand Metro. Pub. Ltd. Co. v. Pillsbury Co. (In re Pillsbury Co. Shareholders Litigation)*, 558 A.2d 1049, 1051 (Del. Ch. 1988).

377. Daily Stock Price Record New York Stock Exchange 347 (April, May, June 1988).

378. Daily Stock Price Record New York Stock Exchange 343 (July, Aug., Sept 1988).

379. Daily Stock Price Record New York Stock Exchange 347 (April, May, June 1988); Daily Stock Price Record New York Stock Exchange 343 (July, Aug., Sept. 1988); Daily Stock Price Record New York Stock Exchange 343 (Oct., Nov., Dec. 1988); Daily Stock Price Record New York Stock Exchange 338 (Jan., Feb., Mar. 1989).

380. *Pillsbury*, 558 A.2d at 1052. Tied-House Statutes are statutes that are in effect in certain states which generally "prohibit a manufacturer of

Grand Metropolitan made a tender offer.³⁸¹ During the month of September 1988, the closing price of Pillsbury's stock ranged between \$34 1/2 per share and \$39 per share.³⁸²

On October 3, Grand Metropolitan filed an action seeking declaratory and injunctive relief against Pillsbury.³⁸³ Pillsbury's stock closed at \$39 per share on this day.³⁸⁴

The next day, on October 4, Grand Metropolitan announced an all-cash tender offer at \$63 per share for all the outstanding stock of Pillsbury.³⁸⁵ The stock rose on the announcement of the tender offer and closed at \$57 on October 4.³⁸⁶

Pillsbury's board met on October 17 and decided to recommend against the tender offer.³⁸⁷ The board based its recommendation against the tender offer largely on its finding that the \$63 price was inadequate.³⁸⁸ On October 17, Pillsbury's stock closed at \$58 5/8.³⁸⁹

Pillsbury entered into an agreement on November 6 to spin off Burger King as a separate company.³⁹⁰ On November 7, which was the next business day, Pillsbury's stock closed at \$59.³⁹¹

The final opinion of the Delaware Court of Chancery came down on December 16.³⁹² On this day, Pillsbury's stock closed at \$62 1/4.³⁹³

alcoholic beverages from owning or having an interest in a distributorship or retail outlet." *Id.* at 1051.

381. *Id.* at 1051-52.

382. Daily Stock Price Record New York Stock Exchange 343 (July, Aug., Sept. 1988).

383. *Pillsbury*, 558 A.2d at 1050.

384. Daily Stock Price Record New York Stock Exchange 343 (Oct., Nov., Dec. 1988).

385. *Pillsbury*, 558 A.2d at 1052.

386. Daily Stock Price Record New York Stock Exchange 343 (Oct., Nov., Dec. 1988).

387. *Pillsbury*, 558 A.2d at 1052.

388. *Id.*

389. Daily Stock Price Record New York Stock Exchange 343 (Oct., Nov., Dec. 1988).

390. *Pillsbury*, 558 A.2d at 1061.

391. Daily Stock Price Record New York Stock Exchange 343 (Oct., Nov., Dec. 1988).

392. *Pillsbury*, 558 A.2d at 1049.

393. Daily Stock Price Record New York Stock Exchange 343 (Oct., Nov., Dec. 1988).

Grand Metropolitan's tender offer for the stock of Pillsbury closed on December 23.³⁹⁴ Pillsbury's stock closed at \$65 3/4 on this day.³⁹⁵

On December 30, Pillsbury's stock closed at \$65 7/8.³⁹⁶ This was a high for the stock during the period of the takeover.³⁹⁷

During the course of the takeover process Pillsbury's stock showed a significant gain.³⁹⁸ Pillsbury's stock closed as low as \$33 5/8 per share on July 19, and rose to a high of \$65 7/8 on December 30.³⁹⁹ This is a gain of 96%.⁴⁰⁰

394. *Pillsbury*, 558 A.2d at 1060.

395. Daily Stock Price Record New York Stock Exchange 343 (Oct., Nov., Dec. 1988).

396. *Id.*

397. Pillsbury's stock also closed at \$65 7/8 on January 3 and January 10, 1989. Daily Stock Price Record New York Stock Exchange 347 (April, May, June 1988); Daily Stock Price Record New York Stock Exchange 343 (July, Aug., Sept. 1988); Daily Stock Price Record New York Stock Exchange 343 (Oct., Nov., Dec. 1988); Daily Stock Price Record New York Stock Exchange 338 (Jan., Feb., Mar. 1989).

398. *See supra* note 397.

399. Daily Stock Price Record New York Stock Exchange 343 (July, Aug., Sept. 1988); Daily Stock Price Record New York Stock Exchange 343 (Oct., Nov., Dec. 1988). If the close of the tender offer on December 23 is considered the end of the takeover period, the closing high for Pillsbury's stock would be \$65 3/4 per share. This price was attained on December 23. I have used the closing price of \$65 7/8 attained on December 30, because this price resulted from the takeover process.

