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Corporate Takeover Defenses After *QVC:* Can Target Boards Prevent Hostile Tender Offers Without Breaching Their Fiduciary Duties?

By Melissa M. Kurp[*]

The 1980s became the decade of the corporate takeover.[1] Until recently, takeover activity in the 1990s has paled in comparison for various reasons, including the recent recession, increased equity prices, and continued reluctance of traditional lenders to finance acquisitions.[2] Media coverage of the QVC and Viacom contest for control of Paramount has focused the public's attention once again on the corporate takeover.

Along with the renewed interest in corporate acquisitions is a reminder that many takeover-related issues brought to the forefront of corporate jurisprudence in the 1980s remain unresolved. One of the most important of these unsettled issues is the validity of takeover defenses.[3] In a corporate climate where shareholders demand that directors of corporations justify their every action,[4] an issue of great concern to corporate directors is their ability to fend off hostile tender offers without breaching any fiduciary duties to the corporation or shareholders. Before analyzing takeover defenses and corporate directors' ability to use them, this Article first will explore the basics of corporate takeovers.

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1. *See* Joseph Kershenbaum, Note, *Corporate Law—A Snapshot of the Takeover Decade:* Polaroid Corp. v. Disney—*Whether a Target Corporation has Third Party Standing to Assert a Violation of the All-Holders Rule*, 13 W. NEW ENG. L. REV. 63, 63 n.2 (1991); Harvey L. Pitt, *On the Precipice: A Reexamination of Directors' Fiduciary Duties in the Context of Hostile Acquisitions*, 15 DEL. J. CORP. L. 811, 812 n.7 (1990); HAROLD S. BLOOMENTHAL ET AL., EMERGING TRENDS IN SECURITIES LAW § 4.01 (1990).

2. John M. Olson, *The Fiduciary Duties of Insurgent Boards*, 47 BUS. LAW. 1011, 1011 (1992).

3. Robert A. Ragazzo, *The Legitimacy of the Takeover Defense in the '90s*, 41 DEPAUL L. REV. 689, 690 (1992).

4. *See, e.g.*, Carol Hymnowitz, *More Employees, Shareholders Demand That Sacrifices in Pay Begin At the Top*, WALL ST. J., Nov. 8, 1990, at B1; Alexandra Peers, *Inside Track*, WALL ST. J., June 26, 1991, at C1.

I. THE BASICS OF CORPORATE TAKEOVERS

A corporate takeover involves a change of corporate control, usually prompted when an acquirer[5] makes a tender offer[6] to the shareholders of a target corporation.[7] In the wake of the first wave of corporate takeovers, Congress passed the Williams Act[8] in 1968 to supplement the Securities Exchange Act of 1934 (the "Exchange Act")[9] and to regulate corporate takeovers in the national markets. The main objective of the Williams Act is to protect investors in target corporations.[10] To protect target shareholders, the Williams Act regulates tender offers by requiring full disclosure of tender offers and establishing procedural rules governing tender offers.[11] The Williams Act also contains an antifraud provision directed at both the acquirer and the target board to prevent influencing the decision of investors or the outcome of the tender offer.[12]

In a takeover contest, the acquirer's weapon is the attractiveness of the offer. By contrast, the target board is equipped with a full arsenal of weapons to fend off the acquirer. Collectively, the arsenal of the target board is commonly referred to as "takeover defenses."[13] Target boards may implement a variety of takeover defenses, including: (1) effecting stock repurchases; (2) engaging white knights; (3) incorporating no-shop provisions in agreements with a friendly acquirer; (4) accelerating loans; (5) providing for golden parachutes; (6) selling crown jewels; (7) creating employee stock option plans ("ESOPs"); (8)

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5. Often, more than one acquirer is involved in a contest for corporate control.

6. A tender offer occurs when a person or group offers to purchase from stockholders of a target corporation their stock in that corporation. 13A BYRON E. FOX & ELAENOR M. FOX, BUSINESS ORGANIZATIONS, CORPORATE ACQUISITIONS & MERGERS § 27.01 (1992). Tender offers can be either friendly or unfriendly. A friendly offer involves a change of control between parties who want to effect a sale to the benefit of both parties; an unfriendly offer typically involves a contest for corporate control between the acquirer and target management. *Id.*

7. Throughout this Article, a corporation, including its directors, management and shareholders, which is the subject of a tender offer will be referred to as the target corporation, target board or target stockholders. The person or group that is making the offer to the target shareholders will be referred to as the acquirer(s) or the acquiring corporation.

8. Pub. L. No. 90-439, 82 Stat. 454 (codified at 15 U.S.C. §§ 78l, 78m, 78n (1988)).

9. Securities Exchange Act of 1934, ch. 404, 48 Stat. 881 (codified as amended at 15 U.S.C. §§ 78a-78ll (1988)).

10. *See* H.R. REP. NO. 1711, 90th Cong., 2d Sess. (1968), *reprinted in* 1968 U.S.C.C.A.N. 2811.

11. *See* 15 U.S.C. §§ 78m(d)-(f) (1988).

12. 15 U.S.C. § 78n(e) (1988).

13. *See infra* part IV for examples and detailed explanation of takeover defenses and how they are implemented.

instituting defensive lawsuits; and (9) implementing poison pill rights plans.[14] Generally, target boards are driven to implement defensive tactics in order to: (1) protect shareholders and (2) maintain control over the corporation. Because these two goals are often conflicting, directors are rightfully wary of possibly breaching their fiduciary duty to the corporation and its shareholders.

To test the legality of target boards' use of takeover defenses, courts generally use an "enhanced" business judgment rule.[15] The traditional business judgment rule provides that, in the absence of bad faith or self-dealing, a court will not interfere with the judgment of a board of directors.[16] Because the threat of a takeover bid may give rise to a conflict-of-interest situation,[17] courts have shifted the burden under the traditional business judgment rule from the plaintiff, usually either the acquirer and/or the target shareholders, to the target board, creating an enhanced business judgment rule, otherwise known as the *Unocal* standard.[18] Depending upon the circumstances, however, a court's application of the enhanced business judgment rule may only mirror the traditional business judgment rule.[19]

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14. For an explanation of each defense see *infra* part IV.B.

15. *See infra* part II.A. The traditional business judgment rule shields directors from liability for their conduct in the daily management of the corporation. *Responsibilities of Corporate Officers & Directors Under Federal Securities Laws*, FED. SEC. L. REP. (CCH) No. 1438, ¶ 707 (Mar. 15, 1991) [hereinafter *Responsibilities of Corporate Officers*]. Because the business judgment rule is a function of corporate law, implementation of the rule may vary among jurisdictions. *Id.* Basically, the rule prevents a court from interfering with the decision of a board of directors so long as the directors' business judgments are: (1) attributable to any rational business purpose; and (2) made by directors who have informed themselves of all the information reasonably available. *Id.*; *see, e.g.*, Smith v. Van Gorkom, 488 A.2d 858 (Del. 1985).

In addition to these two requirements, the enhanced business judgment rule, sometimes referred to as the "*Unocal* standard," requires directors to: (1) prove that they reasonably believed that the acquirer threatened the company; and (2) prove that their response (implementation of takeover defenses) was reasonable in relation to the threat posed. Unocal Corp. v. Mesa Petroleum Corp., 493 A.2d 946, 955 (Del. 1985); *see infra* part II.A. Thus, under the *Unocal* standard, a target board cannot rely on the business judgment rule until all four requirements are met.

Although courts usually apply an enhanced business judgment rule leniently, a court will invalidate a takeover defense that indirectly affects the right of shareholders to participate in the premium offered by the hostile bidder if the primary purpose of the target management is to maintain corporate control or to prevent shareholders from obtaining the highest value for their stock. *See infra* part II.

16. *Responsibilities of Corporate Officers*, *supra* note 15, ¶ 707.

17. A successful hostile takeover usually results in a change in the board of directors. Consequently, target boards often have a large stake in the outcome of a takeover contest.

18. *See infra* part II.

19. *See infra* part II.

The circumstances that surround a target board's decision to employ a takeover defense affect a court's decision as to whether the enhanced business judgment rule will shield directors from liability. For example, pre-offer defenses[20] usually do not come under as much judicial scrutiny as post-offer defenses[21] and, therefore, courts are much more likely to allow the implementation of a pre-offer defense as a mere business decision under a lenient application of the enhanced business judgment rule.[22] Courts also apply the enhanced business judgment rule to post-takeover defenses in a lenient fashion, unless circumstances require otherwise.[23] Although courts have haphazardly applied the enhanced business judgment rule over the years, this Article asserts that a pattern has emerged: Courts will only scrutinize the use of takeover defenses under an enhanced business judgment standard when the target board implemented the defenses after it placed the target corporation up for sale.[24]

This Article will provide a comprehensive examination of corporate takeover defenses and their availability to target boards in defending against an unwanted tender offer. Part II discusses the judicial response to takeover defenses by describing the past uncertainty of the application of the enhanced business judgment rule and the recent emergence of a pattern in the courts' scrutiny of takeover defenses. Part III analyzes the Delaware Supreme Court's recent decision in the QVC-Paramount takeover battle and demonstrates that, after *QVC*, a court will scrutinize a target board's actions in response to a hostile bid, rather than accord it protection under the business judgment rule, only when the action is taken after the target board has placed the target corporation up for sale. Part IV describes the most frequently employed takeover defenses, distinguishing between those defenses implemented in the pre-tender offer period and those defenses implemented in the post-tender offer period. In addition, Part IV will provide specific examples of how courts have reacted to certain

20. Pre-offer defenses are those implemented by a board of directors prior to any tender offer. *See* Debra Denise Palmer, Comment, *Corporate Takeover Battles—Shark Repellant Charter and Bylaw Provisions that Deter Hostile Tender Offers or Other Acquisitions—A Comprehensive Examination*, 27 HOW. L.J. 1683, 1687 & n.10 (1984); *see infra* part IV.A.

21. Post-offer defensive tactics are those tactics implemented by a board of directors after the acquirer makes the tender offer. *See* Palmer, *supra* note 20, at 1687 & n.10; *see infra* part IV.B.

22. *See infra* part II.B.

23. *See infra* part II.B.

24. *See infra* note 54.

defenses in the past and the impact of the *QVC* decision on the availability of defenses in the future.

