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Surviving Enhanced Judicial Scrutiny of Directors' Decisions--Reaching the Protection of the Business Judgment Rule

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Surviving Enhanced Judicial Scrutiny of Directors' Decisions- Reaching the Protection of the Business Judgment Rule

Paramount Communications Inc. v. QVC Network Inc.[1]

I. INTRODUCTION

In the merger and acquisition craze of the 1980's, it became increasingly apparent that shareholders needed protection from directors who were not always acting in the best interests of the corporation. Due to the presumptions raised under the business judgment rule, it was difficult to question the decisions of the directors. Therefore, in a line of cases from 1984 to present, Delaware courts have utilized an "enhanced judicial scrutiny" doctrine which creates threshold conditions for directors to meet before protection under the business judgment rule can be claimed.

This note traces the history of the enhanced judicial scrutiny doctrine and explores the difficulty boards of directors face in characterizing and analyzing the myriad of transactions and events which may occur in a merger or sale scenario. Then, possible courses of action such boards may take to protect themselves are discussed.

II. FACTS AND HOLDING

Paramount, a Delaware corporation headquartered in New York City, owns and operates a diverse group of entertainment businesses.[2] The majority of Paramount's stock is publicly held and traded.[3]

Viacom is a Delaware corporation with its principal offices in Massachusetts.[4] Control of the company rests with Sumner Redstone, who owns a majority of its voting and non-voting stock.[5] Viacom controls a wide range of entertainment operations, including cable television channels.[6]

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1. 637 A.2d 34 (Del. 1993) (hereinafter *Paramount II*).
2. *Id.* at 37.
3. *Id.*
4. *Id.* at 38.
5. *Id.*
6. *Id.*

QVC, also a Delaware corporation, is headquartered in Pennsylvania.[7] Barry Diller, the Chairman and Chief Executive Officer, is a substantial stockholder in the corporation, along with several other large stockholders.[8] QVC owns a cable television shopping channel.[9]

In the late 1980's, Paramount began investigating the possibility of expanding by acquisition or merger with other entertainment-related entities.[10] In 1989, Paramount made an unsuccessful offer to buy Time, Inc.[11] Paramount continued its efforts of strategic expansion, and in 1993 it began to explore a possible affiliation with Viacom.[12]

In September 1993, Paramount's board of directors approved a merger agreement with Viacom.[13] The deal provided that for each share of Paramount stock, the Paramount shareholder would receive 0.10 shares of Viacom Class A voting stock, 0.90 shares of Viacom Class B non-voting stock, and $9.10 in cash.[14] If the merger was completed, the combined corporation would be controlled by Viacom's Mr. Redstone, who would end up owning a majority of the combined company's stock.[15] The proposed agreement also contained a number of defensive measures designed to discourage competing bids from other companies. Three of these measures were: a "no-shop" provision, a Termination Fee, and Stock Option Agreement.[16]

Under the no-shop provision, Paramount's board agreed not to solicit, negotiate, or bargain with any other parties interested in making a competing bid, subject to some conditions.[17] Under the Termination Fee Provision, Viacom would receive a $100 million fee if, due to some action by Paramount's board or shareholders, the deal was not consummated.[18] Under

7. *Id.*

8. *Id.*

9. *Id.*

10. *Id.*

11. *Id. See also* Paramount Communications, Inc. v. Time Inc., 571 A.2d 1140 (Del. 1990) (hereinafter *Time-Warner*).

12. *Paramount II*, 637 A.2d at 38.

13. *Id.* at 39.

14. *Id.*

15. QVC Network v. Paramount Communications Inc., 635 A.2d 1245, 1251 (Del. Ch. 1993) (hereinafter *Paramount I*).

16. *Paramount II*, 637 A.2d at 39.

17. *Id.* For instance, the board agreed not to solicit, encourage, discuss, negotiate, or endorse any competing offers unless (1) "a third party 'makes an unsolicited written, bona fide proposal, which is not subject to any material contingencies relating to financing'" *Id.*; and, (2) the board determines that contact with the third party is necessary to satisfy its fiduciary duties.