400. If one looks at the low for Pillsbury's stock in May of 1988, which was when Pillsbury first became aware of Grand Metropolitan's interest in Pillsbury, instead of the \$33 5/8 low achieved during the course of the takeover process, the percentage of change would be different. The closing low for Pillsbury's stock in May 1988 was \$35 1/4 per share. When compared with the December 30 high of \$65 7/8, this results in a gain of 87%.

The gain in value of Pillsbury's stock might also be calculated by limiting the reference period to the date of the Delaware Court of Chancery's opinion. The high for this period was \$63 which occurred on December 14. A comparison of the low price for Pillsbury's stock of \$33 5/8, against the high price on December 14 of \$63, yields a gain in the price of Pillsbury's stock of 87%. Daily Stock Price Record New York Stock Exchange 343 (Oct., Nov., Dec. 1988).

Pillsbury's strategic plan was valued by its experts as achieving a present minimum value of \$68 per share.⁴⁰¹ Grand Metropolitan's tender offer price for Pillsbury's shares was \$63 per share.⁴⁰² The difference in price is \$5 or 8% per share. Although this is a significant difference, it could be argued that this disparity appears more modest when one considers that the tender offer was a present cash offer and the board's plan was based on projected growth, which if realized, would be received in the future.⁴⁰³ It might be argued that the holding of the court in *Pillsbury* could be supported by a position based on an economic evaluation of the facts, concentrating on what could be argued is a modest difference in value between the alternatives when one considers all the relevant factors involved.

From an economic perspective, the *Interco* and *Pillsbury* cases share four characteristics. First, in both cases, the target's shares rose greatly in value during the course of the takeover process.⁴⁰⁴ This gave the shareholders the opportunity to receive a considerable premium on their shares due to the existence of a tender offer.

Second, it could be argued that the difference in value between the respective offers in each case was modest when consideration is given to all the relevant factors.⁴⁰⁵

Third, an argument could be made that the lower offer in each case was a cash offer while the higher offers, which were based on projected growth, were speculative.⁴⁰⁶

Regardless of which figures are used, the point is clear that Pillsbury's stock rose sharply in price during the course of the takeover process.

401. *Grand Metro. Pub. Ltd. Co. v. Pillsbury Co. (In re Pillsbury Co. Shareholders Litigation)*, 558 A.2d 1049, 1057 (Del. Ch. 1988).

402. *Id.* at 1052.

403. The Delaware Court of Chancery in *Pillsbury* recognized the fact that the value of the board's plan was based on projected growth, which, if realized, was expected to materialize perhaps in 1992 or 1993. *Id.* at 1057.

404. Daily Stock Price Record New York Stock Exchange 229, 347 (April, May, June 1988); Daily Stock Price Record New York Stock Exchange 227, 343 (July, Aug., Sept. 1988); Daily Stock Price Record New York Stock Exchange 226, 343 (Oct., Nov., Dec. 1988); Daily Stock Price Record New York Stock Exchange 223, 338 (Jan., Feb, Mar. 1989).

405. *See Pillsbury*, 558 A.2d at 1057-58; *City Capital Assocs. Ltd. Partnership v. Interco Inc.*, 551 A.2d 787, 798-99 (Del. Ch.), *appeal dismissed*, 556 A.2d 1070 (Del. 1988). This argument is more difficult to make in *Pillsbury* than in *Interco* because of the greater difference in price.

406. *See Pillsbury*, 558 A.2d at 1052, 1057; *Interco*, 551 A.2d at 798-800.

Fourth, in each case, shareholders could realize the value in the lower offers immediately, instead of waiting, as was required by each of the higher offers.⁴⁰⁷

The four characteristics identified above provide plausible arguments to support the holdings of the Delaware Court of Chancery in *Interco* and *Pillsbury*. Though these four points are worthy of consideration, they should not overshadow the legal significance of these two holdings, nor the negative implications that they embody. As outlined previously in this Article,⁴⁰⁸ these holdings make it difficult for boards of directors and those advising boards to know where they stand with respect to mergers and tender offers. These decisions weaken the protection afforded to directors under the business judgment rule as it is interpreted in *Unocal*. This results in undercutting a board of directors' position to defend a company against hostile raiders and to maximize shareholder value. It is ironic that these decisions may have the result of undermining just what the Delaware Court of Chancery was trying to achieve in both cases, which was to help shareholders maximize the value of their shares. Further, the Delaware Court of Chancery failed to recognize the precedents set forth by the Delaware Supreme Court in prior decisions.

What is most distressing is that the Delaware Court of Chancery failed to address the main issue in these cases and many other merger cases, which is the problem of valuation. The Delaware Court of Chancery avoided this issue. If it had properly addressed this issue, the Delaware Court of Chancery probably could have held as it did in *Interco* and *Pillsbury* without establishing dangerous and vague legal standards.