II. JUDICIAL RESPONSE TO TAKEOVER DEFENSES

The takeover contests of the 1980s shaped the current marketplace for corporate control. These contests were fought in the courts of Delaware by entrepreneurial raiders aligned with individual shareholders[25] against directors and management of large public corporations.[26] Most courts, in Delaware[27] and elsewhere,[28] generally determine the validity of these defenses by applying the business judgment rule in one form or another.[29]

A. *Standards of Judicial Review: The* Unocal *Approach*

The early decisions on the validity of takeover defenses held that the business judgment rule protected board action. So long as directors could articulate valid business purposes for the implementation of takeover defenses, courts found such actions valid.[30]

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25. One author claims that the shareholder plaintiffs were seeking to "enforce the right to sell their property." Samuel N. Levin, *Raiding the Establishment: New Perspectives on Takeover Law*, 26 U. RICH. L. REV. 507, 511 (1992).

26. *See id.*

27. *See, e.g.*, QVC Network, Inc. v. Paramount Communications Inc., 635 A.2d 1245, 1264-66 (Del. Ch. 1993), *aff'd*, 637 A.2d 34, 41-42 (Del. 1994); *see also* Paramount Communications, Inc. v. Time Inc., 571 A.2d 1140, 1152 (Del. 1990); Mills Acquisition Co. v. Macmillan, Inc., 559 A.2d 1261, 1287-88 (Del. 1989); Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 179-82 (Del. 1986); Moran v. Household Int'l, Inc., 500 A.2d 1346, 1350 (Del. 1986); Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 954 (Del. 1985).

28. *See, e.g.*, International Ins. Co. v. Johns, 874 F.2d 1447, 1459 (11th Cir. 1989); Hanson Trust PLC v. ML SCM Acquisition Inc., 781 F.2d 264, 273 (2d Cir. 1986); Radol v. Thomas, 772 F.2d 244, 257-58 (6th Cir. 1985), *cert. denied*, 477 U.S. 903 (1986); Jewel Cos. v. Pay Less Drug Stores Northwest, Inc., 741 F.2d 1555, 1560-61 (9th Cir. 1984); Panter v. Marshall Field & Co., 646 F.2d 271, 295 (7th Cir.), *cert. denied*, 454 U.S. 1092 (1981).

29. *See supra* note 15 and accompanying text. A minority of courts continue to hold the view that the business judgment rule should not apply to determine the validity of defensive measures. DENNIS J. BLOCK ET AL., THE BUSINESS JUDGMENT RULE: FIDUCIARY DUTIES OF CORPORATE DIRECTORS 233-37 (4th ed. 1993). This Article focuses on the decisions that apply the business judgment rule or variations thereof.

30. *See, e.g.*, Buffalo Forge Co. v. Ogden Corp., 717 F.2d 757 (2d Cir.) (affirming the lower court's use of the business judgment rule to validate a takeover defense), *cert. denied*, 464 U.S. 1018 (1983); *Panter*, 646 F.2d at 293-94 (noting that mere allegation of a desire of incumbent directors to retain their positions was insufficient to shift burden of proof to directors); Martin Marietta Corp. v. Bendix Corp., 549 F. Supp. 623, 634 (D. Md. 1984) (applying business judgment rule); Cheff v. Mathes, 199 A.2d 548, 554 (Del. 1964) (applying the "primary purpose test" which was the business judgment rule disguised in name only).

In the seminal case, *Unocal Corp. v. Mesa Petroleum Co.*,[31] the Delaware Supreme Court established a heightened standard of review for takeover defenses. Under the *Unocal* standard,[32] before target directors may rely on the business judgment rule, they have the burden of proving: (1) that they had "reasonable grounds for believing that a danger to corporate policy and effectiveness existed" and (2) that they had acted "reasonabl[y] in relation to the threat posed."[33] In essence, the *Unocal* court's two prong test shifted the burden under the business judgment rule to the target board.[34] This enhanced business judgment rule does not apply where the employed defense only serves to perpetuate the target board in office or is used in any other inequitable manner.

To meet their burden of proof under *Unocal*, directors must show that they acted in "good faith and [conducted a] reasonable investigation"[35] in consideration of:

> the adequacy and terms of the offer; its fairness and feasibility; the proposed or actual financing for the offer, and the consequences of that financing; questions of illegality; the impact of both the bid and the potential acquisition on other constituencies, provided that it bears some reasonable relationship to general shareholder interests; the risk of non-consummation; the basic [shareholder] interests at stake; the bidder's identity, prior background and other business venture

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31. 493 A.2d 946 (Del. 1985).

32. The Delaware Supreme Court has repeatedly reaffirmed the *Unocal* standard. *See, e.g.*, Stroud v. Grace, 606 A.2d 75, 82 (Del. 1992); Gilbert v. El Paso Co., 575 A.2d 1131 (Del. 1990); Mills Acquisition Co. v. Macmillan, Inc., 559 A.2d 1261, 1267 (Del. 1989); Ivanhoe Partners v. Newmont Mining Corp., 535 A.2d 1334, 1339 (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, 1349 (Del. 1985).

33. *See, e.g.*, *Stroud*, 606 A.2d at 82; Paramount Communications, Inc. v. Time Inc., 571 A.2d 1140, 1152 (Del. 1990); *Macmillan*, 559 A.2d at 1288; *Newmont*, 535 A.2d at 1341; *Revlon*, 506 A.2d at 180; *Moran*, 500 A.2d at 1356; *Unocal*, 493 A.2d at 955.

34. The *Unocal* standard is an enhanced version of the business judgment rule because it places the burden on the directors rather than on the party attacking the defenses. Additionally, it requires that directors take action only in response to a threat. *See supra* note 15.

Where the directors are purely motivated by self-interest, Delaware courts will not apply the *Unocal* standard. *Macmillan*, 559 A.2d at 1279; *Newmont*, 535 A.2d at 1341; *Unocal*, 493 A.2d at 955. "Where actual self-interest is present and affects a majority of the directors approving a transaction, a court will apply even more exacting scrutiny to determine whether the transaction is entirely fair to the [shareholders]." Paramount Communications Inc. v. QVC Network Inc., 637 A.2d 34, 42 n.9 (Del. 1994) (citing as examples Weinberger v. UOP, Inc., 457 A.2d 701, 710-11 (Del. 1983) and Nixon v. Blackwell, 626 A.2d 1366, 1376 (Del. 1993)).

35. *Unocal*, 493 A.2d at 955 (quoting Cheff v. Mathes, 199 A.2d 548, 555 (Del. 1964)); *see also Time*, 571 A.2d at 1152; *Revlon*, 506 A.2d at 180.

> experiences; and the bidder's business plans for the corporation and their effects on [shareholder] interests.[36]

Once the directors satisfy this burden, a court will apply the traditional business judgment rule placing the burden on the plaintiff to establish that the directors breached their fiduciary duties, rather than shifting the burden to the directors to prove that their actions were valid.[37]

Courts construing state laws outside Delaware have applied the *Unocal* standard in determining the validity of takeover defenses.[38] Several states, however, have rejected the *Unocal* standard through legislation.[39] Nevertheless, the trend seems to be that courts construing laws of states other than Delaware will approve and rely upon the *Unocal* standard.[40]

B. Application of the Unocal *Standard*[41]

Despite the numerous instances in which courts employed the *Unocal* test in the 1980s, no judicial model exists which explains the circumstances under which directors may resist takeover bids. Consequently, consideration of the relevant decisions of Delaware and other courts is useful to explain recent judicial responses and to

36. *Macmillan*, 559 A.2d at 1282 n.29.

37. *Moran*, 500 A.2d at 1356; *Unocal*, 493 A.2d at 958.

38. *See* International Ins. Co. v. Johns, 874 F.2d 1447, 1458-59 (11th Cir. 1989) (applying *Unocal* in a case governed by Florida law); Amanda Acquisition Corp. v. Universal Foods Corp., 708 F. Supp. 984, 1009 (E.D. Wis.) (construing Wisconsin law and relying upon *Unocal*), *aff'd on other grounds*, 877 F.2d 496 (7th Cir.), *cert. denied*, 493 U.S. 955 (1989); Torchmark Corp. v. Bixby, 708 F. Supp. 1070, 1081 (W.D. Mo. 1988) (construing Missouri law and applying *Unocal*); Gelco Corp. v. Coniston Partners, 652 F. Supp. 829, 845 (D. Minn. 1986) (relying on *Unocal* in construing Minnesota law), *aff'd in part and vacated in part on other grounds*, 811 F.2d 414 (8th Cir. 1987). *But see* Hanson Trust PLC v. ML SCM Acquisition Inc., 781 F.2d 264, 273 (2d Cir. 1986) (citing Norlin Corp. v. Rooney, Pace Inc., 744 F.2d 255, 260 (2d Cir. 1984)); *Norlin*, 744 F.2d at 257-58 (2d Cir. 1984) (following the traditional business judgment rule but focusing on whether the adoption of a certain takeover defense infringes upon the shareholders' right to govern the "ultimate destiny" of the corporation).

39. Indiana, Ohio, and Pennsylvania have laws that reject the *Unocal* standard. IND. CODE § 23-1-35-1(f) (1994); OHIO REV. CODE ANN. § 1701.59(c)(1) (1993); 15 PA. CONS. STAT. ANN. § 1715(d), (e) (1994). For a discussion of legislation refusing to follow the *Unocal* standard, see BLOCK ET AL., *supra* note 29, at 264-66.

40. *See* BLOCK ET AL., *supra* note 29, at 263-66.

41. In applying *Unocal* to determine the validity of a particular defense, courts have faced three sub-issues: (1) whether the board's actions constituted a defense; (2) whether a threat existed; and (3) whether the defense was a reasonable response to the threat. *See* BLOCK ET AL., *supra* note 29, at 243. The focus of this Article is under what circumstances and at what time takeover defenses are appropriate. This Section, therefore, will focus on the third of these issues. For a discussion of the first two issues see BLOCK ET AL., *supra* note 29, at 244-46.

formulate guidelines for directors to follow in preparing for or in reacting to unsolicited tender offers.