18. *Id.*

the Stock Option Agreement, which is also called a stock-option lockup, Viacom had the right to buy 19.9% of Paramount's stock at a predetermined price if any of the triggering events under the Termination Fee provision occurred.[19] In addition, the stock-option lockup had two provisions not customarily contained in such agreements: (1) Viacom could purchase the stock with a note of questionable marketability[20] instead of cash; and, (2) if Viacom so desired, it could purchase the stock with cash at a price equal to the difference between the fair market value of Paramount's stock and the predetermined stock price.[21] These two additional provisions, needless to say, were highly beneficial to Viacom.[22]

After the deal was announced to the public, QVC began to court Paramount in the hopes of acquiring it. On September 20, 1993, QVC made a bid of $80 per share for Paramount's stock, and expressed its desire to meet with Paramount's board and negotiate the details of a possible buy-out.[23] Paramount's board, concerned with violating the no-shop provision, asked for, and received, additional information regarding the financing of QVC's bid.[24] Satisfied that the no-shop provision would not be violated, the board began negotiations with QVC; however, negotiations proceeded very slowly.[25]

On October 21, 1993, QVC publicly announced an offer to buy controlling interest in Paramount by paying $80 per share.[26] In addition, QVC filed a suit with the Court of Chancery of Delaware requesting an injunction barring the Paramount/QVC merger, as well as requesting the invalidation of the Stock Option Agreement, worth over $200 million at that point.[27]

At this point, Viacom realized it would have to revise its bid in order to compete. Therefore, Viacom began to negotiate with Paramount in order to revise its earlier agreement.[28] On October 24, 1993, an amended agreement was approved in which Viacom increased its offer to $80 per share, but left intact the defensive provisions of the earlier agreement.[29]

QVC continued to press Paramount by requesting guidelines calling for a "fair bidding process" which were rejected by Paramount because "auction

19. *Id.*
20. Commonly known as "junk bonds".
21. *Id.*
22. *Id.*
23. *Id.*
24. *Id.* at 39-40.
25. *Id.* at 40.
26. *Id.*
27. *Id.*
28. *Id.*
29. *Id.*

procedures" were contrary to its agreement with Viacom.[30] On November 6, Viacom made a sweetened bid of $85 per share.[31] QVC responded on November 12 by raising its offer to $90 per share.[32] On November 15, the Paramount board decided that the QVC offer was not acceptable because it was "excessively conditional."[33] Importantly, Paramount did not communicate with QVC regarding the details of the conditions because it believed that the no-shop provision precluded any negotiation on its part.[34] After this final rejection, QVC continued its fight in court.

QVC's position was that the Paramount board breached its fiduciary duty in three major ways: (1) once the board agreed to a transaction involving a change of control from Paramount's public stockholders to Sumner Redstone, it became subject to duties articulated in *Revlon Inc. v. MacAndrews & Forbes Holdings, Inc.*,[35] which require the board to obtain the highest possible value for the shareholders without creating obstacles hindering that goal;[36] (2) the board failed to exercise its fiduciary duty of due care to adequately consider all of the information available and did not adequately inform itself before making a decision;[37] and (3) the board failed the reasonableness standard under the enhanced scrutiny doctrine mandated by *Unocal Corp. v. Mesa Petroleum Co.*[38] QVC argued that its offers could not be construed as threats to Paramount and its stockholders.[39]In the alternative, QVC asserted that even if its offers were a threat, Paramount's response was unreasonable.[40]

30. *Id.* at 41.
31. *Id.*
32. *Id.*
33. *Id.*
34. *Id.*
35. 506 A.2d 173 (Del. 1986).
36. *Paramount I*, 635 A.2d at 1261.
37. *Id.*
38. 493 A.2d 946 (Del. 1985). "*Unocal* requires that the directors demonstrate that they reasonably perceived QVC's proposal as representing a threat to corporate policy and effectiveness, and that the measures they took in response were reasonable and proportionate in relation to that threat." *Paramount I*, 635 A.2d at 1262.
39. *Paramount I*, 635 A.2d at 1262.
40. *Id.* Paramount responded by implementing a Termination Fee and a Stock-Option Lockup. A $100 million Termination Fee would be paid to Viacom if: "(a) Paramount terminated the Original Merger Agreement because of a competing transaction; (b) Paramount's stockholders did not approve the merger; or (c) the Paramount Board recommended a competing transaction." *Paramount II*, 637 A.2d at 39. The Stock Option Agreement "granted to Viacom an option to purchase approximately 19.9 percent (23,699,000 shares) of Paramount's outstanding common stock at $69.14 per share if any of the triggering events for the Termination Fee occurred." *Id.*

