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The Wake of Paramount v. QVC: Can A Majority Shareholder Avoid Triggering the Auction Duty During A Merger and Retain a Significant Equity Interest? Suggestion: A Pooling of Interests

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NOTES


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INTRODUCTION

Tyler and Julie are fraternal twins, and, like most fourteen year-old children, they enjoy all varieties of music. Their mother has told them that they can buy a compact disc player as long as they do not keep it in the family room. This is not a problem because they have their own rooms. Because it would not make sense for them to purchase two compact disc players and duplicate albums, they agree that Tyler will buy the CD player and Julie will buy several albums. At home, however, they have trouble deciding in whose room the CD player and albums will be kept. In Scenario A, Tyler is willing to compromise. He knows that they have always gotten along well, so he offers to let Julie keep everything in her room on the condition that she will share control of the CD player with him. In Scenario B, Julie wants to keep the CD player in her room more than Tyler does, so she is more willing to compromise. She offers Tyler ten dollars to let her keep the CD player and albums in her room, and they will still share control. Tyler agrees after negotiating an additional five dollars in cash from Julie.

The next day Tyler comes home from school and runs up to Julie’s room to listen to his favorite Bruce Springsteen album. He finds that the door is locked and Julie is inside listening to Mariah Carey’s latest release. He walks away muttering, “I never should have given up control.”

This hypothetical illustration, though simplistic, illustrates how a “change of control” can occur when two parties agree to merge their interests. Even the party that grants a premium—like Tyler in Scenario A (when he granted physical control of the CD player to Julie)—has no guarantee of control after certain types of mergers.

In cases like Scenario A, if Tyler were the board of a corporation, he certainly could be accused of having made a bad deal for his owners, who would no longer have control over the CD player or recourse to get it back. In Scenario B, however, Julie could argue that this is exactly why she paid Tyler fifteen dollars, so that she would have ultimate control. Tyler, having bargained for a premium in cash, would have a difficult time arguing otherwise.
Fortunately for "Tyler Inc.,” assuming it is a Delaware corporation, protection for its shareholders is built into the General Corporation Law of Delaware and has developed through several of the state's Supreme Court decisions. Scenario A is analogous to a stock-for-stock merger as Tyler exchanged some of his equity in the CD player for some of Julie's equity in the albums. Here Delaware law requires, with some limited exceptions, a vote by the shareholders to approve the merger.¹ Scenario B is analogous to a merger where "Tyler Inc." received a control premium ($15) in return for his grant of a controlling interest in the CD player and albums to Julie. In these cases, the Delaware Supreme Court has required corporate boards to maximize the company's value for the shareholders.²

These hypothetical transactions between Tyler and Julie are analogous to recent cases testing the outer limits of director discretion when corporations engage in transactions that have the potential to change the corporation's control structure. In Paramount Communications Inc. v. QVC Network, Inc.,³ the Delaware Supreme Court held that a merger transaction negotiated between Paramount and Viacom, Inc., where Viacom's Chairman would have owned approximately sixty to seventy percent of the merged company's outstanding shares, would constitute a "change of control" in Paramount.⁴ What made this finding significant was the same court's earlier holding in Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.,⁵ which required that when a board recognizes that the company it manages is for sale, its duty changes from preservation of the corporate entity to maximization of the company's value at an auction of the company for the shareholders' benefit.⁶ The Delaware Supreme Court's holding that a "change of control" would have occurred if the merger in the QVC case was consummated required Paramount's board to meet this duty.⁷

Thus the Paramount board’s responsibility to its shareholders required it to shop for the best deal possible, which, as the Chancery Court determined, it had not done because it did not properly consider a competing offer.⁸ In such cases, corporate defensive measures

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³. 637 A.2d 34 (Del. 1994). This case is referred to as QVC throughout this Note to avoid confusion with the Chancery Court's decision in the same case and another case in which Paramount Communications is named as a party.
⁴. Id. at 42-43.
⁵. 506 A.2d 173 (Del. 1986).
⁶. Id. at 182. This duty will be referred to as the "auction duty."
⁸. QVC Network, Inc. v. Paramount Communications Inc., 635 A.2d 1245, 1269 (Del. Ch. 1993), aff'd, 637 A.2d 34 (Del. 1994). This case is referred to as QVC Chancery throughout this Note to avoid confusion with the Delaware Supreme Court's
like poison-pills,\textsuperscript{9} lock-up\textsuperscript{10} agreements and no-shop clauses\textsuperscript{11} are generally not enforceable because they interfere with the maximization of shareholder return in the context of a "corporate auction."\textsuperscript{12} What has proved problematic for boards, courts, practicing attorneys and commentators is the actual determination of when a transaction triggers the \textit{Revlon} duty. In \textit{QVC} the Delaware Supreme Court held that the auction duty prescribed in \textit{Revlon} arises when a transaction either contemplates a change of control of the company or makes the breakup of the company inevitable.\textsuperscript{13}

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\textsuperscript{9} The device most frequently associated with the term "poison-pill" is the share purchase rights plan. In order to prevent a would-be acquiror from acquiring a controlling interest in a target corporation, most rights plans permit the holders of the rights, usually shareholders other than the acquiror, to purchase shares of the target company at half price if the acquiror either (1) purchases more than a specified percent (generally 15-50\%) of the stock of the target or (2) purchases more than some specified percentage of the stock of the target and then engages in "self-dealing" transactions. I Martin Lipton & Erica H. Steinberger, \textit{Takeovers & Freezeouts} § 6.03[4][a] (1994). Another type of "poison-pill" is the note purchase rights plan. Generally, the note purchase right gives the holder a right to "put" his stock to the issuer in exchange for a specified package of securities if a specified percentage of the company is acquired by a third party. \textit{Id.} § 6.03[4][c]. These plans may be validly adopted as "pre-takeover" defenses. See \textit{Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.}, 506 A.2d 173, 180-81 (Del. 1986).

\textsuperscript{10} Lock-up agreements provide friendly acquirors and white knights assurance that the planned transaction will be consummated without interference from hostile offers and/or that they will be compensated if the deal is not consummated. For a long time, lock-ups were generally accepted by courts as a means of inducing a friendly acquiror to enter into a merger agreement. I Lipton & Steinberger, supra note 9, § 1.07[2]. However, several 1985 and 1986 cases cast doubt on the use of lock-ups in certain defensive situations. See \textit{Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.}, 506 A.2d 173 (Del. 1986); \textit{Unocal Corp. v. Mesa Petroleum Co.}, 493 A.2d 946 (Del. 1985). Other decisions, however, have indicated that lock-up options are acceptable even in a competitive bidding situation where a proper record is established. When a bidding contest arises, however, the courts will closely scrutinize the auction process to see whether a lock-up is appropriate. I Lipton & Steinberger, supra note 9, § 1.07[2] (citing \textit{Mills Acquisition Co. v. Macmillan, Inc.}, 559 A.2d 1261 (Del. 1989)).

\textsuperscript{11} A no-shop provision is a covenant by the target company not to solicit or encourage anyone to make a competing bid or to engage in any negotiations with or supply any information to any other person who expresses an interest in acquiring the target company. "In \textit{Revlon}, the court held that a no-shop provision, while not illegal \textit{per se}, is impermissible . . . when a board's primary duty becomes that of an auctioneer responsible for selling the company to the highest bidder;" \textit{Id.} § 5A.03[4][a](quoting \textit{Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.}, 506 A.2d 173, 184 (Del. 1986)).