VII. CONCLUSION

While it could be argued that there is some economic justification for the Delaware Court of Chancery's holdings in *Interco*⁴⁰⁹ and *Pillsbury*,⁴¹⁰ this is overshadowed by the inappropriate and misapplied legal reasoning used to arrive at the final determinations in both cases. The Delaware Court of Chancery paid little attention to and/or misapplied previous holdings of the Delaware Supreme Court and set dangerous legal precedents to be considered by those in both the legal and business communities.⁴¹¹

407. See *Pillsbury*, 558 A.2d at 1057; *Interco*, 551 A.2d at 799.

408. See *supra* parts III(A)-(E), IV(A)-(B).

409. *City Capital Assocs. Ltd. Partnership v. Interco Inc.*, 551 A.2d 787 (Del. Ch.), *appeal dismissed*, 556 A.2d 1070 (Del. 1988).

410. *Grand Metro. Pub. Ltd. Co. v. Pillsbury Co. (In re Pillsbury Co. Shareholders Litigation)*, 558 A.2d 1049 (Del. Ch. 1988).

411. The Delaware Court of Chancery paid little attention to and/or

Fortunately, the situation today may not be as bad as it seemed just after the Delaware Court of Chancery announced its decision in *Pillsbury*.⁴¹² The Delaware Court of Chancery's opinions in both *TW Services*⁴¹³ and *Paramount*,⁴¹⁴ as well as the Delaware Supreme Court's opinion in *Paramount*,⁴¹⁵ seem to greatly undercut and limit the impact of *Interco* and *Pillsbury* with regard to poison pills and the related issues that a board must address in a takeover setting. The Delaware Court of Chancery went to great lengths to distinguish its decisions in *TW Services* and *Paramount* from its holdings in *Interco* and *Pillsbury*.⁴¹⁶ This was done to preserve as much of the prior opinions as possible, but however viewed, the opinions in *TW Services* and *Paramount* mark a change in course for the Delaware Court of Chancery and a lessening in significance of the previous two decisions. Possibly the aspect of *TW Services* and *Paramount* that is of greatest importance is the Delaware Court of Chancery's recognition that a board of directors in a takeover setting can choose to maximize the long-term value of a company at the expense of short-term gains.⁴¹⁷ This is sure to be an

misapplied the holdings of the Delaware Supreme Court in *Unocal*, *Revlon*, *Moran*, and other cases. See *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986); *Moran v. Household Int'l, Inc.*, 500 A.2d 1346 (Del. 1985); *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946 (Del. 1985); see also Schwartz, *Chancery Court Ignores Del. Supreme Court Precedents*, *supra* note 3.

Interestingly, the *Interco* court could have better supported its holding without setting the dangerous legal precedents that it did, by concentrating on a valuation-based analysis and argument such as the one I discussed in Part IV(C) of this Article.

412. The Delaware Court of Chancery decided *Pillsbury* on December 16, 1988. *Pillsbury*, 558 A.2d at 1049.

413. *TW Servs., Inc. v. SWT Acquisition Corp.*, Nos. 10427, 10298, 1989 WL 20290 (Del. Ch. Mar. 2, 1989).

414. *Paramount Communications, Inc. v. Time, Inc.*, [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,514 (Del. Ch. July 14, 1989), *aff'd*, 571 A.2d 1140 (Del. 1990).

415. 571 A.2d 1140 (Del. 1990).

416. See *Paramount*, [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,514, at 93,282-83; *TW Servs.*, 1989 WL 20290, at *9-10.

417. See *TW Servs.*, 1989 WL 20290, at *6-7, 11; *Paramount*, [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,514, at 93,267, 93,272, 93,276-77, 93,283, 93,284; see also *supra* part V (discussing the potential negative aspects of this position in the analysis of the Delaware Supreme Court's *Paramount* decision).

argument raised by future boards that are faced with defending against a hostile takeover attempt.

The major failure of the Delaware Court of Chancery in all of these decisions is that the court failed to adequately address the valuation issue, which was the central problem in all four cases and is a critical part of most takeover settings. Until more clearly defined valuation guidelines are established, ones that will lead to more realistic and consistent results, and methodologies are formulated to put the responsibility for valuations on those who conduct and advise on valuations, rather than on those that are advised, the valuation-based litigation that we have seen in recent years will continue. The root of the valuation problem must be addressed and not its end result.

In the final analysis, the poison pill has come through this series of decisions by the Delaware Court of Chancery largely intact.⁴¹⁸ It is still the foremost weapon at the disposal of a board of directors to defend a company against an unwanted, hostile, takeover attempt.⁴¹⁹

418. It can be argued that the poison pill might have even benefitted from this series of Delaware Court of Chancery decisions if one considers that it can be contended that poison pills can be used to defend a company's long-term strategy, even if such a strategy may be at the expense of short-term gains in share value.

419. See *Compounding the Headache*, *supra* note 3.