1. *Unocal v. Mesa Petroleum Co.*

In *Unocal*, T. Boone Pickens, heading a group that owned thirteen percent of Unocal's stock, offered $54 per share in cash for an additional thirty-seven percent of the outstanding stock and announced that, if successful, he also would purchase the other fifty percent of outstanding Unocal stock.[42] Following Pickens' offer, the Unocal board responded in two ways. First, the Unocal board rejected Pickens' offer as inadequate based on their investment banker's estimate that Unocal stock was worth $60 or more per share upon liquidation.[43] Second, the Unocal board resolved to make a self-tender offer, in which the board offered to purchase Unocal's outstanding stock, except those shares owned by Pickens, in exchange for $72 per share in debt securities.[44]

After holding that an inadequate offer price constituted a threat to Unocal's corporate policy,[45] the court applied the second prong of the new *Unocal* test. The court addressed whether the Unocal board's defensive action was reasonable in relation to the threat posed by Pickens' offer.[46] The court did not address this issue rigorously.[47] Rather, the court accepted the *Unocal* board's justifications at face value.[48] Although Unocal's self-tender offer was a "showstopper" because it effectively killed Pickens' offer,[49] the court found it reasonable because Pickens' two-tiered offer was "a classic coercive measure designed to stampede shareholders into tendering at the first tier, even if the price is inadequate, out of fear of what they will receive at the back end of the transaction."[50] Not all takeover bids are coercive; thus, whether a show stopper, like the one used in *Unocal*, would be reasonable depends upon the surrounding circumstances.

In the decisions following *Unocal*, the Delaware Supreme Court continuously has given target boards wide latitude when responding to

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42. Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 949 (Del. 1985).

43. *Id.* at 950.

44. *Id.* at 951.

45. *Id.* at 956. The court also viewed Pickens' offer as a two-tiered offer which represented a substantial threat to shareholder choice. *Id.*

46. *Id.* at 955.

47. *See* Ragazzo, *supra* note 3, at 694.

48. *Unocal*, 493 A.2d at 956.

49. Ragazzo, *supra* note 3, at 695. A "showstopper" refers to an action by one party to a bidding contest for corporate control that causes the bidding to end.

50. *Unocal*, 493 A.2d at 956.

hostile takeover bids.[51] As demonstrated by the cases set forth below, the courts have extended the application of the *Unocal* standard to include pre-tender offer defenses.[52] Moreover, judicial application of the *Unocal* standard seems indistinguishable from the traditional business judgment rule.[53] The case law, however, also indicates that courts will apply the *Unocal* standard rigorously in appropriate situations: specifically, situations in which an impending sale or change of control exists.[54]

2. Lenient Application of the *Unocal* Standard

One year after *Unocal*, the Delaware Supreme Court affirmed the chancery court's decision in *Moran v. Household International, Inc.*[55] to uphold a poison pill shareholders' rights plan.[56] In *Moran*, the plaintiff challenged the adoption of the plan by Household's board and argued that it would entrench management and deny the shareholders the opportunity to obtain a premium.[57] Household's board argued that the business judgment rule protected them in their choice of this pre-takeover defense, especially because the Household board contained a

51. *See* Ragazzo, *supra* note 3, at 698; *see, e.g.*, Paramount Communications, Inc. v. Time Inc., 571 A.2d 1140 (Del. 1990); Moran v. Household Int'l, Inc., 500 A.2d 1346 (Del. 1985).

52. *See supra* note 20 and accompanying text. For examples of the various pre-tender offer defenses, see *infra* part IV.A.

53. *See* Ragazzo, *supra* note 3, at 702.

54. *See, e.g.*, Paramount Communications Inc. v. QVC Network Inc., 637 A.2d 34, 46 (Del. 1994) (finding an impending change of control and, thus, applying enhanced scrutiny); *Time*, 571 A.2d at 1150 (finding merger agreement did not constitute a change of control and, thus, applying a more traditional business judgment rule).

When there is a pending sale of control, "the responsibility of the directors is to get the highest value reasonably attainable for the shareholders." *QVC*, 637 A.2d at 46 (restating the duties of directors set forth in Mills Acquisition Co. v. MacMillan, Inc., 559 A.2d 1261, 1288 (Del. 1989)). This responsibility is sometimes referred to as a duty to "auction" the target corporation in an effort to obtain the best value for the shareholders. *See infra* note 88.

55. 500 A.2d 1346 (Del.), *aff'g*, 490 A.2d 1059 (Del. Ch. 1985).

56. *Moran*, 490 A.2d at 1083. Household's defense was a preferred stock plan under which each shareholder received one right for each common share outstanding. The right entitled each holder to the option to buy one-hundredth of a share of a new series of participating preferred stock which was non-redeemable and non-transferable until a triggering event occurred. *Id.* at 1066. Its dividend right was 100 times that declared on the common stock and its exercise price was $10,000 per share. The rights could be exercised if the holder acquired 20 percent of the common stock or a tender offer was made for 30 percent or more of the common stock. *Id.* The plan also provided for a "flip over" provision. *Id.* For a brief explanation of poison pill shareholders' rights plans and "flip over" provisions, *see infra* part IV.B.7.

57. *Moran*, 490 A.2d at 1067.

majority of outside directors.[58]

The Delaware Supreme Court determined that the Household board implemented the plan to resist potential two-tiered[59] and bust-up offers,[60] which constituted threats under the *Unocal* standard.[61] In concluding that the plan was a reasonable response under the *Unocal* standard's second prong, the court noted that Household's poison pill was not lethal to all tender offers but only to two-tiered and bust-up offers.[62] *Moran* exemplifies the leniency with which Delaware courts judge target boards in allowing them to prevent takeovers. Accordingly, it seems that Delaware courts sometimes apply the traditional business judgment rule under the guise of an "enhanced" business judgment rule.

3. Rigorous Application of the *Unocal* Standard

After *Unocal* and *Moran*, the Delaware Supreme Court changed direction and applied the *Unocal* standard in a more rigorous manner that was distinguishable from the traditional business judgment rule.[63] As a result of the rigorous application of *Unocal*, corporate management and directors became alarmed and suspicious as to what standard they would be held to when responding to hostile tender offers.

Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.[64] concerned the legality of a defensive tactic implemented by a board of directors in response to a hostile tender offer.[65] Specifically, the Revlon board took pre-emptive action against an anticipated unsolicited bid by Pantry Pride.[66] The Revlon board adopted a two part plan composed of an exchange offer[67] to repurchase Revlon stock and a poison pill.[68] The

58. *Id.* at 1074-75.

59. A two-tiered offer occurs when a bidder makes an offer for less than all of the target's shares at one price and then makes a second offer for the rest of the target's shares at another price.

60. A bust-up offer refers to the acquirer's intent to break up the target's corporate structure upon acquisition of the target corporation.

61. *Moran*, 500 A.2d at 1351-55.

62. *Id.* at 1356-57.

63. *See* Revlon, Inc. v. MacAndrew & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1986).

64. *Id.*

65. *Id.* at 175-76.

66. *Id.* at 175. Initially, Pantry Pride proposed a friendly acquisition of Revlon at a price between $40-50 per share. *Id.* at 176. Pantry Pride attempted to continue negotiations with Revlon, but Revlon refused. Thereafter, Revlon adopted a defensive measure to dissuade Pantry Pride. *Id.* at 178.

67. An "exchange" offer is an offer by the acquirer to purchase the target shares using the acquirer's own stock, rather than cash or debt to finance the offer.

68. *Id.* at 177. *See infra* part IV.B.7 for discussion of the poison pill defense.

board designed the plan to maximize and protect the value of Revlon's shares when faced with a tender offer.[69]

Thereafter, Pantry Pride made a hostile bid for Revlon shares at $47.50 per common share.[70] The Revlon board rejected this offer as inadequate and responded by making a self-tender offer.[71] Pantry Pride then made another offer contingent upon its receiving ninety percent of Revlon's outstanding stock.[72] Again, the Revlon board rejected Pantry Pride's offer and began negotiating a leveraged buy out[73] with Forstmann Little and authorized management to look for prospective buyers.[74] Pantry Pride offered as much as $53 per share, but the Revlon board approved a leveraged buy out at $56 per share.[75] Pantry Pride then raised its offer to $56.25.[76] Forstmann Little countered with an offer of $57.25, subject to a no-shop provision,[77] a lock-up option, and a condition that Revlon management not participate in the merger.[78]

Finally, Pantry Pride raised its offer to $58 per share and filed suit seeking to enjoin the Forstmann Little transaction.[79] The Revlon board claimed that the *Unocal* business judgment rule protected its actions. The court determined that Pantry Pride's actions posed a threat to Revlon and, therefore, the *Unocal* standard applied.[80]

In reaching its decision, the court examined whether the Revlon board's actions were reasonable in response to the Pantry Pride threat. Although the court found that the poison pill and exchange offer were

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69. *Revlon*, 506 A.2d at 177. Revlon's board responded in this manner because Revlon's investment bankers told the board that in order to finance the acquisition, Pantry Pride would finance its tender offer with junk bonds and then break up Revlon's divisions. *Id.*

70. *Id.*

71. *Id.*

72. *Id.*

73. A "leveraged buy out" refers to a transaction where the target board seeks outside financing for its own bid for the target corporation's shares.

74. *Id.* at 177-78.

75. *Id.*

76. *Id.* at 177.

77. "No-shop" clauses create a promise by the target board to refrain from soliciting other offers. BLOCK ET AL., *supra* note 29, at 426.

78. *Revlon*, 506 A.2d at 178. "Lock-up" options give the holder of the option, usually a white knight, the right to purchase a lucrative portion of the target. *See infra* part IV.B.6 for a discussion of white knights and lock-up options. The lock-up option gave Forstmann Little the right to purchase two of Revlon's divisions, and could have been exercised when a bidder acquired 40 percent of Revlon's shares. *Revlon*, 506 A.2d at 178.

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

80. *Id.* at 185.

justified, the court viewed the Revlon board's response after Pantry Pride's $53 offer as unreasonable.[81] Because the Revlon board acted as if the breakup of the company was inevitable, the Delaware Supreme Court determined that the board's duty was to act as an auctioneer and to refrain from fending off a hostile acquirer.[82] The court found that the Revlon board violated its fiduciary duty by accepting Forstmann Little's offer of $57.25, which included the lock-up option and no-shop provision.[83] In reaching this conclusion, the court found that once the Revlon board decided to sell the corporation, it had a duty to invite all bidders to equally participate in negotiations.[84] Thus, in granting the lock-up option, the board breached its "fundamental duty of care."[85] According to the court, this action required a finding that the business judgment rule did not apply.[86]

Although the *Revlon* court invalidated the lock-up option and no-shop provision, it allowed the poison pill plan and selective repurchase plan.[87] The lock-up option and no-shop provision were unreasonable because they were adopted after Revlon was in auction stage.[88] Once placed in auction stage, a more rigorous *Unocal* test is applied to determine if the board's takeover defense is reasonable.