\textsuperscript{12} \textit{See generally Revlon}, 506 A.2d at 185 (invalidating protective measures that interfered with maximization of value for shareholders where sale of control occurred).

\textsuperscript{13} \textit{Paramount Communications Inc v. QVC Network, Inc.}, 637 A.2d 34, 47-48 (Del. 1994).
Before QVC, however, in Paramount Communications Inc. v. Time, Inc., the Delaware Supreme Court stated that there were generally two circumstances, without excluding other possibilities, that implicated the duties arising under the Revlon case:

1. When a corporation initiates an active bidding process seeking to sell itself or to effect a business reorganization involving a clear break-up of the company.

2. Where, in response to a bidder's offer, a target abandons its long-term strategy and seeks an alternative transaction involving the breakup of the company.

In Time, the Delaware Supreme Court held that a merger agreement between Time, Inc. and Warner Communication, Inc. did not create Revlon duties for Time directors. The court concluded that the transaction did not make the breakup of Time inevitable and that the merger was consistent with the board's long-term plans for the company. The court reached this conclusion despite the fact that Warner shareholders would have received a premium in Time shares to consummate the merger and ultimately would have owned sixty-two percent of the merged entity. By any measure, the Delaware Supreme Court's Time opinion implied that courts would not interfere with business combinations that resulted from a board's thoughtful, well-planned, long-term strategy.

In QVC, however, the Delaware Supreme Court distinguished the proposed Paramount-Viacom merger from the proposed Time-Warner merger, holding that the circumstances of the former resulted in a sale of control and therefore implicated Revlon duties for Paramount's board. At the same time the Delaware Supreme Court seemed to recast Time's meaning and implications by expanding the range of transactions that could trigger Revlon. The QVC decision suggests that companies controlled by individuals, or groups, owning controlling blocks of shares cannot participate in friendly mergers without running the risk of putting the partner corporation "in play" if the individual or block will continue to hold a significant equity interest in the combined corporation.

14. 571 A.2d 1140 (Del. 1990). This case is referred to as Time throughout this Note to avoid confusion with the Delaware Chancery Court's decision in the same case and another case in which Paramount Communications is named as a party.

15. Id. at 1150.

16. Id.

17. Id.

18. Id. at 1151.

19. Id.

20. Id. at 1146.


22. As used in this Note the phrase "in play" means that the entity becomes committed to an auction for control if another bidder makes a competing offer.
This Note distinguishes the Time and QVC cases. It highlights how QVC casts new light on the Time decision and "tightens the leash" on directors in the exercise of their fiduciary obligation to shareholders when assessing transactions affecting a corporation's structure. It also suggests a possible way in which companies controlled by shareholder blocks may merge with other companies without implicating Revlon. Part I introduces the legal principles necessary to the discussion of the above issues: the business judgment rule, the standard established by the Delaware Supreme Court in Unocal Corp. v. Mesa Petroleum Co., and the Revlon standard. Part II traces the evolution of the Revlon standard by discussing and comparing the Time and QVC cases. Part III argues that the QVC decision creates an additional hurdle for companies controlled by single shareholders or groups owning blocks of shares that wish to participate in the merger market, as opposed to corporations that may be similar in size but have ownership spread among many shareholders. This Part then argues that the boards of such companies can avoid Revlon duties by including protective devices for non-controlling stockholders in the terms of a merger agreement; specifically, the boards of such companies can avoid triggering the Revlon duty by structuring mergers as poolings of interests, an accounting term for a pure common stock merger. This Note concludes by suggesting that Delaware's courts should not apply Revlon where mergers are structured as poolings of interests.

I. LEGAL PRINCIPLES AND BACKGROUND

A discussion of some legal principles in the area of corporate governance provides a useful foundation for the analysis that follows in Parts II and III.

A. Delaware Law and the Business Judgment Rule

Section 141 of Delaware's General Corporation Law contains the general grant of powers given to boards of directors of companies incorporated in Delaware. In addition to the powers conferred in sec-

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23. This Note does not purport to define the phrase "change of control." It instead suggests a form of transaction that provides enough structural protection to non-controlling shareholders so that it should not trigger the Revlon duty as defined by the QVC decision.
25. Section 141(a) states:

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

tion 141, the board may deal in the corporation's stock.\textsuperscript{26} Thus, the board may offer shares as consideration for the purchase of an asset, or offer a benefit, such as a stock purchase rights plan, to the shareholders as a defensive measure to prevent a hostile takeover.\textsuperscript{27} Finally, a board has a fundamental duty to protect the corporate enterprise, which includes stockholders, from harm reasonably perceived, irrespective of its source.\textsuperscript{28} The directors' duty does not include an obligation to maximize the immediate value of the corporation or its shares;\textsuperscript{29} therefore, directors, when acting deliberately, in an informed manner, and in the good faith pursuit of corporate interests, may follow a course designed to achieve long-term value even at the cost of immediate value maximization.\textsuperscript{30}

Courts have developed the "business judgment rule" as the standard for reviewing corporate board decisions challenged by stockholders.\textsuperscript{31} The business judgment rule is "a presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company."\textsuperscript{32} Thus, Delaware's courts hesitate to review board decisions themselves, but focus instead on the circumstances surrounding the decisions. If these circumstances show

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\textsuperscript{26} Section 160(a) of the Delaware General Corporation Law states: "Every corporation may purchase, redeem, receive, take or otherwise acquire, own and hold, sell, lend, exchange, transfer or otherwise, dispose of, pledge, use and otherwise deal in its own shares." Del. Code Ann. tit. 8, § 160(a) (1993).

\textsuperscript{27} See 1 Lipton & Steinberger, supra note 9, § 6.03[4]. The directors, however, are prohibited from acting in such a manner if the sole purpose is to entrench themselves in office. See, e.g., Cheff v. Mathes, 199 A.2d 548, 554 (Del. 1964).

\textsuperscript{28} See, e.g., Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 954 (Del. 1985).

\textsuperscript{29} Paramount Communications, Inc. v. Time, Inc., Fed. Sec. L. Rep. (CCH) $94,514, at 93,277 (Del. Ch. 1989), aff'd, 571 A.2d 1140 (Del. 1990). This case is referred to as Time Chancery throughout this Note to avoid confusion with the Delaware Supreme Court's decision in the same case and another case in which Paramount Communications is named as a party.

\textsuperscript{30} Id.

\textsuperscript{31} Delaware case law repeatedly suggests that a high level of deference should be accorded to board decisions. E.g., Grobow v. Perot, 539 A.2d 180, 191-92 (Del. 1988) (dismissing challenge to board's decision to repurchase block of shares from dissident shareholder); Moran v. Household Int'l Inc., 500 A.2d 1346, 1356 (Del. 1985) (affirming adoption of a share purchase rights plan); Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 954 (Del. 1985) ("[A] court will not substitute its judgment for that of the board if the latter's decision 'can be attributed to any rational business purpose.'") (citation omitted); Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984) ("Absence of abuse of discretion, [a board's] judgment will be respected by the courts."); Sinclair Oil Corp. v. Levien, 280 A.2d 717, 720 (Del. 1971) ("[A board's] decisions will not be disturbed if they can be attributed to any rational business purpose. A court under such circumstances will not substitute its own notions of what is or is not sound business judgment.").