Paramount disputed QVC's allegations, insisting that the board exercised diligent due care and was fully informed at all times.[41] They argued that the transaction with Viacom was more advantageous to Paramount than QVC's offer for several reasons, even though QVC's offer looked more valuable on its face.[42] First, Viacom had many entertainment companies which, combined with Paramount's several companies, would offer the combined company many growth opportunities.[43] QVC, with only its Home Shopping Program, could not offer the same opportunities for growth.[44] Second, a combined Paramount/QVC company would consist primarily of Paramount assets, which could not generate enough income to sustain the $90 acquisition price.[45] Third, much of the deal was on the "back end" of the merger, depending upon the value of the stock of QVC at the time of the merger, which was too closely tied to market perceptions of Mr. Diller and QVC's prospects of acquiring Paramount.[46] Fourth, QVC had placed too many conditions on the deal to which Paramount had no control.[47] Therefore, Paramount's board contended that it was reasonable for them to reject QVC's offer, and that their use of the defensive provisions in their agreement with Viacom were reasonable as well.[48]

The Court of Chancery held that due to the proposed change of control, Paramount's board was subject to enhanced judicial scrutiny under the *Revlon* doctrine.[49] In addition, the court found that the board breached its fiduciary duties of due care and diligence by failing to fully inform itself before making a decision.[50] Finally, since fiduciary duties were breached, the board could not utilize its "poison pill" or other defensive antitakover provisions.[51]

Upon appeal, the Delaware Supreme Court affirmed the Order of the Court of Chancery.[52]

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41. *Paramount I*, 635 A.2d at 1262.
42. *Id.* at 1263.
43. *Id.*
44. *Id.*
45. *Id.*
46. *Id.*
47. *Id.*
48. *Id.*
49. *Id.* at 1266.
50. *Id.* at 1269.
51. *Id.* at 1270.
52. *Paramount II*, 637 A.2d at 51.

III. LEGAL BACKGROUND

Since the acquisition and merger boom of the 1980's, Delaware courts have increasingly been asked to define and refine the fiduciary duties of directors in the consideration of merger transactions. Following is a summary of the history of the evolution of the "enhanced judicial scrutiny" doctrine, showing how the fiduciary obligations of directors have grown since the early 1980's.

A. *Aronson v. Lewis*[53]

Normally, directors making business decisions rely on the business judgment rule to protect them from liability. The rule is a presumption that directors of a corporation make business decisions in good faith and in the honest belief that decisions are made with the best interests of the corporation in mind.[54] When the presumption holds true, the court will not substitute its judgment for that of the directors.

However, *Aronson* indicated that at least two conditions must be met before directors could claim protection under the business judgment rule.[55] First, the protections of the rule can only be utilized by "disinterested directors whose conduct otherwise meets the test of business judgment."[56] The second and most important condition is that the directors must fully inform themselves of all material information reasonably available before making a decision.[57] This becomes important in the analysis the court uses in later cases. If the directors do not meet these "preconditions," then the actions of the board do not fall under the business judgment rule, and judicial scrutiny of the decision will result.

B. *Unocal Corp. v. Mesa Petroleum Co.*[58]

Unocal adds to the preconditions elucidated in *Aronson* that must be met before directors can claim any protection under the business judgment rule. While *Aronson* involved a shareholder derivative suit, *Unocal* came about in a change of control context. Mesa Petroleum, a minority shareholder, made a hostile tender offer for Unocal's stock.[59] Unocal's directors rejected the

53. 473 A.2d 805 (Del. 1984).
54. *Id.* at 812.
55. *Id.*
56. *Id.*
57. *Id.*
58. 493 A.2d 946 (Del. 1985).
59. *Id.* at 949.