4. *Paramount v. Time*: The Shift Back to Leniency

In *Paramount Communications, Inc. v. Time Inc.*,[89] the Delaware Supreme Court reintroduced the discretion given to target boards as exemplified in *Unocal*.[90] Time, which had been looking for a merger partner for several years, eventually negotiated a deal with Warner Brothers.[91] As a result, Time's stock which had been trading at approximately $107 the week the merger was signed, increased by more than twenty-five percent.[92]

81. *Id.* at 182. The Revlon board justified its actions by stating its desire to preserve Revlon in its corporate form. *Id.*

82. *Id.*

83. *See id.* at 182-84.

84. *See id.* at 182. Accordingly, the Revlon board's duty seemed to be to auction the corporation to the highest bidder. *Id.*; *see also supra* note 54.

85. *Revlon*, 506 A.2d at 185.

86. *Id.*

87. *Id.* at 181.

88. An "auction" occurs when the target board places the target corporation up for sale. *See, e.g.*, *id.* at 182.

89. 571 A.2d 1140 (Del. 1990).

90. *See supra* part II.B.1.

91. *Time*, 571 A.2d at 1147.

92. Roger Lowenstein & David B. Hilder, *Time's Stock Soars Again as Some Still Hope for Takeover Effort*, WALL ST. J., May 31, 1989, at C1, C2.

Thereafter, Paramount made a cash offer of $175 per share for 100 percent of Time's stock.[93] Time's board rejected Paramount's offer as inadequate, based upon its investment banker's advice and the board's belief that the long-term value of Time, plus a control premium, raised the intrinsic value of Time's stock to greater than $175 per share.[94] In response to Paramount's offer, Time's board revised its merger plans with Warner. Rather than proceed with a merger which would have required shareholder approval, Time's board made a cash tender offer for fifty-one percent of Warner's stock at a per share price greater than the price pursuant to the original merger terms.[95] Paramount then increased its offer to $200 per share, which Time's board again rejected as inadequate.[96]

The Delaware Supreme Court applied the *Unocal* test to the Time board's decision to restructure the Time-Warner transaction in response to Paramount's unsolicited bid.[97] The court did not examine in detail whether the Time board's action was reasonable in response to the Paramount threat.[98] Rather, the court held that recasting the form of the transaction to preclude Paramount's bid was a reasonable response because it protected the Time-Warner transaction.[99] The Delaware Supreme Court held that precluding Paramount's offer in this manner was permissible because preservation of the Time-Warner transaction was a legitimate business purpose.[100] The court also noted that Time's board acted in good faith after a detailed investigation.[101]

Time demonstrates that in the absence of a finding by a court that the defensive measure was implemented during the auction stage, a court will apply the *Unocal* standard in a manner indistinguishable from the traditional business judgment rule. In the 1990s, the Delaware Supreme Court generally has continued this lenient application of *Unocal*, unless the target board has placed the target corporation up for sale, thus, into the auction stage. The most recent example of this

93. *Time*, 571 A.2d at 1147.

94. *Id.* at 1147-48.

95. *Id.* at 1148.

96. *Id.* at 1149.

97. *Id.* at 1153.

98. *Id.*

99. *Id.* at 1154-55. The Delaware Supreme Court noted that the Time board was justified in protecting its strategic business plan without regard to comparative values. *Id.* at 1154. Ironically, three years later in *QVC*, the Delaware Supreme Court found that the Paramount board's defensive actions, which were similar to those of the Time board, were impermissible. *See* Paramount Communications Inc. v. QVC Network Inc., 637 A.2d 34, 49-51 (Del. 1994). For a discussion of *QVC*, *see infra* part III.A.

100. *Time*, 571 A.2d at 1152-54.

101. *Id.* at 1153-54.

trend is *Paramount Communications Inc. v. QVC Network Inc.*[102]

III. JUDICIAL REVIEW OF TAKEOVER DEFENSES IN THE 1990S: *PARAMOUNT V. QVC*

Although many legal issues remain unresolved from the takeover frenzy of the 1980s,[103] one unresolved issue of particular significance is under what circumstances target directors can use takeover defenses to resist a hostile takeover.[104] The trend in the 1990s is for courts to uphold reasonable takeover defenses that target boards implement to further viable business plans unless a particular defense interferes with the decision-making power of shareholders.[105] As exemplified by *QVC*, courts will find that a takeover defense interferes with shareholders' decision-making power when a target board adopts such a defense after *Revlon* has been triggered.[106] Although under certain circumstances courts will find takeover defenses that are implemented before *Revlon* is triggered unreasonable, such defenses usually will withstand judicial scrutiny under the *Unocal* approach if a valid business purpose exists.

A. *The Facts*

The takeover contest between QVC Network Inc. and Viacom Inc. over Paramount Communications Inc. began on September 12, 1993.[107] After four years of negotiations, Viacom and Paramount entered into a friendly merger agreement (the "Merger Agreement") and a stock option agreement (the "Stock Option Agreement") worth $9.2 billion in aggregate.[108] The public announcement of the Merger Agree-

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102. 637 A.2d 34 (Del. 1994).

103. Outstanding issues include: what the fiduciary duties of directors, management and attorneys are in a sale of control; when these duties are triggered; and whether the fiduciary duties of corporate directors extend to non-corporate settings.

104. *See* Levin, *supra* note 25, at 511.

105. Under the laws of many states, fundamental corporate changes are subject to approval by shareholder vote, including mergers, elections of directors, and so forth. *See, e.g.*, DEL. CODE ANN. tit. 8, § 251 (1991); ILL. COMP. STAT. ch. 805, § 5/7.85 (West 1993). Accordingly, courts seek to protect shareholders from interference with voting rights. *See QVC*, 637 A.2d at 42 (citing other Delaware cases for this proposition).

106. *Revlon* is triggered in a hostile takeover situation when the target board has "abandon[ed] its long term strategy and [has sought] an alternative transaction involving the breakup of the company." Arnold v. Society for Sav. Bancorp, Inc., 30 Fed. Sec. L. Rep. (CCH) ¶ 98,006 (Del. Ch. Dec. 17, 1993). In *QVC*, the Delaware Supreme Court clarified this rule explaining that *Revlon* is triggered if a company either puts itself into play, or plans a reorganization involving a clear breakup. *See QVC*, 637 A.2d at 47-48.

107. 635 A.2d 1245, 1250-51 (Del. Ch. 1993).

108. *Id.* The Paramount board approved the Merger Agreement and the Stock Option

ment and Stock Option Agreement stated that Viacom was "acquiring" Paramount, "but clarified that Paramount was for sale only to Viacom."[109]

The Merger Agreement required the Paramount board to amend its poison pill rights agreement to prevent it from triggering upon the closing of the Merger Agreement.[110] Furthermore, the Merger Agreement contained a no-shop provision, which prohibited Paramount from soliciting or considering competitive transactions unless required by law.[111] A termination provision also protected the deal by providing Viacom with a termination fee of $100 million if one of the following events occurred: Paramount terminated the Merger Agreement in favor of a competing transaction; the Paramount shareholders failed to approve the merger; or, the Paramount board recommended a competing transaction.[112] The Stock Option Agreement created a lock-up stock option, which permitted Viacom to purchase 19.9% of Paramount's common stock at $69.14 per share or to put the option to Paramount and receive 16.7% of the bidding price from a competitor.[113] In effect, the Merger Agreement and Stock Option Agreement would shift voting control from the public Paramount shareholders to Mr. Sumner Redstone ("Redstone"), who was the majority shareholder of Viacom through NAI which Redstone controls.[114]

Eight days later, QVC offered to acquire Paramount for approximately $9.5 billion.[115] On that same day, Viacom and Para-

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Agreement within three hours based on detailed term sheets of the agreements, a business overview of the Viacom-Paramount entity, and pro forma financial data. *Id.* at 1251. The Paramount board also discussed its fiduciary duties with respect to the proposed merger. *Id.* at 1252.

In entering into the Merger Agreement, the Paramount board also relied upon a fairness opinion that explicitly denied that any "market check" had been undertaken. *Id.* at 1251 n.11. A target board conducts a "market check" when it compares the bid against the fair market value of the target. If the target is a public corporation (as in Viacom's case), the fair market value is probably its trading value. The board's reliance on the "market check" is significant because when *Revlon* is triggered in a friendly merger or takeover case, courts require some form of proof that the friendly merger or takeover obtains the best value for shareholders. *See QVC*, 634 A.2d at 44. In the past, courts have found that a "market check" is adequate to satisfy this requirement. *See, e.g.*, Mills Acquisition Co. v. Macmillan, Inc., 559 A.2d 1261 (Del. 1989).

109. *QVC*, 635 A.2d at 1252.

110. *Id.* at 1251.

111. *Id.*

112. *Id.*

113. *Id.*

114. *Id.*

115. James Bates, *Paramount Deal: As Show Closes, a Look at the Script*, L.A.

mount made a public announcement cautioning against QVC's bid.[116] Paramount also publicly announced that Viacom's offer provided the best option for Paramount in the long run, but that the Paramount board would consider QVC's offer.[117]

On October 11, the Paramount board authorized negotiations with QVC.[118] According to QVC, Paramount delayed negotiations and, thus, on October 21, QVC filed suit and made a hostile tender offer for Paramount.[119] In response to QVC's actions, Paramount and Viacom revised the Merger Agreement (the "Amended Merger Agreement") and the Stock Option Agreement (the "Amended Stock Option Agreement") as follows: (1) Viacom would make a tender offer for 51 percent of Paramount's outstanding share for $80 per share, followed by a stock-for-stock exchange valued at $80 per share;[120] (2) Paramount would revise its poison pill rights plan and the termination provision to allow the Paramount board to reject the Viacom offer in favor of a competing transaction to avoid breaching its fiduciary duties;[121] and (3) the buy-out alternative cash payment contained in the Stock Option Agreement would be based upon a successful bid rather than on a five-day average market price.[122]

The Paramount board reviewed one-page summaries of the QVC and Viacom proposals and comparisons of the transactions.[123] Thereafter, the Paramount board approved the revised Viacom transaction.[124] Meanwhile, QVC and Viacom raised their bids, and the Paramount board continued to reject QVC's advances.[125] By the time the Delaware Chancery Court eventually considered QVC's lawsuit, QVC's first-step tender offer was at $90 per share in cash and its

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TIMES, Feb. 16, 1994, at A1. QVC's initial offer was approximately $9.5 billion, while Viacom's was approximately $9.2 billion. *Id.*

116. *QVC*, 635 A.2d at 1252.

117. *Id.*

118. *Id.* at 1253.