\textsuperscript{32} Aronson, 473 A.2d at 812 (Del. 1984). For a detailed discussion of the development of the business judgment rule, see Dennis J. Block et al., The Business Judgment Rule 1-49 (4th ed. 1993).
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good faith on the part of the board, the courts will dismiss challenges to a board’s actual decision even if it proved to be a poor one.

When the facts surrounding a decision raise the possibility that a board may be acting primarily in its own interest, there is no longer a presumption in favor of the board. In such cases the board must meet an enhanced standard which requires judicial examination at the threshold of the action before a court may confer the protection of the business judgment rule upon the decision. Therefore, when addressing a challenge to a board decision and determining whether that decision should be accorded the protection of the business judgment rule, a court must consider the circumstances surrounding the decision before determining if the business judgment rule is applicable. When considering challenges to a board’s actions in the context of a business combination or corporate takeover, Delaware’s courts generally look to the Unocal and Revlon standards to determine if the board has met its obligations to the shareholders.

B. Permissible Responses to Takeover Threats

The Unocal case introduced the modern standard used by the Delaware courts when assessing whether a board’s response to a takeover threat is entitled to the protection of the business judgment rule. This standard requires a two-part analysis of any defensive measures taken by a board in response to a threat to corporate control. First, the directors must not have acted solely or primarily out of a desire to perpetuate themselves in office; therefore, the court must determine if the measure was motivated by reasonable investigation and good faith concern for the welfare of the corporation and its stockholders.

33. Unocal, 493 A.2d at 954.
34. Different facts require different analyses before the business judgment rule may be applied. For example, when reviewing the decision of a Special Litigation Committee not to proceed with a derivative lawsuit by a shareholder against a corporate officer, a court actually may use its own business judgment to determine whether the litigation should have been pursued, even if the court finds that the decisionmakers acted in good faith and were independent. Zapata Corp. v. Maldonado, 430 A.2d 779, 788–89 (Del. 1981). Yet such interference with a board’s judgment would not be acceptable when reviewing, for example, a decision to close a factory, or not to play baseball games at night, because there is less danger that the board is acting in its own interests. See, e.g., Shlensky v. Wrigley, 237 N.E.2d 776 (Ill. App. Ct. 1968) (refusing to interfere with board’s choice not to offer night baseball games).
35. 493 A.2d 946 (Del. 1985).
36. Id. at 955. The Unocal standard can be described as the offspring of Cheff v. Mathes, 199 A.2d 548 (Del. 1964), as the first step of the analysis was taken from that case. The Unocal court went on to admonish that “[w]e must bear in mind the inherent danger in the purchase of shares with corporate funds to remove a threat to corporate policy when a threat to control is involved. The directors are of necessity confronted with a conflict of interest, and an objective decision is difficult.” 493 A.2d at 955 (quoting Bennet v. Propp, 187 A.2d 405, 409 (Del. 1962)).
ond, if a defensive measure is to fall within the realm of the business judgment rule, it must be reasonable in relation to the threat posed.37

Defensive measures became increasingly important during the 1980s, even in the absence of a specific raider, as the possibility of a hostile takeover was a threat to any company at any time.38 Because of the ever-present possibility of a hostile takeover interfering with strategic plans and transactions, many corporations adopted measures to deter unwelcome suitors,39 and such measures normally survived

37. 493 A.2d at 955. This entails an analysis by the directors of the nature of the threat and its effect on the corporate enterprise. Factors to consider include: inadequacy of the price offered, nature and timing of the offer, legal issues, impact on parties other than the shareholders, risk of nonconsummation, and the quality of the securities offered in exchange. The board should also consider long-term and short-term shareholder interests. Id. at 955-56.

In Unocal, the Delaware Supreme Court considered the propriety of an injunction granted by the Chancery Court to prevent a stock exchange plan enacted to thwart a hostile takeover. Mesa, a company that was perceived as participating in the practice of “greenmail” (see infra note 47 for definition), had made a two-part tender offer for Unocal which Unocal’s board had determined was inadequate.

As a defensive measure Unocal’s board adopted a plan that would require the company to buy back its own shares at a price significantly higher than Mesa’s offer if Mesa were to acquire a specific percentage of shares. This planned buy-back excluded Mesa from participation. Mesa challenged this aspect of the plan.

The Delaware Supreme Court reversed the Chancery Court’s decision, which enjoined Unocal from implementing this defense, based on findings that the buy-back offer was made in the good-faith belief that Mesa’s offer was inadequate, that the action was informed and taken with due care, and that the action was reasonable in response to a “greenmail” threat. Id. at 959.

38. Much of the responsibility for the activity of the 1980s has been attributed to Michael Milken, head of high-yield securities at Drexel Burnham Lambert, as his ability to raise huge sums of money in relatively little time meant that any size corporation could be a target. As one author described:

The big money was in the struggle for corporate control, in mergers and acquisitions and, increasingly, in a variation that seemed even more promising to Milken: the leveraged buyout. . . . It was clearly just a matter of time before Milken, having quietly nurtured his financing network into a huge money-spewing engine, burst upon the takeover scene. . . . Milken often told [an associate], there would be no deal that he couldn’t do, no company so big that it need not fear his power. “We’re going to tee-up GM, Ford and IBM. . . . And make them cringe.”


39. See supra notes 9-11 and accompanying text. Courts have upheld a wide variety of takeover defense tactics. See, e.g., Barkan v. Amstel Indus., Inc., 567 A.2d 1279 (Del. 1989) (finding that management buyout was fair response to threat posed by a reputed “greenmailer” who had acquired a significant portion of the company); Ivanhoe Partners v. Newmont Mining Corp., 535 A.2d 1334 (Del. 1987) (upholding asset sale and dividend to shareholders in response to hostile tender offer); Moran v. Household Int’l, Inc., 500 A.2d 1346 (Del. 1985) (approving preferred purchase rights plan that would dilute raider’s holdings). See also Panter v. Marshall Field & Co., 646 F.2d 271 (7th Cir.) (upholding corporation’s entry into acquisition transaction to frustrate potential raider with antitrust complications), cert. denied, 454 U.S. 1092 (1981). Other defenses that have been upheld include “white knight” and “scorched earth” defenses. A “white knight” is an acquiror either preferred by management or invited to bid for the target corporation. See Andrea Lowenthal, Note, Corporate Takeovers and the Business Judgment Rule: The Second Circuit Puts Target Corporations on the
Unocal scrutiny.\textsuperscript{40} Where a court is asked to review a transaction approved by a corporation's board that would be construed as a sale of the corporation or could result in the break-up of the company, the Revlon decision prescribes the applicable standard of review for determining whether the business judgment rule applies to the decision.\textsuperscript{31} The difference between the Unocal and Revlon standards is that the former is used to assess reactions to threats to corporate policy or continuity, while the latter is used to assess actions taken by the board to effect its own policy choices that might result in a change to the corporation's control structure or long-term strategy. When the policy choice in question is a departure from established policy in response to a perceived threat, the standards may overlap.