offer as inadequate and, as a defensive tactic, decided to effect a self-tender offer for the corporation's own shares.[60] The directors argued that their actions came under the business judgment rule because they acted in good faith, on an informed basis, and used due care.[61] The court opined that when change in control of a corporation is threatened, a board is likely to act primarily in its own interests in lieu of the corporation's. Therefore, "there is an enhanced duty which calls for judicial examination at the threshold before the protections of the business judgment rule may be conferred."[62] Specifically, directors facing this situation must meet two additional conditions: (1) they must prove that is was reasonable for them to believe there was a danger to corporate policy and effectiveness; and, (2) the defensive measure must be reasonable in relation to the threat posed.[63] If the directors meet this threshold, then they will enjoy the protection of the business judgment rule.[64] Interestingly, the court ruled that the directors could consider the impact of their decision on "constituencies" other than shareholders.[65] The importance of this decision for a board is that it does not have to necessarily accept a "great" buyout offer; it can consider preserving the corporate culture and autonomy as more important than "selling out."

From a practical standpoint, in situations where control of a corporation is at stake, *Unocal* sets out a reformulated business judgment rule for boards of directors.[66] Directors now bear the burden of proof to show grounds for reasonable belief that danger to corporate effectiveness existed, and the defensive measures they employed were reasonable to the threat posed.[67] Once met, the burden shifts back to the plaintiff under the traditional business judgment rule to prove that the board of directors failed to properly exercise its fiduciary duty.[68]

60. *Id.* at 950.

61. *Id.* at 953.

62. *Id.* at 954.

63. *Id.* at 955.

64. *Id.*

65. These include "creditors, customers, employees, and . . . the community". *Id.*

66. Richard C. Brown, *The Role Of The Court In Hostile Takeovers*, 93 DICK. LAW. REV. 195, 241 (1989).

67. *Id.* at 240.

68. *Id.* at 241.

C. *Revlon, Inc. v. MacAndrews & Forbes Holdings Inc.*[69]

In this case, the Delaware Supreme Court utilized enhanced judicial scrutiny in yet another situation: Acquisition of a corporation (Revlon) through an active bidding process by more than one suitor. Faced with a hostile takeover attempt by Pantry Pride (owned by MacAndrews), Revlon instituted certain defensive measures.[70] When Pantry Pride continued its hostile efforts, Revlon began looking for a new suitor, finally negotiating a sale to another company.[71] In holding that this defensive measure violated the fiduciary duties of the directors, the court indicated that once the sale of the corporation became inevitable, responsibilities of the directors shifted from the preservation of the corporation as an entity to the duty to obtain the highest possible price for the shareholders.[72] In similar instances, directors can consider only the interests of the shareholders, (concern for other constituencies became irrelevant), and their only goal can be to gain the highest possible price in the sale of the corporation. This differed from *Unocal* in that trying to preserve the corporate entity is no longer an option in a sale; achieving the highest price is the only option. Anything to the contrary would invite enhanced judicial scrutiny. Again, if the directors could satisfy this threshold requirement, they would be protected by the business judgment rule.[73]

In effect, the *Revlon* court "applied the *Unocal* standard in a more rigorous manner that was distinguishable from the traditional business judgment rule."[74]

Subsequent court decisions refined the *Unocal/Revlon* conditions in different contexts and factual situations.[75] One question which still remained: how did *Unocal* and *Revlon* fit together?

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69. 506 A.2d 173 (Del. 1989).

70. *Id.* at 176-77.

71. *Id.* at 176-78.

72. *Id.* at 182.

73. *Id.* at 184.

74. Melissa M. Kurp, *Corporate Takeover Defenses After QVC: Can Target Boards Prevent Hostile Tender Offers Without Breaching Their Fiduciary Duties?*, 26 LOY. U. CHI. L.J. 29, 38 (1994).

75. *See, e.g., In Re* J.P. Stevens & Co., Inc. Shareholders Litigation, 542 A.2d 770 (Del. Ch. 1988); City Capital Assoc. Ltd. Partnership v. Interco Inc., 551 A.2d 787 (Del. Ch. 1988); Citron v. Fairchild Camera and Instrument Corp., 569 A.2d 53 (Del. 1989).