119. QVC offered to pay $80 per share in cash for 51 percent of Paramount's outstanding shares and a stock-for-stock exchange for the remaining shares (second-step merger). *Id.* QVC's common stock was worth a little over $80 per share on October 27, 1993, the commencement date of the QVC tender offer. *Id.*

120. *Id.* at 1254.

121. *Id.* at 1254-55.

122. *Id.* at 1255.

123. *Id.*

124. *Id.* at 1256.

125. Although QVC's bids were higher than Viacom's, the Paramount board determined that QVC's offers were highly contingent and not the best alternative in the long run. *Id.* at 1255-59.

second-step was at $90 per share in securities.[126] By contrast, Viacom's first-step tender offer was at $85 per share in cash and its second-step was at $85 per share in securities.[127]

B. The Court Battles

In taking the QVC-Viacom battle to the Delaware courts, QVC and certain Paramount shareholders sought, *inter alia*: (1) to invalidate the lock-up and break-up fee provisions agreed upon by Paramount and Viacom; (2) to enjoin Viacom's tender offer until the lock-up and poison pill agreements were invalidated; and (3) to require Paramount's board to remove all other defenses to QVC's hostile bid.[128] On November 24, the Delaware chancery court preliminarily enjoined: (1) the Paramount defendants from amending or modifying the Paramount stockholder rights plan, from taking any other action to facilitate the Viacom tender offer, or taking action to consummate the Merger Agreement or the Amended Merger Agreement; and (2) the Paramount defendants and Viacom from taking any action to exercise any part of the Stock Option Agreement.[129] The chancery court, however, refused to enjoin the termination fee.[130] Thereafter, the Paramount defendants and Viacom appealed to the Delaware Supreme Court.[131]

On December 9, 1993, the Delaware Supreme Court affirmed the lower court's decision to bar certain takeover defenses adopted by the Paramount board.[132] After reciting the facts of the case, the Delaware Supreme Court stated that it would analyze the Paramount board's actions using an enhanced business judgment rule because this was one of the "rare situations which mandate[s] that a court take a more direct and active role in overseeing the decisions made and actions taken by directors."[133] The Delaware Supreme Court set forth a two-step analysis that courts must follow when applying enhanced scrutiny.[134] First, a court must make a determination as to whether the directors' actions were based upon an informed decision.[135] Second, a

126. *Id.* at 1256.
127. *Id.*
128. *Id.* at 1246.
129. *Id.*
130. *Id.* at 1271.
131. Paramount Communications Inc. v. QVC Network Inc., 637 A.2d 34 (Del. 1994).
132. *Id.* The Delaware Supreme Court issued its final opinion on Feb. 4, 1994.
133. *QVC*, 637 A.2d at 42.
134. *Id.* at 43-46 (restating the test under *Unocal* and its progeny).
135. *Id.* at 44-45.

court must examine the reasonableness of the board's actions.[136]

The court concluded that in the case at bar, two events required the court to apply enhanced scrutiny: (1) a change of control had occurred;[137] and (2) the target corporation had adopted defensive measures in response to a hostile bid.[138] Accordingly, because the Paramount-Viacom transaction triggered *Revlon*,[139] the Paramount board had the following obligations in making an informed decision and in taking reasonable action. First, the Paramount board needed to critically examine the QVC offers and the Viacom-Paramount transactions.[140] Second, the Paramount board must have acted in good faith.[141] Third, the Paramount board had to review all reasonably available and material information to determine which alternative provided the best value to the shareholders.[142] Fourth, the Paramount board was required to negotiate fairly with all potential suitors in its attempt to obtain the best value for the Paramount shareholders.[143] The Delaware Supreme Court concluded that the Paramount board breached these obligations because its process was unreasonable and its actions were not taken to maximize shareholder value.[144]

The court determined that the Paramount board failed in its duties because the Paramount board did not properly investigate the alternatives. Specifically, the Paramount board failed to give sufficient attention to "the potential consequences of the defensive measures

136. *Id.*

137. *Id.* at 42. The Delaware Supreme Court explained that the Paramount-Viacom transaction would result in a corporate change in control because before the Paramount-QVC transaction, the public shareholders controlled Paramount but after the transaction the public shareholders would be a minority. *Id.* A change in control is sometimes referred to as the triggering of *Revlon*. *See supra* note 106.

138. *QVC*, 637 A.2d at 42. Although the court implied that either a triggering of *Revlon* or an adoption of defensive measures in response to a threat of corporate control implicates *Unocal*, in reality the Delaware Supreme Court in *QVC* and other cases only applied enhanced scrutiny where defensive measures were at issue *and* when *Revlon* was already triggered. *Compare id.* at 48-49 *with Time*, 571 A.2d at 1151-52. Furthermore, the *QVC* court stated that it has recognized that a target board may resist a hostile bid where "a potential sale of control by a corporation is not the consequence of a [target] board's action . . . ." *QVC*, 637 A.2d at 43 n.13.

139. Because the Merger Agreement would have caused the majority ownership interest to change from the public Paramount shareholders to Redstone, the Delaware Supreme Court determined that *Revlon* was triggered at the time Paramount entered into the merger agreement with Viacom. *See QVC*, 637 A.2d at 43, 48.

140. *Id.* at 48.

141. *Id.*

142. *Id.* The court emphasized that the Paramount board needed to critically evaluate the reasonableness of each defensive measure individually. *Id.*

143. *Id.*

144. *Id.* at 49.

demanded by Viacom."[145] Furthermore, the Paramount board failed to adequately consider the QVC offer while relying on its claim of a strategic alliance with Viacom.[146] In short, the Delaware Supreme Court found that the Paramount board members "chose to wall themselves off from material information . . . and to hide behind the defensive measures" rather than use the QVC offer to obtain the best value for the Paramount shareholders.[147]

The Delaware Supreme Court held that a court must be satisfied that the course of action determined by the directors, in the context of a sale of control, was reasonably calculated to secure the best value available to the Paramount shareholders.[148] The court addressed the following actions taken by Paramount: (1) entering into the Stock Option Agreement which gave Viacom a lock-up stock option; (2) agreeing to a no-shop provision and "fiduciary out" provision;[149] (3) agreeing to the proposed disparate use of the poison pill plan as to the Viacom and QVC offers, respectively; and (4) providing for a termination fee.[150]

The court determined that these defensive measures were designed to impede potential competing bidders and, thus, were unreasonable.[151] Consequently, the Paramount board's actions were in violation of its fiduciary duties and the Delaware Supreme Court invalidated all of the defensive measures.[152]

After losing in the courts, Viacom was declared the winner for a price of $9.7 billion in cash and stock.[153] In the end, the Paramount shareholders and not the Delaware Supreme Court declared Viacom the winner over QVC.[154]

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145. *Id.* at 49.

146. *Id.* at 49-50.

147. *Id.* at 51.

148. *Id.* at 44.

149. A "fiduciary out" provision allows the target board to withdraw from an acquisition agreement (where the target is being sold) in the event the board members' fiduciary duties to the corporation and its shareholders would be breached if they followed through with the acquisition agreement.

150. *Id.* at 48-51.

151. *Id.* at 50-51.

152. *Id.* The court also noted that under Delaware law, directors of a corporation are not bound by any agreement that violates their fiduciary duties to shareholders. *Id.* at 51.

153. Hubert B. Herring, *Business Diary: Redstone Stands Victorious on a Littered Battleground*, N.Y. TIMES, Feb. 20, 1994, at C2.

154. The courts should leave the ultimate decision in a takeover contest up to the target shareholders. Thus, on its face, the Delaware Supreme Court's decision in *QVC* seems appropriate. In the long run, however, the shareholders who continue their ownership may be harmed because Viacom incurred a substantial amount of debt in its eventual acquisition of Paramount. *See* Herring, *supra* note 153.

IV. POST-*QVC*: THE AVAILABILITY OF TAKEOVER DEFENSES

As described above, target boards have adopted a variety of defensive measures in the past, including:[155] (1) stock repurchases; (2) no-shop provisions; (3) acceleration of loans; (4) golden parachutes; (5) engagement of white knights; (6) sale of crown jewels; (7) employee stock option plans ("ESOPs"); (8) defensive lawsuits; and (9) poison pill rights plans. The litany of takeover defenses continually changes as new takeover defenses are created and existing defenses are modified to resist hostile tender offers.[156] Consequently, to list and describe every defense is an insurmountable task.

A brief description of the common takeover defenses employed by target management follows. These defenses can be divided into two broad classes: (1) pre-tender offer defenses; and (2) post-tender offer defenses.[157] Moreover, each broad class can be broken down into subclasses, which are generalizations of the types of defenses implemented by target boards.

This part describes the various types of takeover defenses, their availability to targets in the past, and whether the recent *QVC* decision will impact their validity in the future.

A. *Pre-Tender Offer Defenses*

In order to discourage unsolicited offers from unwanted acquisitions, target boards often take precautions (known as "shark repellents"), to defend against takeovers. These precautions require amendments to a corporation's charter or modifications to existing corporate contracts.[158] Generally, these defenses make hostile takeovers more difficult. Because target boards do not implement pre-tender offer defenses in response to hostile bids, *Unocal*'s enhanced

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Viacom's "win" over QVC gave Viacom and Redstone majority ownership of Paramount. This win, however, was not without its costs which included a substantial decrease in the value of Viacom's stock, a debt of $10 billion, and many disgruntled shareholders. *Id.*

155. For an explanation of each defense, see *infra* parts IV.A, B.

156. ROBERT C. CLARK, CORPORATE LAW § 13.6, at 571 (1986).

157. *Id.*; *see, e.g.*, Palmer, *supra* note 20, at 1686-87 (classifying defenses into pre-tender and post-tender tactics).

Dividing takeover defenses into two classes serves two purposes. First, it provides organization for this Article. Second, and more importantly, courts analyze the validity of takeover defenses using different standards depending upon whether the defense at issue was implemented prior to a tender offer or after a hostile bidder has made a tender offer.

158. *See* CLARK, *supra* note 156, § 13.6, at 576.

business judgment rule does not apply in most cases.[159] Most courts apply the traditional business judgment rule in their determination of the validity of pre-tender offer defenses.[160] The recent *QVC* decision reinforces this proposition and allows target boards to feel comfortable in their adoption of takeover defenses in the pre-tender period.