The Revlon duty requires that a board, upon recognition that the corporation is for sale, must maximize the company's value at an auction for the stockholders' benefit.\textsuperscript{42} The board only retains discretion

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\textsuperscript{40} Auction Block, 53 Brook. L. Rev. 409, 414 n.23 (1987). A target employs a "scorched earth" defense by selling off valuable assets that may have initially attracted a potential bidder in order to reduce interest in a takeover. \textit{Id.} at 419 n.48.
\textsuperscript{41} 506 A.2d 173, 182 (Del. 1985). In \textit{Revlon}, the Delaware Supreme Court affirmed a lower court decision enjoining the Revlon board from consummating a transaction with a "white knight" bidder in an attempt to thwart the efforts of a hostile party to acquire Revlon. The transactions in question were: (a) an option granting the "white knight," Forstmann Little Co., the right to purchase certain Revlon assets at a specified price (a lock-up arrangement); (b) a $25 million cancellation fee to be paid if the transaction were aborted; and (c) a no-shop clause meaning that Revlon could only deal with Forstmann Little if the company were to be taken over. \textit{Id.} at 175.

As in Unocal, this case involved an unfriendly bid for Revlon that the Revlon board had rejected as insufficient. In \textit{Revlon}, however, the board, while considering the hostile offer, began to examine possible alternatives to the offer, including a leveraged buyout by Forstmann Little. \textit{Id.} at 178.

The facts of the case show that Revlon's board granted several advantages to Forstmann Little: besides the lock-up and cancellation fee, Forstmann Little had financial information about Revlon that the competitor did not. Therefore the parties were not negotiating on an even playing field. The court's analysis of Revlon's earlier defensive measures—a corporate buyout plan and stock exchange offer for 10 million shares—would have survived a Unocal analysis. See \textit{Id.} at 181. The Revlon board's fatal mistake was its decision to search for an alternative bidder:

The Revlon board's authorization permitting management to negotiate a merger or buyout with a third party was a recognition that the company was for sale. The duty of the board . . . thus changed from the preservation of Revlon as a corporate entity to the maximization of the company's value at a sale for the stockholders' benefit.

\textit{Id.} at 182.

The grants of the asset lock-up provision, the no-shop clause, and the cancellation fee were deemed breaches of the directors' duty of care because these devices interfered with the board's ability to maximize the company's value for the shareholders. \textit{Id.} at 182-85. Because "[n]o . . . defensive measure can be sustained when it represents a breach of the directors' fundamental duty of care," these measures were invalidated. \textit{Id.} Ultimately the board was required to conduct an auction for control of the corporation, which resulted in the takeover of the company by the hostile bidder.


\textsuperscript{42} Revlon, 506 A.2d at 182.
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over the type of auction procedure to implement in carrying out this
duty. According to the Delaware Supreme Court's most recent
proclamation in QVC, the Revlon duties are implicated when a corpo-
ration undertakes a transaction that will cause a change in corporate
control or a breakup of the corporate entity.

II. The Evolution of the Revlon Trigger

The Delaware Supreme Court's formulation of the various circum-
stances requiring a corporation's board to meet Revlon's requirements
evolved primarily in three stages. This part discusses the cases which
comprise the stages in the Revlon trigger's development.

A. Barkan v. Amsted Industries

In Barkan v. Amsted Industries, the Delaware Supreme Court at-
tempted to define the type of event that would trigger Revlon obliga-
tions. In Barkan, Amsted Industries' board of directors had become
concerned that Charles Hurwitz, a reputed "greenmailer," was acquir-
ing significant amounts of Amsted common stock. In response to
this threat, the board adopted a common stock purchase rights plan (a
poison-pill) as a deterrent. Next, the board considered a leveraged
buyout involving an Employee Stock Ownership Plan ("ESOP"); ulti-
mately this resulted in a proposal by the ESOP's representatives and
senior management to purchase Amsted. The board's special committee
assigned to investigate these strategies had hired an investment banking firm which opined that the price
offered in the proposal was high in the range of fairness. After ne-
egotiating a modest increase in the cash component of the offer, the
special committee approved the transaction and recommended it to
the full board, which also voted its approval. Hurwitz, the green-
mailer, and four other shareholders challenged the adequacy of the
transaction in Delaware's Chancery Court. This challenge was set-
tled before any discovery was conducted after another slight increase

43. Ronald J. Rinaldi, Note, Radically Altered States: Entering the "Revlon Zone,"
44. Paramount Communications Inc v. QVC Network, Inc., 637 A.2d 34, 48 (Del.
1994).
45. Id.
46. 567 A.2d 1279 (Del. 1989).
47. Id. at 1282. The term "greenmail" refers to stock accumulation coupled with
threats of takeover attempts or proxy fights to force a buyback at a premium. The
greenmailer's goal is not to acquire the company but to be bought out at a good price.
1 Lipton & Steinberger, supra note 9, § 1.06[7].
49. Id.
50. Id. at 1283.
51. Id.
52. Id.
was added to the package. Finally, the buyout offer closed with the tender of eighty-nine percent of Amsted’s outstanding stock.

Barkan, a shareholder, filed his action one week later and joined the prior class action which, although settled, had not received final approval from the Chancery Court. After the Chancellor approved the settlement, Barkan appealed. He argued, among other things, that the Amsted directors breached their fiduciary duties of loyalty and care by not implementing procedures designed to maximize Amsted’s price when the sale became inevitable, thus violating Revlon’s requirements.

The Delaware Supreme Court affirmed the approval of the settlement, holding that the board had not violated its fiduciary duty to the shareholders. The court also provided some guidance on Revlon:

We believe that the general principles announced in [Revlon] . . . govern this case and every case in which a fundamental change of corporate control occurs or is contemplated. . . . However, Revlon does not demand that every change in the control of a Delaware corporation be preceded by a heated bidding contest. Revlon is merely one of an unbroken line of cases that seek to prevent the conflicts of interests that arise in the field of mergers and acquisitions by demanding that directors act with scrupulous concern for fairness to shareholders.

This case suggested that any transaction which results in a “fundamental change of corporate control” implicates Revlon duties. In Time, however, less than three months later, the Delaware Supreme Court appeared to limit this holding by defining general circumstances that would implicate Revlon duties.

B. Paramount v. Time

On March 3, 1989, the boards of Time and Warner authorized a merger agreement. The agreement created a twenty-four member board equally divided between incumbent board members of the two companies. To protect editorial independence in Time’s magazine divisions, editors would report to a special committee consisting of two former Time directors and one former Warner director. The merger agreement also provided a parallel structure for management

53. Id.
54. Id.
55. Id.
56. Id. at 1281.
57. Id. at 1285.
58. Id. at 1286-88.
59. Id. at 1286.
61. Id. at 93,269.
62. Id.
of Warner's relationship with creative artists. J. Richard Munro, Time's CEO, and Stephen Ross, CEO of Warner, were to share the chief executive officer position until 1990 when N. J. Nicholas would succeed Munro. Then, upon Ross' retirement, Nicholas would remain as the lone chief executive officer.