D. Mills Acquisition Co. v. MacMillan Inc.[76]

Mills answered this question. The case involved the sale of MacMillan through an active bidding process. When faced with a hostile takeover, break-up of the corporation is not inevitable, and *Unocal* says that defensive measures instituted to continue the existence of the corporation are acceptable if reasonable.[77] However, once the decision is made to sell the company, change in control becomes inevitable, and focus under *Unocal* shifts to the *Revlon* duties to obtain the best possible deal for the shareholders.[78] If the directors favor one bid over another, they must show that they reasonably believed that the shareholder benefitted by such favoritism (a *Unocal*-type analysis).[79] Again, once these preconditions are met, the business judgment rule will protect the board.[80]

Another question remained: what exactly constitutes a "sale" so that these duties are triggered?

E. Paramount Communications Inc. v. Time Inc.[81]

In this case, Time was planning a strategic merger with Warner Communication Inc. Paramount made a hostile cash tender offer for Time. As a result of this hostile effort, Time restructured its merger with Warner into an acquisition by Warner of a majority of Time's stock.[82] Paramount argued that this defensive tactic was an agreement to put Time up for "sale," thus triggering *Revlon* duties to obtain the best possible deal for the shareholders.[83] Since the stock of the combined companies would remain with a large group of fluid, changeable shareholders, the court held that no "sale" or change of control transaction occurred, and, therefore, the *Revlon* duties were not triggered.[84] The argument shifted to the *Unocal* analysis, and the court held that the defensive tactic met that test.[85]

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76. 559 A.2d 1261 (Del. 1989)
77. *Unocal,* 493 A.2d at 958.
78. *Revlon,* 506 A.2d at 184-85.
79. *Mills,* 559 A.2d at 1287-88.
80. *Id.* at 1288.
81. 571 A.2d 1140 (Del. 1990).
82. *Id.* at 1143-49.
83. *Id.* at 1149.
84. *Id.* at 1151.
85. *Id.* at 1155.

IV. THE INSTANT DECISION

A. Change of Control Transaction

The *Paramount II* court addressed a problem left unanswered in previous cases: What is the definition of "change of control transaction" which triggers the *Revlon* duties? Paramount argued that under *Revlon*, a break-up of the company must be inevitable in order to have a change of control transaction.[86] Paramount viewed the sale of their stock to Viacom as a strategic alliance between the two companies.[87] Since the company would continue to be an entity after the sale, Paramount felt that its situation paralleled the *Time-Warner* scenario and did not constitute a "sale." Therefore, the defensive tactics they employed in their agreement with Viacom should fall under the *Unocal* reasonableness standard.

The Delaware Supreme Court disagreed. They specifically stated that a break-up of a company did not have to occur in order to have a change of control transaction.[88] They placed importance on the fact that in *Time-Warner*, control of the stock would remain in the hands of a large, fluid, and changing group of stockholders, much like before the transaction.[89] In contrast, control of a combined Paramount/Viacom entity would rest with one person, Sumner Redstone of Viacom. This situation would be much different than in Time/Warner. Since the risk to minority shareholders was greater in this instance, enhanced judicial scrutiny was necessary.[90] The court held that the Paramount/Viacom deal was a change in control transaction, thus triggering *Revlon* duties.[91]

B. Enhanced Judicial Scrutiny and Breach of Duties

Specifically, the court found that the Paramount directors had four obligations: (1) to be diligent and vigilant in examining and considering both the Viacom transaction and QVC's tender offer; (2) to act in good faith; (3) to obtain and carefully act on all reasonably available information, including that which was needed to compare the two offers, looking towards what would

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86. *Paramount II*, 637 A.2d at 46. Paramount had reason to believe this, based upon their experience with Time in *Time-Warner*. In that case, Paramount lost because the court held that the acquisition of a majority of Time's stock by Warner was not a sale. *Time-Warner*, 571 A.2d at 1151.

87. *Paramount II*, 637 A.2d at 36.

88. *Id.* at 47.

89. *Time-Warner*, 571 A.2d at 1151.

90. *Paramount II*, 637 A.2d at 47.