1. Supermajority Provisions

This defense involves an amendment to a potential target corporation's charter that increases the percentage of shareholder votes to as high as eighty percent to approve director elections, mergers, and other corporate changes.[161] By increasing the percentage of shareholder votes in these instances, the acquirer will find it more difficult to complete its acquisition in the event the acquirer plans to follow up the acquisition of the control block with a freezeout merger.[162]

To determine whether supermajority provisions are valid defenses, courts make a preliminary inquiry into whether the governing state corporation law allows inclusion of such provisions in a corporation's charter.[163] Next, courts look at whether the board's adoption of the supermajority provisions constitutes a valid exercise of business judgment. Under the business judgment rule, courts have upheld supermajority provisions unless circumstances indicate that no valid

159. *See supra* part II.B.

160. Courts, however, will look at whether any amendment to a corporation's charter or modification to an existing contract is permissible under the governing state's statutory and common law.

161. *See* CLARK, *supra* note 156, § 13.6, at 576; *Responsibilities of Corporate Officers*, *supra* note 15, ¶ 702.

162. *See* CLARK, *supra* note 156, § 13.6, at 576.

163. For example, section 212(a) of the Delaware General Corporation Law provides that a holder of stock in a Delaware corporation is entitled to one vote per share held, unless the charter provides otherwise. DEL. CODE ANN. tit. 8, § 212(a) (1991); *see* ERNEST L. FOLK III ET AL., FOLK ON THE DELAWARE GENERAL CORPORATION LAW: A COMMENTARY AND ANALYSIS § 212 (3d ed. 1993). Courts have upheld the statutory authority of Delaware corporations to place supermajority provisions in their charters. *See, e.g.*, Providence & Worcester Co. v. Baker, 378 A.2d 121 (Del. 1977) (holding that charter provisions for voting power based upon the size of each shareholder's holding are valid); Lacos Land Co. v. Arden Group, Inc., 517 A.2d 271, 275 (Del. Ch. 1986) (reaffirming that Delaware allows flexibility to shareholders in creating the capital structure of their firm and recognizing that differing classes of stock with different voting rights are permissible under Delaware law). Courts also have upheld supermajority provisions under the state corporation laws of Iowa and Pennsylvania. Baron v. Strawbridge & Clothier, 646 F. Supp. 690, 698 (E.D. Pa. 1986) (Pennsylvania law does not require a policy of one vote per share in common stock, and restrictions on the transferability of shares are valid unless manifestly unreasonable); Kersten v. Pioneer Hi-Bred Int'l, Inc., 626 F. Supp. 647, 649 (N.D. Iowa 1985) (upholding the amendments approved by the shareholders because the Iowa code neither prohibited nor permitted voting restrictions at issue).

business plan existed.[164]

2. Veto Stock

This defense involves an amendment to a corporate charter to create a class of stock with veto power over mergers or other organic changes.[165] Similar to the supermajority provisions, veto stock creates an obstacle to completion of a hostile takeover.

For implementation of veto stock to withstand judicial scrutiny, the corporation law of the governing state must allow such stock.[166] Furthermore, the board's adoption of the veto stock provisions must constitute a valid exercise of business judgment.

3. Blank Check Preferred Stock

This defense also involves amendment to a corporate charter to create a class of stock, the final terms of which the board determines at its discretion.[167] As with other shark repellents, the effect of blank check preferred stock is to make the corporation unattractive to the acquirer.

Again, courts scrutinize this defense using a two-step inquiry. First, such stock must be allowed under the governing state corporation law.[168] Second, the board's adoption of the blank check preferred stock provisions must constitute a valid exercise of business judgment.[169]

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164. *See Baron*, 646 F. Supp. at 698 (denying preliminary injunctive relief in a challenge to the board's adoption of supermajority provisions); Hahn v. Carter-Wallace, Inc., Civil Action No. 9097 (Del. Ch. Oct. 9, 1987) (finding that the board's adoption of supermajority provisions subject to shareholder approval constituted a valid exercise of business judgment); Packer v. Yampol, 12 DEL. J. CORP. L. 332 (Del. Ch. Apr. 18, 1986) (enjoining the board's reclassification plans involving supervoting stock during a proxy contest because the board's purpose was to entrench itself, which is not a valid exercise of business judgment). Note that the board adopted supermajority provisions in *Packer* as a post-tender offer defense.

165. *See* CLARK, *supra* note 156, § 13.6, at 576.

166. For example, section 151(a) of the Delaware General Corporation Law provides that a Delaware corporation may issue stock with no voting powers. DEL. CODE ANN. tit. 8, § 151(a) (1991).

167. *Responsibilities of Corporate Officers*, *supra* note 15, ¶ 702 (1991).

168. For example, section 151(a) of the Delaware General Corporation Law provides that the board of directors of a Delaware corporation may use resolutions to adopt, modify, or amend the terms of stock, provided the certificate of incorporation clearly and expressly authorizes such board action. DEL. CODE ANN. tit. 8, § 151(9) (1991).

169. Since the blank check preferred stock provision is a pre-tender defense, courts will not apply heightened scrutiny. *See supra* text accompanying note 22.

4. Staggered Board

This defense also involves an amendment of the charter to create a staggered board of directors.[170] A staggered board is a board whose members are elected in different years. Implementation of a staggered board may cause an acquirer to have to wait several years before it controls the board of directors. Because the acquirer would not control the board initially, the acquirer would not have the power to change management or the corporation's business plan.[171]

As with the other pre-tender offer defenses, courts will allow amendment of the charter to create a staggered board of directors provided the amendment is allowed under the governing corporation law and the amendment was made for a valid business reason.[172]

5. Accelerated Loans

This defense involves revisions to the corporation's loan agreements in order to make them become payable in the event of a hostile takeover.[173] Acceleration of the loans would obligate the corporation to pay large sums of money to its creditors. Effectively, this defense creates a procedural obligation for the acquirer because the acquirer merely would have to refinance the loan.[174]

Generally, boards of directors (or their hand-picked management) have the sole decision-making power over corporate matters, including entering into and modifying contracts.[175] Accordingly, any decision to revise a corporation's loan agreements to become payable in the event of a hostile takeover will be subject to the business judgment rule.[176]

6. Golden Parachutes

This defense requires management to arrange employment contracts with management and key employees to increase their post-

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170. *See* CLARK, *supra* note 156, § 13.6, at 576.

171. *Id.*

172. For further discussion of staggered boards as defensive measures, see RALPH C. FERRARA ET AL., TAKEOVERS: ATTACK AND SURVIVAL 334 (1987).

173. *See* CLARK, *supra* note 156, § 13.6, at 576. Because this defense does not involve amendment to the corporate charter, a shareholder vote on revisions to the loan agreements probably is not required. *See id.*

174. *Id.* at 577.

175. WILLIAM A. KLEIN & JOHN C. COFFEE, JR., BUSINESS ORGANIZATIONS AND FINANCE 125 (3d ed. 1988).

176. As explained earlier, the business judgment rule applies rather than the *Unocal* standard because pre-tender offer defenses are not implemented in response to a threat. *See supra* part IV.A.

employment compensation in the event of a hostile takeover.[177] When golden parachutes are created for management and key employees, a corporation becomes less attractive to the acquirer because generous payments to departing management could financially deplete the corporation.[178]

Because golden parachutes are a form of executive compensation arrangements, some courts test the validity of these arrangements under a "reasonableness" standard rather than the traditional business judgment rule.[179] Courts generally allow adoption of golden parachutes as pre-tender offer defenses provided that disinterested directors approve them and the board exercises care in approving the agreement.[180]

B. *Post-Tender Offer Defenses*

Target boards have a wide array of defenses which they can employ to resist unsolicited tender offers from unwanted acquirers.[181] These defenses may have one or more of the following effects: (1) to thwart the takeover bid; (2) to increase the acquirer's bidding price; or (3) to damage the target corporation.[182] After *QVC*, target boards must refrain from employing takeover defenses once *Revlon* has been triggered, unless the target board clearly intends such defenses to serve as a mechanisms to maximize target shareholder value.

1. Propaganda

Target boards may use corporate funds to issue press releases, advertise and further communicate their anti-takeover arguments to target shareholders.[183] Propaganda as a defense to a premium offer, however, may backfire because target shareholders may deem a target

177. *See* CLARK, *supra* note 156, § 13.6, at 577.

178. *Id.*

179. *See* International Ins. Co. v. Johns, 874 F.2d 1447, 1467-68 (11th Cir. 1989); Buckhorn, Inc. v. Ropak Corp., 656 F. Supp. 209, 232-35 (S.D. Ohio), *aff'd*, 815 F.2d 76 (6th Cir. 1987); *see also* Nault v. XTRA Corp., [1992 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 97,022, at 94,501 (D. Mass. July 9, 1992). *But see* Tate & Lyle PLC v. Stanley Continental, Inc., [1987-1988 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 93,764, at 98,585 (Del. Ch. May 9, 1988).

180. *International Ins. Co.*, 874 F.2d at 1459-60; *Buckhorn*, 656 F. Supp. at 232-33; Bender v. Highway Truck Drivers Local 107, 598 F. Supp. 178, 189 n.16 (E.D. Pa. 1984), *aff'd*, 770 F.2d 1066 (3d Cir. 1985); Gaillard v. Natomas Co., 256 Cal. Rptr. 702, 715 (Cal. Ct. App. 1989).

181. *See* CLARK, *supra* note 156, § 13.6, at 571.

182. *See Responsibilities of Corporate Officers*, *supra* note 15, ¶ 702.

183. *See* CLARK, *supra* note 156, § 13.6, at 571-72.

board's negative advertising suspect.[184]

In *QVC*, the chancery court focused on two public announcements made by the Paramount board. The Paramount board had announced that the company was only for sale to Viacom and that the board would consider the QVC offer despite the fact that the Viacom deal was better.[185] This propaganda hurt Paramount in the long run because it provided evidence that the Paramount board had decided to consummate the Viacom deal without adequately considering other offers. Because *Revlon* had been triggered, the Paramount board had the duty to consider all offers. Thus, the public announcements served as evidence of the Paramount board's breach of its fiduciary duties.

2. Litigation

Target management also may commence litigation against an unwanted acquirer.[186] These defensive suits may allege violations of securities laws, antitrust laws, and other regulatory laws, or any other laws.[187] This litigation effectively delays commencement of an unwanted tender offer and provides a target board with time to implement other defenses.[188] Moreover, litigation may compel the acquirer to provide more complete disclosure.[189] In some instances, more disclosure (i.e., plans for the target's future) may cause the target shareholders to develop a negative impression of the acquirer.