As for the stockholders, the transaction was structured as a stock for stock exchange. Time's board agreed to an exchange ratio of .465 Time shares for each Warner share. This represented approximately a twelve percent premium for Warner's shareholders as the actual market value of each Warner share was approximately .38 of each Time share. Ultimately, had the merger been consummated, Warner's stockholders would have owned sixty-two percent of the common stock and voting power of Time-Warner.

In Time, the original merger agreement between Time and Warner included a share exchange agreement and a no-shop provision. While noting that these protective measures were not at issue in this case because the transaction was ultimately abandoned, the Delaware Supreme Court agreed with the trial court that inclusion of these defensive measures did not violate the Unocal standard of care in this case.

63. Id.
64. Id.
65. Id. at 93,270.
66. Id.
67. Id. at 93,279. Even if Warner's shareholders had not been granted a premium, they would have owned a majority of the new entity. Warner had approximately 180 million shares outstanding (17,292,747 divided by 9.4%, id. at 93,270), while the market ratio of Time shares to Warner was .38 per share. Therefore, at market, Time would have been required to issue approximately 68.4 million shares. This, compared to the approximately 57 million shares of Time which were already outstanding (Time's charter authorized up to 200 million shares, id. at 93,266), still would have given Warner's shareholders a majority interest in Time-Warner.
68. The share exchange agreement provided that Time would receive 9.4% of Warner's outstanding common stock and Warner would receive 11.1% of Time's outstanding shares if either party triggered the exchange. Id. at 93,270.
69. The no-shop clause prevented Time from considering any other consolidation proposals, regardless of their merits. Time did so at Warner's insistence. Warner did not want to be left "on the auction block" for an unfriendly suitor, if Time withdrew from the deal. Id. at 93,271.
70. Paramount Communications Inc. v. Time, Inc., 571 A.2d at 1151 n.15 (Del. 1990). The Delaware Supreme Court stated:

Although the legality of various safety devices adopted to protect the original agreement is not a central issue, there is substantial evidence to support each of the trial court's related conclusions. Thus, the court found that the concept of the Share Exchange Agreement predated any takeover threat by Paramount and had been adopted for a rational business purpose: to deter Time and Warner from being "put in play" by their March 4 agreement. The court further found that Time had adopted the "no-shop" clause at Warner's insistence and for Warner's protection.

Id.
On June 7, 1989, Paramount Communications challenged the Time-Warner merger with a tender offer of $175 per share, in cash, for all outstanding Time shares. This offer caused the companies to terminate the merger and recast the transaction as an outright purchase of Warner by Time.\(^{71}\) Under New York Stock Exchange rules, the merger agreement would have required approval by Time’s shareholders because of the number of shares to be issued.\(^{72}\) After Paramount’s bid, Time’s board felt that such approval would be “problematic.”\(^{73}\) The purchase agreement, however, did not require shareholder approval.\(^{74}\)

In response to the new agreement, Paramount raised its offer to $200 per share.\(^{75}\) The Time board rejected Paramount’s offer as insufficient, concluding that the Warner purchase offered greater long-term value for the stockholders and did not pose a threat to Time’s “culture.”\(^{76}\) After its $200 offer was rejected, Paramount filed suit in Delaware seeking an injunction to restrain Time from completing the purchase transaction. Paramount argued that Time’s board had breached its duty to Time’s shareholders by not considering the Paramount offer.\(^{77}\)

Paramount argued only that Time’s board breached its duty under \textit{Unocal} by approving the purchase transaction over Paramount’s offer.\(^{78}\) Time prevailed. Delaware’s Supreme Court found that Time reasonably responded to the threat that Paramount posed to Time’s

\(^{71}\) Paramount Communications, Inc. v. Time, Inc., Fed. Sec. L. Rep. (CCH) \(194,514\), at 93,265 (Del. Ch. 1989), aff’d, 571 A.2d 1140 (Del. 1990). The agreement was structured in two tiers. Time made an immediate all-cash offer for 51% of Warner’s outstanding stock at $70 per share. The remaining 49% of stock would be purchased at a later date for a mixture of cash and securities worth $70 per share. \textit{Id.}

\(^{72}\) \textit{Id.} at 93,270. The New York Stock Exchange Listed Company Manual \S 312.03(c) (1990) requires, as a prerequisite to listing, shareholder approval prior to the issuance of securities if: common stock or securities convertible into or exercisable for common stock are to be issued in any transactions, other than a public offering for cash, and (i) if the common stock has or will have upon issuance voting power equal to or in excess of 20% of the voting power outstanding before the issuance of such stock or securities convertible into or exercisable for common stock, or (ii) the number of shares of common stock to be issued is or will be equal to or in excess of 20% of the number of shares of common stock outstanding before the issuance of the stock.

\(^{73}\) \textit{Time Chancery} at 93,273.

\(^{74}\) \textit{Id.} at 93,272.

\(^{75}\) Paramount Communications Inc. v. Time, Inc., 571 A.2d 1140, 1149 (Del. 1990).

\(^{76}\) \textit{Id.}

\(^{77}\) \textit{Time Chancery} at 93,265.

\(^{78}\) \textit{Time}, 571 A.2d at 1149. Paramount argued that Time’s leveraged buyout agreement to purchase Warner was an unreasonable reaction to the perceived threat posed by Paramount’s tender offer. \textit{Time Chancery} at 93,281. The Delaware Supreme Court, applying \textit{Unocal}, determined that Time’s board reasonably, and in good faith, determined that Paramount’s offer posed a threat to corporate policy and
strategic plans for the company, which included a merger with Warner.\textsuperscript{79} The shareholder-plaintiffs, who had joined Paramount’s action, advanced a different argument—that the Time board breached its Revlon duty.\textsuperscript{80} The shareholder-plaintiffs argued that Revlon duties were triggered by the original merger agreement because of: (1) the fact that Warner shareholders would own sixty-two percent of the merged entity;\textsuperscript{81} (2) the director’s perceptions that they were putting the company up “for sale;”\textsuperscript{82} (3) the adoption of various defensive measures in the agreement;\textsuperscript{83} and (4) the assertion that the merger with Warner would preclude Time shareholders from ever receiving a control premium for their Time interests.\textsuperscript{84}

The ultimate issue was summarized as follows: “Under what circumstances must a board of directors abandon an in-place plan of corporate development in order to provide its shareholders with the option to elect and realize an immediate control premium?”\textsuperscript{85} In other words, when does a transaction trigger the Revlon duty?

Focusing on the distribution of ownership contemplated before and after the merger, the Chancery Court held that the terms of the original agreement did not constitute a “change of control” sufficient to invoke Revlon duties:

I am entirely persuaded of the soundness of the view that it is irrelevant for purposes of making such a determination that 62% of Time-Warner stock would have been held by former Warner shareholders. . . . But where, as here, the shares of both constituent corporations are widely held, corporate control can be expected to remain unaffected by a stock for stock merger. . . . When the specif-

stockholder interests, and that the board was not motivated by entrenchment or self interest. \textit{Time}, 571 A.2d at 1153.