91. *Id.* at 48.

provide the best value to the stockholders; and (4) to actively negotiate in good faith with both suitors.[92] In holding that the Paramount directors did not meet these obligations, the court stated: "We conclude that the Paramount directors' process was not reasonable, and the result achieved for the stockholders was not reasonable under the circumstances."[93] Due to the No-Shop Provision, the board was prevented from actively negotiating with other bidders, thus limiting its ability to gather material information in which to make an informed decision. Further, the board's failure to eliminate or modify the counterproductive defensive devices showed that they gave insufficient attention to the potential consequences of such measures.[94] These problems caused the Paramount directors to "squander" any opportunity to negotiate for the stockholders and to fulfill their duty to secure the best value reasonably available.[95]

V. COMMENT

A. Change of Control Transaction-A Clear Definition?

This decision leaves Paramount in a quandry, because it appears that it lost from both sides of quite similar transactions. In *Time-Warner*, the court allowed Time to be sold to Warner without the transaction being defined as a "change in control" because the sale was made from one large, fluid, and changing group of stockholders to another.[96] When Paramount found itself in Time's position in its fight with QVC, it logically used the same argument that Time used against it. Paramount lost again when the court distinguished *Time-Warner*, reasoning that control was not going to another large, fluid group of stockholders; control was going to one person, Sumner Redstone of Viacom[97] Why was the latter a change of control while the former was not? The court explained that in the latter situation, the risk to minority shareholders was greater.[98] It reasoned that if control rests with only one person, he can more easily and quickly move to the detriment of minority shareholders.[99] If contol rests with a large group of fluid stockholders,

92. *Id.*
93. *Id.* at 49.
94. *Id.* at 49-50.
95. *Id.* at 50.
96. *Time-Warner*, 570 A.2d at 1151.
97. *Paramount I*, 635 A.2d at 1251.
98. *Paramount II*, 637 A.2d at 47.
99. *Id.*

minority shareholders are in no worse position than they were before the transaction; control, in effect, did not really pass to anyone.[100]

However, even if control rests with one person, the court recognized that minority shareholders were protected by the imposition of fiduciary duty upon the controlling shareholder.[101] The court does not explain why this fiduciary duty is not adequate to protect minority shareholders and why an enhanced judicial scrutiny doctrine, administered by the courts, offers better protection.

B. *Unocal or Revlon: Which Analysis Controls?*

The *Revlon* standard has been described as "a more rigorous *Unocal* test."[102] The *Unocal* test has been termed a "reformulated business judgment rule."[103] What does *Paramount II* add to the analysis?

As described earlier, the traditional business judgment rule is a presumption that directors make business decisions in good faith and in the honest belief that decisions are made with the best interests of the corporation in mind, based on the conditions that the directors must fully inform themselves of all material information reasonably available, and they must be disinterested.[104] *Revlon*'s pertinent addition to the *Unocal* framework of analysis is that once a change in control becomes inevitable, the best interests of the corporation are limited exclusively to securing the best value for the shareholders that is reasonably available.[105]

Paramount II adds nothing to the *Unocal/Revlon* standards of analysis. *Paramount II's* importance is as a definitional tool to give a board clearer guidelines to use in determining which analytical framework (*Unocal* or *Revlon*) controls in a specific situation.

C. *Defensive Antitakover Measures-When Can They Be Used?*

Certainly, as long as a company is trying to fight off a hostile takeover where there is no change of control contemplated, *Unocal* states that defensive

100. "But here, effectuation of the merger would not have subjected Time shareholders to the risks and consequences of holders of minority shares. This is a reflection of the fact that no control passed to anyone in the transaction contemplated." *Id.*

101. *Id.*

102. Kurp, *supra* note 74, at 40.

103. Brown, *supra* note 66, at 241.

104. See *supra* notes 53-56 and accompanying text. *See also, generally,* Dan L. Goldwasser and Edward Himmelfarb, *The Business Judgment Rule: 1985 Developments,* 507 PLI/CORP 329 (1985).

105. See *supra* notes 65-69 and accompanying text.

measures may be employed if reasonable.[106] However, the question remains whether defensive tactics can ever be used when *Revlon* controls.

In *Mills*, the court held that measures such as lock-ups or no-shop provisions are not invalid per se as long as they further the bidding process and enhance the opportunity to advance the interests of the stockholders.[107] However, the court in *Paramount II* stated, "[w]hile we have held that lock-up options are not per se illegal...no options with similar features have ever been upheld by this Court."[108] It is difficult to imagine a situation where such defensive tactics would encourage bidders, thus enhancing the value to the stockholders. Therefore, in a change of control situation, it appears that any defensive measures are going to be scrutinized by the courts.[109] This means that the courts will increasingly use their "enhanced judicial scrutiny" doctrine to review directors' decisions in these areas.