Generally, the business judgment rule protects a target board that authorizes a defensive suit against the hostile acquirer, provided that the claims are not frivolous.[190] Accordingly, a court will typically uphold a target board's commencement of litigation as a defense to a hostile bid.[191] The decision in *QVC* did not address this defensive

184. As with other defenses, courts would apply the *Unocal* standard to determine the validity of propaganda in the event the propaganda was deemed a "defense." *See supra* note 41.

185. *See supra* part III.B.

186. *See* BLOCK ET AL., *supra* note 29, at 677; CLARK, *supra* note 156, § 13.6, at 572.

187. *See* BLOCK ET AL., *supra* note 29, at 667; CLARK, *supra* note 156, § 13.6, at 572.

188. *See* BLOCK ET AL., *supra* note 29, at 678.

189. The federal securities laws require disclosure of certain information by a party who acquires more than 5 percent of the outstanding stock of a public corporation. *See* 15 U.S.C. § 78m(d) (1988 & Supp. II 1990).

190. *See* Panter v. Marshall Field & Co., 646 F.2d 271, 297 (7th Cir.), *cert. denied*, 454 U.S. 1092 (1981); Berman v. Gerber Prods. Co., 454 F. Supp. 1310, 1318-19 (W.D. Mich. 1978); Edelman v. Phillips Petroleum Co., 10 DEL. J. CORP. L. 835, 843 (Del. Ch. Feb. 12, 1985).

191. *See, e.g.*, Kennecott Copper Corp. v. Curtiss-Wright Corp., 584 F.2d 1195 (2d Cir. 1978); CRTF Corp. v. Federated Dep't. Stores, Inc., 683 F. Supp. 422 (S.D.N.Y. 1988); Plaza Sec. Co. v. Office, 12 DEL. J. CORP. L. 1145 (Del. Ch. Dec. 15, 1986).

measure. If, however, the purpose of defensive litigation is only to thwart an unsolicited offer during an auction situation, a court will likely find that a target board has breached its fiduciary duty in taking such action.

3. White Squire Transactions

The white squire defense involves the placing of a substantial block of stock in the hands of friendly investors who are not interested in acquiring control.[192] Several variations of the white squire defense exist: (1) selling stock to friendly third parties;[193] (2) issuing more stock for the target corporation's ESOP;[194] and (3) obtaining financing necessary to restructure or complete other corporate transactions.[195] The primary effect of white squire transactions is to increase a target board's voting power and, thus, make it difficult or impossible for an unwanted acquirer to obtain control of the target.[196]

Courts apply either the traditional business judgment rule[197] or the *Unocal* standard[198] to white squire transactions.[199] In either case, courts uphold these transactions provided the target board has exercised prudent business judgment in an effort to protect the rights of the target shareholder. For example, a court may refuse to enjoin a sale of stock to friendly third parties when the target board effects a sale of

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192. *See* BLOCK ET AL., *supra* note 29, at 348.

193. *See id.* The effect of issuing and selling more stock to friendly parties is twofold. First, it dilutes the acquirer's percentage ownership. Second, it increases the target board's voting power.

194. *See id.* ESOPs are retirement plans that allow employees to invest in the corporation. *See id.* at 363. As a defense, ESOPs may block completion of a hostile takeover because they provide management with increased voting power. *See id.*

195. *See id.* at 348, 396. Sometimes referred to as "bridge financing," this defense involves short-term loans from a lender who may receive a voting position in exchange. *Id.* at 396. Again, the effect is to increase target management's voting power. *See id.*

196. *See id.*

197. Glazer v. Zapata Corp., Civil Action No. 12958, 1993 Del. Ch. LEXIS 77 (Del. Ch. May 14, 1993); Shamrock Holdings, Inc. v. Polaroid Corp., 559 A.2d 278 (Del. Ch. 1989); Doskocil Cos. v. Griggy, 14 DEL. J. CORP. L. 661 (Del. Ch. Aug. 4, 1988).

198. Ivanhoe Partners v. Newmont Mining Corp., 535 A.2d 1334 (Del. 1987); Kingsbridge Capital Group v. Dunkin' Donuts Inc., 15 DEL. J. CORP. L. 663 (Del. Ch. Aug. 7, 1989). Courts applying the *Unocal* standard will enjoin white squire transactions if the sales to third parties are motivated solely for entrenchment purposes. Manbourne, Inc. v. Conrad, 796 F.2d 884, 890 (7th Cir. 1986); Gregory v. Correction Connection, Inc., Civil Action No. 88-7990, 1991 U.S. Dist. LEXIS 3659 (E.D. Pa. Mar. 27, 1991).

199. Although judicial decisions to use either the traditional business judgment rule or the *Unocal* standard when evaluating white squire transactions seems arbitrary, their inconsistent actions are probably due to the unsettled state of the law on the validity of takeover defenses until the recent *QVC* decision.

stock, but it will do so only after the target board determines that the unfriendly bid was inadequate.[200] Furthermore, a court will find a white squire transaction valid provided that it does not prevent the target shareholders from choosing to vote for the hostile bidder.[201]

Unlike the white squire transactions involving third party sales, courts applying *Unocal* judge white squire transactions involving ESOPs more harshly. Courts reason that during takeover battles, ESOPs by nature give rise to a strong inference of management entrenchment.[202] If, however, a target board can prove that the ESOP was planned prior to the commencement of the hostile bid, a court will find that the ESOP is protected under the business judgment rule.[203]

Because white squire transactions do not increase shareholder value and instead burden the target corporation financially, post-*QVC* courts will not uphold such transactions if *Revlon* has been triggered.

4. Stock Manipulation

Similar to white squire transactions, the stock manipulation defense also involves stock transactions which may prevent an acquirer from completing a tender offer.[204] A target board may manipulate the target corporation's stock by: (1) repurchasing stock from target shareholders;[205] (2) paying greenmail[206] to the acquirer for target shares that he has already acquired;[207] (3) making a self-tender or exchange offer to the target shareholders;[208] and (4) paying extraordinary divi-

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200. *See, e.g.*, NCR Corp. v. AT & T, 761 F. Supp. 475 (S.D. Ohio 1991).

201. *See, e.g.*, News Int'l PLC v. Warner Communications, Inc., Civil Action No. 7420, 1984 WL 21871 (Del. Ch. Jan. 12, 1984) (where no evidence was presented that third party was under obligation to vote its shares with target's management, nor that it was likely to do so).

202. *See, e.g.*, RCM Sec. Fund, Inc. v. Stanton, 928 F.2d 1318 (2d Cir. 1991); Norlin Corp. v. Rooney, Pace Inc., 744 F.2d 255 (2d Cir. 1984); *NCR*, 761 F. Supp. at 475. *But see* Shamrock Holdings, Inc. v. Polaroid Corp., 559 A.2d 257 (Del. Ch. 1989).

203. British Printing & Communication Corp. PLC v. Harcourt Brace Jovanovich, Inc., 664 F. Supp. 1519, 1531 (S.D.N.Y. 1987); Danaher Corp. v. Chicago Pneumatic Tool Co., 633 F. Supp. 1066, 1071 (S.D.N.Y. 1986). *See generally In re* Anderson, Clayton Shareholders Litigation, 519 A.2d 680 (Del. Ch. 1986).

204. *See* BLOCK ET AL., *supra* note 29, at 458; CLARK, *supra* note 156, § 13.6.

205. *See* CLARK, *supra* note 156, § 13.6. Repurchases are effective only if the incumbent management or controlling group has a substantial block of stock. *Id.* This defensive measure could then result in the incumbent group obtaining voting control of the target corporation. *Id.*

206. To pay "greenmail" means that the target will purchase shares from the acquirer at a premium contingent upon the acquirer discontinuing the takeover attempt. CLARK, *supra* note 156, § 13.6; *Responsibilities of Corporate Officers*, *supra* note 15, ¶ 702.

207. *See* CLARK, *supra* note 156, § 13.6.

208. *See* BLOCK ET AL., *supra* note 29, at 458. Self-tender offers and exchange offers

dends.[209] This defense, in its various forms, causes the target corporation to incur debt, thus making the corporation less attractive to the acquirer.[210]

State statutes usually limit stock repurchases to prevent impairment of a corporation's capital.[211] Under the *Unocal* approach, courts uphold repurchase programs in the form of self-tender offers and exchange offers, provided the target boards have used sound business judgment in their decision to commence a repurchase program.[212] Likewise, in testing the validity of extraordinary dividend transactions that act to restructure the corporation, courts may apply the *Unocal* standard and uphold extraordinary dividend transactions.[213]

Courts will apply the enhanced business judgment rule to stock repurchase programs and extraordinary dividend transactions that are adopted or invoked in response to a hostile bid by targets in auction-mode. Moreover, courts following *QVC* probably will invalidate stock manipulations adopted or invoked after *Revlon* has been triggered because the effect of stock manipulation is to make the target less attractive rather than to entice the hostile bidder to increase its bid and, thus, increase shareholder value.

5. Sale of Crown Jewels

The sale of crown jewels defense involves a sale of the corporation's valuable assets or divisions of business (referred to as "crown jewels") that usually make the corporation an attractive

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are made to all of the target corporation's shareholders. *Id.* at 459. The effects of this version of stock manipulation may include: (1) diverting shares from the acquirer; (2) making the target corporation less attractive by burdening it with debt; (3) creating future financing problems for the target corporation; and (4) increasing management's percentage control. *Id.*

209. *Id.* at 458. The effects of declaring a dividend are similar to those from a self-tender or exchange offer. *Id.* Unlike a self-tender or exchange offer, this version of stock manipulation does not require shareholder action. *Id.* at 483.

210. *Id.* at 458 (stating that self-tender offers, exchange offers and extraordinary dividends make the corporation less attractive by depleting cash or incurring debt).

211. *See, e.g.*, DEL. CODE ANN. tit. 8, § 160 (1991); ILL. COMP. STAT. ch. 805, § 5/9.05-.10 (West 1993).

212. Gelco Corp. v. Coniston Partners, 652 F. Supp. 829, 845 (D. Minn. 1986); *Unocal*, 493 A.2d at 954-55; Shamrock Holdings Inc. v. Polaroid Corp., 559 A.2d 278, 286-87 (Del. Ch. 1989); AC Acquisitions Corp. v. Anderson, Clayton & Co., 519 A.2d 103, 111-12 (Del. Ch. 1986). *But see Revlon*, 506 A.2d at 182 (exchange plan was a valid measure, but after the point that a break-up of the company was inevitable, the board's responsibilities changed to getting the best price). These cases demonstrate that courts will enjoin repurchase programs instituted after the target board has placed the corporation up for sale. *Compare Revlon*, 506 A.2d 173, *with Polaroid*, 559 A.2d 278. See *supra* part III.B for a discussion of the *QVC* decision.