79. \textit{Id.} at 1155. Paramount argued that, assuming its tender offer posed a threat, Time’s response was unreasonable because it precluded Time’s shareholders from accepting the tender offer or receiving a control premium in the immediately foreseeable future. \textit{Id.} at 1154. Delaware’s Supreme Court concluded that the directors were not obliged to abandon a deliberately conceived corporate plan for a short term shareholder profit unless there is clearly no basis to sustain the corporate strategy. \textit{Id.} at 1154. Because the transaction was not aimed at “cramming down” on its shareholders management’s alternative offer, the response was reasonably related and proportionate to the threat. \textit{Id.} at 1154-55. “In essence, Paramount was asking the courts to enjoin Time from acquiring an asset because Paramount preferred to effect an acquisition of Time without that asset.” Brief for Appellee at 38, Paramount Communications Inc. v. QVC Network, Inc., 635 A.2d 1245 (Del. Ch. 1993) (Nos. 427 & 428).

80. \textit{Time}, 571 A.2d at 1149.
81. \textit{Id.}
82. \textit{Id.}
83. \textit{Id.}
ics of that situation are reviewed . . . neither corporation could be said to be acquiring the other. Control of both remained in a large, fluid, changeable and changing market.\textsuperscript{86}

The Chancellor continued:

The existence of a block of stock in the hands of a single shareholder or a group with loyalty to each other does have real consequences to the financial value of "minority" stock. The law offers some protection to such shares through the imposition of a fiduciary duty upon controlling shareholders. . . . The shareholders of Time would have "suffered" dilution, of course, but they would suffer the same type of dilution upon the . . . public distribution of new stock.\textsuperscript{87}

Addressing the stockholders' second argument, that they would be precluded from ever receiving a control premium, the Chancery Court held that the transaction did not legally prevent a later sale of the merged entity.\textsuperscript{88} Thus a would-be acquiror has no right to preempt the directors' exercise of power pending the outcome of an acquisition battle unless the acts are found to be defensive in nature \textit{and} a violation of Unocal's standard of care.\textsuperscript{89}

The Chancery Court then returned to the original merger agreement. First it noted that Delaware law created no right in the Time shareholders to vote on the Warner merger,\textsuperscript{90} although NYSE rules did.\textsuperscript{91} Then the Chancellor stated: "I am aware of no principle, statute or rule of corporation law that would hold that once a board approves an agreement of merger, it loses power to reconsider that

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\textsuperscript{86} \textit{Time Chancery} at 93,279-280.  \\
\textsuperscript{87} Id. at 93,280.  \\
\textsuperscript{88} Id.  \\
\textsuperscript{89} Id.  \\
\textsuperscript{90} Delaware's General Corporation Law states:

\begin{quote}
Notwithstanding the requirements of subsection (c) of this section, unless required by its certificate of incorporation, no vote of stockholders of a constituent corporation surviving a merger shall be necessary to authorize a merger if (1) the agreement of merger does not amend in any respect the certificate of incorporation of such constituent corporation, (2) each share of stock of such constituent corporation outstanding immediately prior to the effective date of the merger is to be an identical outstanding or treasury share of the surviving corporation after the effective date of the merger, and (3) either no shares of common stock of the surviving corporation and no shares, securities or obligations convertible into such stock are to be issued or delivered under the plan of merger, or the authorized unissued shares or the treasury shares of common stock of the surviving corporation to be issued or delivered under the plan of merger plus those initially issuable upon conversion of any other shares, securities or obligations to be issued or delivered under such plan do not exceed 20\% of the shares of common stock of such constituent corporation outstanding immediately prior to the effective date of the merger. . . .
\end{quote}

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\textsuperscript{91} \textit{See supra} note 72 and accompanying text.
\end{flushright}
action prior to a shareholder vote." Therefore, even though the re-casting of the merger transaction as a purchase was a vehicle for avoiding a shareholder vote that management suspected it would lose, the action did not violate the board's fiduciary duty because the board's action was within its discretion. Ultimately, this justified treating the original merger agreement as a moot transaction—and the court could disregard any implications it may have created.

The Delaware Supreme Court, however, rejected the *Revlon* claims on different grounds. The court held that there was no "substantial evidence to conclude that Time's board, in negotiating with Warner, made the dissolution or break-up of the corporate entity inevitable, as was the case in *Revlon*." The court then proceeded to instruct that, without excluding other possibilities, generally two circumstances implicate *Revlon* duties: (1) when a corporation voluntarily initiates an active bidding process to sell itself or to effect a business reorganization involving a clear break-up of the company, and (2) where a target abandons its long-term strategy in response to a bidder's offer and seeks an alternative transaction also involving the breakup of the company.

The Delaware Supreme Court did not decide whether the Chancery Court correctly ignored the original agreement's anticipated concentration of ownership of the corporation in the hands of Warner's shareholders. Its silence on the issue seemed at the very least to imply that the Supreme Court did not disagree with the Chancery Court on this point.

The *Time* decision received mixed reviews from commentators. Most agreed, however, that the decision implied that greater defer-

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92. *Time* Chancery at 93,281.
94. *Id.*
95. *Id.*
96. Most of the commentary focuses on the effect the decision had in limiting the scope of *Unocal*. See, e.g., Paul E. Burns, *Timing is Paramount: The Impact of Paramount v. Time on the Law of Hostile Takeovers*, 19 Fla. St. U. L. Rev. 761, 803 (1992) ("The Paramount case shows that *Unocal's* enhanced business judgment rule has developed into an effective compromise between the corporation's need for power to be exercised by a knowledgeable and informed board of directors and the shareholders' need to be protected from the 'omnipresent specter' of board entrenchment."); Robert E. Bull, Note, *Directors' Responsibilities and Shareholders Interests in the Aftermath of Paramount Communications v. Time, Inc.*, 65 Chi.-Kent L. Rev. 885, 915 (1989) ("The Time shareholders' interests, as well as the interests of shareholders similarly situated in the future, have been severely lessened by the court's decision."); Daniel S. Cahill & Stephen P. Wink, Note, *Time and Time Again the Board is Paramount: The Evolution of the Unocal Standard and the Revlon Trigger Through Paramount v. Time*, 66 Notre Dame L. Rev. 159, 210 (1990) ("The Time Decision was a reasoned solution to the competing interests of the business judgment rule and the intrinsic fairness test."); E. Ashton Johnston, Note, *Defenders of the Corporate Bastion in the Revlon Zone: Paramount Communications Inc v. Time, Inc.*, 40 Cath. U. L. Rev. 155, 185 (1990) ("The Delaware Supreme Court's decision in Paramount disre-
ence would be paid to board decisions involving corporate strategy even where the long-term benefit is not apparent to the average shareholder. In addition, the *Time* decision appeared to narrow *Revlon*'s applicability. Because the *Time* court chose to list the general scenarios that would implicate *Revlon*, it was unclear whether *Barkan*’s "change of control" formulation was still a viable definition of the *Revlon* trigger. Typical interpretations of *Time* reflected the belief that the case materially reduced *Revlon*'s applicability, and even the Delaware courts acknowledged the inconsistency between the *Time* and *Barkan* holdings.

The first case to suggest the difficulty posed by the *Time* holding was *In re Wheelabrator Technologies Shareholders Litigation*. Waste Management, Inc., after acquiring a twenty-two percent equity interest in Wheelabrator Technologies, Inc. and designating four of its eleven directors, decided to increase its ownership interest to fifty-five percent. Wheelabrator's board unanimously approved the transaction, which took the form of a stock-for-stock merger in which each share of Wheelabrator common stock would be converted into .574 shares of newly issued Wheelabrator stock and .469 shares of Waste Management stock.