D. The Importance of Characterization

Paramount II illustrates the importance of correctly characterizing the type of transaction involved in the sale of a company, and it also goes a long way toward defining how the courts will interpret these transactions.

The Paramount board proceeded under the assumption that their actions would be judged under the *Unocal* framework. Using that standard of analysis, a good argument can be made that the board's decisions were reasonable. However, the board did not count on *Revlon* controlling; under that framework, many of its actions were unreasonable. Therefore, it is very important that a board be able to clearly define what it is trying to do.

One thing that doomed Paramount was its refusal to consider that its situation had changed dramatically. While it more closely resembled the *Unocal* scenario in the beginning, the situation quickly came to resemble *Revlon* more closely once QVC entered the picture. As the court noted, Paramount did not have a procedure in place that would allow it to consider new information;[110] rather, it developed a "bunker" mentality, refusing to solicit and consider new information.

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

107. *Mills*, 559 A.2d at 1287.

108. *Paramount II*, 637 A.2d at 51.

109. *See, e.g.*, Rand v. Western Air Lines, Inc., 1994 WL 89006 (Del. Ch.); In Re Holly Farms Corporation Shareholder Litigation, 1988 WL 143010 (Del. Ch.); Cede and Co. v. Technicolor, Inc., 634 A.2d 345 (Del. 1993).

110. *Paramount II*, 637 A. 2d at 48.

E. Actions Directors Can Take To Guarantee Satisfaction of Fiduciary Duties

As discussed earlier, the line of cases from *Aronson* to *Paramount II* indicate that certain preconditions must be met as a threshold before a board can claim protection under the business judgment rule. When the court deems that a change in control transaction exists, the directors have a duty to obtain the best price possible (*Revlon*).[111] If defensive tactics are employed, they must be reasonable in that they enhance, rather than hinder, the bidding process (*Unocal*).[112] What can directors do to meet this threshold?

One of the criticisms of the board in *Paramount I* was that it did not have an adequate process by which to keep itself fully informed in order to make a reasoned, well informed decision.[113] Therefore, it appears that one thing a board must do is to have a reasonable and open process which ensures that it gets complete, accurate, and timely information upon which to base a decision.[114]

Another problem is the bidding process itself. Once it became clear that the company was up for sale, Paramount made no effort to modify or eliminate the defensive measures it negotiated with the favored suitor, Viacom.[115] In order to ensure that it meets its fiduciary duties, it appears that a board must include in its process a way to modify or eliminate any defensive measures which appear to favor one bidder over another once it becomes apparent that the measures are hindering the auction process.

VI. CONCLUSION

A board must correctly determine whether *Unocal* or *Revlon* controls in its particular situation. Once this has been decided, the directors will know which preconditions they must meet in order to survive enhanced judicial

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

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

113. *Paramount II*, 637 A.2d at 50. "When the Paramount directors met on November 15 to consider QVC's increased tender offer, they remained prisoners of their own misconceptions and missed opportunities to eliminate the restrictions they had imposed on themselves." *Id.*

114. "Directors who have undertaken the responsibility of selling the corporation must take an 'active and direct role' in the process." Kahn v. Caporella, 1994 WL 89016, *5 (Del. Ch.). *See also* Alfred Dennis Mathewson, *Decisional Integrity and The Business Judgment Rule: A Theory*, 17 PEPP. L. REV. 879 (1990); Morton Moskin, *Trans Union: A Nailed Board*, 10 DEL. J. CORP. L. 405 (1985).

115. *Paramount II*, 637 A.2d at 50.

scrutiny. Then, a plaintiff must overcome the presumptions of the business judgment rule in order to set aside the board's decision.

After properly characterizing its transaction, a board's next step would be to utilize a process which is easily indentifiable as fair, open, and reasonable, attracting full and complete information, and encouraging a fair and open bidding process. If it does these things, then a board will likely meet the threshold requirements outlined in the preceding cases.

Additionally, a board must be able to recognize when circumstances may dramatically change a situation and it must be willing to modify its position accordingly. This may include amending or even eliminating any defensive anti-takeover devices. If these areas are addressed, then a board will likely enjoy the protection of the business judgment rule, even if its decision later turns out to be less than optimal, no matter which standard a court may apply.

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