213. *See* BLOCK ET AL., *supra* note 29, at 482-83.

target.[214] While the sale of crown jewels may make the target corporation less attractive to the acquirer, it may also impair the target's financial condition.[215]

Courts generally uphold crown jewel asset sales on business judgment grounds.[216] A court, however, will enjoin these transactions where the target board has acted "to keep control of the company entrenched within the present board of directors regardless of the company's real best interests or else to dismember it piece by piece, even to the point of liquidation of the enterprise."[217] In short, target boards are not bound by agreements that violate their fiduciary duties to shareholders.[218] The recent *QVC* decision reinforces this proposition and suggests that target boards should refrain from entering into crown jewel asset sales if *Revlon* has already been triggered.

6. White Knight Transactions

Target boards implement the white knight defense by searching for a rival bidder (referred to as a "white knight") who is friendly to incumbent management or the controlling group.[219] White knights fend off hostile acquirers because they are willing to acquire the target corporation, usually pursuant to better terms than the acquirer.[220] Frequently, target management obtains a white knight by giving it

214. *Responsibilities of Corporate Officers*, *supra* note 15, ¶ 702; BLOCK ET AL., *supra* note 29, at 399.

215. *Responsibilities of Corporate Officers*, *supra* note 15, ¶ 702; BLOCK ET AL., *supra* note 29, at 399.

216. *See, e.g.*, Terrydale Liquidating Trust v. Barness, 846 F.2d 845 (2d Cir.), *cert. denied*, 488 U.S. 927 (1988); Whittaker Corp. v. Edgar, 535 F. Supp. 933, 949 (N.D. Ill. 1982); GM Sub Corp. v. Liggett Group, Inc., Civil Action No. 6155, 1980 WL 6430 (Del. Ch. Apr. 25, 1980).

217. Joseph E. Seagram & Sons, Inc. v. Abrams, 510 F. Supp. 860, 862 (S.D.N.Y. 1981). Although this case was decided prior to *Unocal*, courts will deem management's entrenchment a conflict of interest and refuse to protect the target board under the business judgment rule. *See supra* part II.

218. *See QVC*, 637 A.2d at 51 (holding such agreements invalid and unenforceable). Although the *QVC* court interpreted Delaware law, history shows that other states tend to follow Delaware's lead.

219. *See* BLOCK ET AL., *supra* note 29, at 403; CLARK, *supra* note 156, § 13.6.

220. *See* BLOCK ET AL., *supra* note 29, at 403.

lock-up stock or asset option advantages,[221] no-shop provisions[222] or breakup fee expense reimbursements[223] and so forth.[224] In the event the hostile acquirer beats the white knight in the takeover contest, these provisions impair the target corporation's financial condition, thus making the target less attractive to the acquirer.

Courts have upheld and enjoined transactions with white knights depending upon the facts and circumstances. Courts allow lock-up options, provided that they are reasonable under *Unocal*.[225] If a target board adopts a lock-up option after *Revlon* has been triggered, a court will not uphold the provision.[226] Since *Unocal*, courts have repeatedly invalidated lock-up asset agreements, but in most of these cases *Revlon* had been triggered.[227] Similar to the lock-up asset agreements, courts generally enjoin no-shop provisions.[228] Despite the similarity to

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221. *See* BLOCK ET AL., *supra* note 29, at 403; CLARK, *supra* note 156, § 13.6. Target management gives asset options when it enters into a sales contract with the white knight for a valuable portion of the target corporation and the contract is not subject to shareholder approval. CLARK, *supra* note 156, § 13.6. These options may insure that the white knight will take control of the corporation. *See* BLOCK ET AL., *supra* note 29, at 404; *Responsibilities of Corporate Officers*, *supra* note 15, ¶ 702.

222. BLOCK ET AL., *supra* note 29, at 426. These provisions reduce the possibility that a white knight will lose the takeover battle to a better offer. *Id.* *See supra* note 77 for a definition of no-shop provisions.

223. *See, e.g.*, *QVC*, 637 A.2d at 39 ($100 million fee if the deal did not close). Break-up fee reimbursement provisions require the target to pay a specific amount to the white knight in the event that the transaction is not consummated. BLOCK ET AL., *supra* note 29, at 440-41.

224. *See generally* BLOCK ET AL., *supra* note 29, at 403-58 (discusses examples and terms of white knight transactions).

225. Grimes v. John P. McCarthy Profit Sharing Plan, 610 A.2d 715 (Del. 1992) (affirming the Chancery Court's disposition that lock-up provision did not interfere with the market); *see In re* Vitalink Communications Corp. Shareholders Litigation, [1991-92 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 96,585, at 92,739-40 (Del. Ch. Nov. 8, 1991), *aff'd sub nom.* Grimes v. McCarthy Profit Sharing Plan, 610 A.2d 725 (Del. 1992); Yanow v. Scientific Leasing, Inc., [1991 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 96,189 at 91,012-13 (Del. Ch. July 31, 1991) (stating that window shop clause in the agreement did not operate as a "lock out" provision).

226. *See, e.g.*, *QVC*, 634 A.2d at 45 (noting that enhanced judicial scrutiny will be required before business judgment rule applies).

227. *See, e.g.*, Hanson Trust PLC v. ML SCM Acquisition Inc., 781 F.2d 264, 282-83 (2d Cir. 1986); Mills Acquisition Co. v. Macmillan, Inc., 559 A.2d 1261, 1280-82 (Del. 1988); Revlon, Inc. v. MacAndrews & Forbes Holdings, 506 A.2d 173, 183-84 (Del. 1986).

228. *See, e.g.*, Hanson Trust PLC v. ML SCM Acquisition Inc., 781 F.2d 264, 282 (2d Cir. 1986); *QVC*, 637 A.2d at 51; Mills Acquisition Co. v. Macmillan, Inc., 559 A.2d 1261, 1286 (Del. 1989); *Revlon*, 506 A.2d at 184. *But see* Paramount Communications, Inc. v. Time Inc., 571 A.2d 1140, 1151 (Del. 1990); Barkan v. Amsted Indus., Inc., 567 A.2d 1279, 1288 (Del. 1989). The court's decision in *Time* seems to be an anomaly. Furthermore, in *Barkan*, the court found that the hostile bid may have been inadequate.

no-shop provisions, courts have allowed break-up fees that maximize shareholder value.[229]

Judicial inconsistency regarding treatment of white knight transactions has been resolved by the *QVC* court's focus on the timing of the target board's actions. If a target board adopts a white knight transaction after *Revlon* has been triggered, a court will invalidate the white knight transaction.[230]

7. Poison Pill Shareholder Rights Plans

Numerous versions of the poison pill defense exist. Poison pills have the effect of making a takeover prohibitively expensive by issuing stock rights that entitle shareholders to purchase common stock at a special price,[231] to receive extra dividends,[232] and so forth.[233] Because these rights mature upon success of the acquirer, the target corporation becomes less attractive to the acquirer.

Courts will allow target boards to adopt poison pill shareholder rights plans as appropriate exercises of business judgment.[234] However, at the time a hostile tender offer invokes the poison pill plan, courts will evaluate whether the plan's effect complies with the *Unocal* standard.[235] Although courts have upheld poison pill plans during the auction context,[236] the trend is to disallow any defenses during this period. The recent *QVC* decision reinforces this propo-

229. Samjens Partners v. Burlington Indus., Inc., 663 F. Supp. 614, 625 (S.D.N.Y. 1987); *In re Vitalink*, [1991-92 Transfer Binder] Fed. Sec. L. Rep. (CCH), at 92,739-40.

230. *See supra* part III.B.

231. BLOCK ET AL., *supra* note 29, at 519-21.

232. *Responsibilities of Corporate Officers*, *supra* note 15, ¶ 702.

233. *See generally* BLOCK ET AL., *supra* note 29, at 519-70. The poison pill plans usually are triggered by either a "flip over" provision or a "flip in" provision. Both of these provisions trigger the poison pill plan upon the acquirer's purchase of a certain amount of the target corporation's stock.

234. *See, e.g.*, A. Copeland Enterprises, Inc. v. Guste, 706 F. Supp. 1283, 1292 (W.D. Tex. 1989); Amanda Acquisition Corp. v. Universal Foods Corp., 708 F. Supp. 984, 1008-09 (E.D. Wis.), *aff'd*, 877 F.2d 496 (7th Cir.), *cert. denied*, 493 U.S. 955 (1989); Desert Partners, L.P. v. USG Corp., 686 F. Supp. 1289, 1295-96 (N.D. Ill. 1988); CRTF Corp. v. Federated Dep't Stores, Inc., 683 F. Supp. 422, 437-39 (S.D.N.Y. 1988); Moran v. Household Int'l, Inc., 500 A.2d 1346, 1351-52 (Del. 1985); Providence & Worcester Co. v. Baker, 378 A.2d 121, 124 (Del. 1977).

In the event a state prohibits "discrimination" among shareholders (i.e., all shareholders must have the same voting rights), courts will enjoin the adoption and use of a poison pill plan that discriminates among shareholders. Dynamics Corp. of Am. v. CTS Corp., 794 F.2d 250 (7th Cir. 1986), *rev'd on other grounds*, 481 U.S. 69 (1987).

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

236. *See, e.g.*, CRTF Corp. v. Federated Dep't Stores, Inc., 683 F. Supp. 422, 441 (S.D.N.Y. 1988) (noting that nothing in record suggested that target board acted with any other motive than to enhance bidding during the auction).

sition and suggests that target boards should refrain from modifying or adopting poison pill plans if *Revlon* has already been triggered. Moreover, the *QVC* decision may be construed as a warning that poison pill plans cannot favor one bidder over another without courts deeming them unreasonable.

V. CONCLUSION

The unlimited number of takeover defenses and the varying court reactions to such defenses have been a cause of great uncertainty for corporate boards of directors. After the Delaware Supreme Court's decision in *QVC*, corporate directors should have an outline to follow in deciding what actions to take to fend off hostile tender offers without breaching any fiduciary duties to the corporation or shareholders.

If the target corporation is not "up for sale" as defined by *Revlon* and its progeny, the business judgment rule will protect a target board's decision to implement takeover. However, if the target corporation is "up for sale" as defined by *Revlon* and its progeny, a target board's decision to implement takeover defenses will be subject to enhanced scrutiny. Consequently, in determining whether to implement takeover defenses, target boards should primarily determined whether *Revlon* has been triggered, and then act accordingly.