Several Wheelabrator shareholders challenged this transaction as a change of control implicating *Revlon* duties; they also claimed that the board violated its duty by not conducting a market check to assure itself that there were no superior alternative transactions. The Chancery Court did not decide whether *Revlon* duties were implicated because the plaintiffs had not pleaded allegations to support the conclusion that the board breached its duties, even if *Revlon* had applied.

Under *Barkan* it appears that a board becomes subject to *Revlon* duties whenever "a fundamental change of corporate control occurs or is contemplated" ... and that the nature of those duties depends upon the interests of the shareholders and the manner in which the transaction is executed...
upon particular factual circumstances. Barkan holds that when only one bidder is present, the directors have a duty to be adequately informed of the value of their own company before committing it to a change-of-control transaction. If the directors act without that knowledge they breach that duty, unless they first conduct an auction or canvass the market.105

The Chancery Court noted that the premise of Time appeared more narrow:

Because Barkan appears not to fit within [Time's] categories, it would be difficult to conclude with confidence that the Barkan formulation was intended as one of [Time's] "other possibilities." It is, of course, possible that [Time] rejects the more generic Barkan formulation of when Revlon duties arise, and, thus, overrules Barkan sub silentio on that point. Absent a clear indication to that effect by our Supreme Court, however, I am not prepared to so conclude. . . . Fortunately, this case does not require the Court to reconcile the standard of [Time] with that of Barkan.106

Delaware's Supreme Court resolved the dichotomy between these cases in Paramount Communications v. QVC Network.107

C. Paramount v. QVC

On September 12, 1993, Paramount and Viacom entered into a merger agreement in which Paramount's shareholders would receive a combination of Viacom shares and cash valued at $69.14 per share.108 The combined value per share constituted a premium over the market price of approximately fifteen dollars.109 Paramount's board understood that after the merger Sumner Redstone, chairman of Viacom, would emerge as the controlling shareholder of the new entity as he already owned approximately a seventy-seven percent interest in Viacom's class A stock and a sixty-two percent interest in its class B stock.110 Redstone would have owned approximately seventy percent of the new entity if the transaction had been consummated.111 Martin Davis, Paramount's CEO, would remain as CEO of the combined entity despite the change in stock ownership.112

The agreement contained: (1) a lock-up provision which granted Viacom an option to purchase up to 19.9% of Paramount's outstanding common stock at the merger price;113 (2) a no-shop clause;114 and

105. Id. at *25-26.
106. Id. at *27-28.
107. 637 A.2d 34 (Del. 1994).
109. Id. at 1251.
110. Id. at 1247.
111. Id. at 1251.
112. Id.
113. Id. at 1250-51.
(3) a $100 million termination fee payable if Paramount cancelled the merger in favor of another transaction. In addition, the board, in agreeing to merge with Viacom, agreed to drop its poison-pill stock purchase plan, which would have impeded the merger.116

On September 20, QVC Network proposed a merger with Paramount that would grant each Paramount shareholder a combination of shares and cash valued at eighty dollars per share.117 Paramount's Davis had a history of animosity with QVC's CEO, Barry Diller, and it was apparent that he and the board preferred the Viacom transaction over QVC's proposal. On October 21, QVC, frustrated by Paramount's lack of responsiveness to its offer, launched a hostile tender offer.118 On October 25, Viacom launched its own tender offer, having amended the terms of its original offer.119 By November 6 Viacom had increased its offer to eighty-five dollars per share.120 The amended agreement included the lock-up, no-shop, and termination-fee clauses.121 In response, QVC increased its offer to ninety dollars per share, contingent on its ability to invalidate the lock-up option and poison-pill defense which Paramount's board still had in place.122

QVC proceeded by filing an action for an injunction against Paramount, its directors, and Viacom to prevent the closing of the proposed merger between Paramount and Viacom.123 The Chancery Court held,124 and the Delaware Supreme Court agreed,125 that the consequence of the original agreement with Viacom would have been a change of control in Paramount from its public stockholders to Mr. Redstone. Thus Paramount's board was required to immediately maximize the value of the corporation for the stockholders. During oral argument, Delaware's Supreme Court raised the issue of Mr. Redstone's potential power after the merger.126 The control by Mr. Redstone, according to the court, would provide him with enough voting power in the future, under certain circumstances, to cause the breakup of the company, to "cash out" the minority shareholders, or

114. Id. at 1250.
115. Id.
116. Id.
117. Id. at 1252.
118. Id. at 1254.
119. Id. at 1256.
120. Id.
121. Id. at 1254-55.
122. Id. at 1256.
123. Id. at 1246.
124. Id. at 1265.
to materially alter the equity interests of the minority public shareholders.\textsuperscript{127}

Paramount argued that \textit{Time} was controlling; the merger was the culmination of strategic analyses and discussions by Paramount and its directors for many years and with many companies.\textsuperscript{128} In addition, because the decision to merge with Viacom was made before any other bidder emerged,\textsuperscript{129} the business judgment rule should have protected the decision. Paramount argued that \textit{Revlon} was inapplicable because, as no breakup of Paramount was contemplated, the action did not fit within either of the \textit{Revlon} triggering circumstances specified in the \textit{Time} case.\textsuperscript{130} In addition, because the merger was a strategic decision like the original merger in \textit{Time}, the board had an absolute right to protect it by including the anti-takeover devices in the agreement.\textsuperscript{131}

Delaware's Supreme Court disagreed with these arguments:

The Paramount defendants have misread the holding of [\textit{Time}]. Contrary to their argument, our decision in [\textit{Time}] expressly states that the two general scenarios . . . are not the \textit{only} instances where "\textit{Revlon} duties" may be implicated. . . . Moreover, the instant case is clearly within the first general scenario set forth in [\textit{Time}]. The Paramount Board, \textit{albeit unintentionally}, had "initiated an active bidding process seeking to sell itself" by agreeing to sell control of the corporation to Viacom in circumstances where another potential acquiror (QVC) was equally interested in being a bidder.\textsuperscript{132}

The court's statement clarified the \textit{Time} decision by encompassing the \textit{Barkan} "change of control" formulation within \textit{Time}'s definition of the \textit{Revlon} trigger. This subjected Paramount's board to \textit{Revlon}'s requirements. Therefore the court did not grant the protection of the business judgment rule to Paramount's board because the strategic alliance with Viacom was predicated on a sale of control to Redstone in the original agreement. Yet in \textit{Time} the same court declined "to extend \textit{Revlon}'s application to corporate transactions simply because they might be construed as putting a corporation either 'in play' or 'up

\textsuperscript{127} \textit{Id.}
\textsuperscript{129} QVC claimed that Paramount knew full well that QVC would make an offer. Barry Diller, QVC's CEO, claimed, "Notwithstanding my constantly saying to Mr. Davis, which I was doing for clearly tactical reasons, that when I had something to say to him I would pick up the phone and call him, he consistently said to me, I know you are after my company." Mr. Davis testified that his intent was not to dissuade a hostile bid from Diller, but that he "assumed there was no bid [and] took [Diller] at his word." \textit{QVC Chancery}, 635 A.2d at 1249 n.5.
\textsuperscript{130} \textit{See supra} text accompanying notes 15-17 (listing the two circumstances triggering \textit{Revlon} duties).
\textsuperscript{131} Brief for Appellant at 17.
\textsuperscript{132} Paramount Communications Inc v. QVC Network, Inc., 637 A.2d 34, 47 (Del. 1994) (italicized emphasis added).
In addition, the court's concession that Paramount had been "unintentionally" put "in play" by its board is a warning to all directors that they must operate with extra caution when considering approval of transactions that affect the control structure of corporations. Whereas *Time* arguably favored directors' discretion over shareholders' economic interests, at least in the short term, *QVC* signals a reversal—directors must now take special care to protect shareholders' interests in any transaction which might constitute a "change of control."

D. Distinguishing *QVC* from *Time*

Some might suggest that the *QVC* decision reversed *Time*, at least with respect to its *Revlon* holding, because Delaware's Supreme Court did not defer to the business judgment of Paramount's board in its selection of a merger partner. The cases are factually different, however. Most importantly, although Warner's shareholders would have owned sixty-two percent of the merged Time-Warner, these shares would be widely held, whereas Redstone himself would have owned approximately seventy percent of the merged Paramount-Viacom entity. In addition, Paramount's board negotiated a premium from Viacom for its shareholders; this fact was a tacit acknowledgement that control of the company was for sale. The board, however, most likely was misled by *Time's* holding, which suggested that strategic mergers like this one, which would result in a continuing entity, would not put a company "in play." Unfortunately for Paramount, *Time* confused the meaning of *Revlon*.

Still, *Paramount v. QVC* "is merely one of an unbroken line of cases that seek[s] to prevent the conflicts of interest that arise in the field of mergers and acquisitions by demanding that directors act with scrupulous concern for fairness to shareholders." It is consistent with its predecessors: *Time*, *Barkan*, and *Revlon*. The problem with *QVC* is that the case is likely to discourage mergers where one party is controlled by an individual or group that wishes to maintain its equity position in the combined corporation, because under the *QVC* facts, such transactions create the risk of putting a partner corporation "in play" and therefore subject to *Revlon's* auction requirements.

134. See supra text accompanying note 59.
135. See supra note 87 and accompanying text.
136. See supra note 111 and accompanying text.
137. See supra note 59 and accompanying text (quoting Barkan v. Amsted Indus., 567 A.2d 1279, 1286 (Del. 1989)).
III. AVOIDING QVC BY A POOLING OF INTERESTS

QVC raises some interesting questions for corporations controlled by individual stockholders or groups of stockholders. Why should a company like IBM, with widespread ownership of its shares, be able to merge with a similarly situated corporation without fear of interference with the transaction, while a company like Microsoft, ostensibly controlled by a block of shares, would be unable to engage in the same transaction due to the fear that its offer, under QVC, would put the other party "in play?" 138 In the latter case a competitor could, in good faith, enter the fray on the premise that it was not offered the same opportunity to bid for the target, even if the target company's board determined that the partner it chose was the "best fit" for the future. The shareholders could walk away with more short-term value, but the new entity might not be as efficient as the one contemplated by the board and could offer less long-term value, either because of the increased cost of the transaction or because a merger with the hostile suitor will not achieve the synergies that the friendly merger would have achieved.139

In the wake of QVC, it is apparent that companies controlled by a block of shareholders or a single shareholder will find it difficult or impossible to participate in a friendly merger while maintaining a substantial interest in the combined corporation. The interests of such a block would be diluted in the new entity, but the QVC case provides no guidance as to what level of share ownership in the new entity

139. This Note endeavors to step back and reconsider the purpose of corporate governance and to strike a balance between the goals of investors and the historical purpose of the corporation. At one end of the debate is the argument that the corporation is a creation of the state, conceived originally as a privilege to be conferred on specific entities for the public good and welfare. Martin Lipton & Steven A. Rosenblum, A New System of Corporate Governance: The Quinquennial Election of Directors, 58 U. Chi. L. Rev. 187, 244 (1991). As with any legal construct, the rules governing it must be justified on the basis of economic and social utility, not the intrinsic right of shareholders. Id. The public corporation is the central productive element of the United States economy, and the health and stability of the economy depend on the ability of corporations to maintain healthy and stable business operations over the long-term and to compete in world markets. Id. at 192. Moreover, the corporation affects employees, communities, suppliers, and customers. Id. Rules of corporate governance and ownership, therefore, must take into account many more interests than rules that treat the stockholder simply as an owner of private property. Id.

An opposing view argues that corporations are organized primarily to maximize shareholder wealth. This theory was expressed in Dodge v. Ford Motor Co.:

A business corporation is organized and carried on for the profit of the stockholders. The powers of directors are to be employed for that end. The discretion of directors is to be exercised in the choice of means to attain that end, and does not extend to a change in the end itself.

170 N.W. 668, 684 (Mich. 1919). While these theories should not be mutually exclusive, it is apparent that Delaware's Supreme Court decisions have favored the view of the corporation as an investment device.
constitutes a "change of control" in the other constituent corporation. In QVC, Delaware's Supreme Court had no difficulty determining that the transaction would result in a "change of control" because a single shareholder would have owned seventy percent of the new company's shares. What if, however, only forty-nine percent of an entity is owned by a single shareholder or control block? In some cases thirty-five percent or even thirty percent ownership of voting shares might be considered a control block.\(^{140}\) This is no trifling issue because many corporations, including CBS, Microsoft, Turner Broadcasting, and the former McCaw Cellular, are or were controlled by a single shareholder or block of shares.\(^{141}\) Should these types of corporations be disadvantaged in the merger market simply because they are controlled by a single, talented, managing executive?

Boards should be able to proceed with such mergers without triggering Revlon responsibilities by instead including protective provisions in the terms of the merger agreement for the benefit of minority, non-controlling shareholders. Delaware's corporations statute approves of arrangements that preserve the voting power of shareholders, such as supermajority voting provisions,\(^{142}\) and Delaware's Supreme Court has approved of limitations on board representat-

\(^{140}\) For example, during August 1994, American General Corp. sued Unitrin Inc.'s board in Delaware to force Unitrin's board to negotiate a merger with American General, a hostile suitor. Arthur Buckler & Greg Steinmetz, Unitrin Is Sued By American General Corp., Wall St. J., Aug. 22, 1994, at A4. Unitrin's board had rejected American General's takeover proposal, stating that the company was not for sale. \textit{Id.}\ Unitrin's board also authorized a stock buyback and adopted a poison-pill defense. \textit{Id.}\ The American General lawsuit, relying on the QVC decision, argued that the stock buyback would result in a change of control because it would increase the ownership stake of five Unitrin directors to 28% from 23%. \textit{Id.}\ Unitrin's by-laws require 75% shareholder approval to sell the company, so if five directors owned 25% they could block a deal. \textit{Id.}\ Therefore, the suit concluded, the buyback would shift control of the company from a "fluid aggregation of unaffiliated stockholders" to five directors. \textit{Id.}\n

While the QVC court specifically stated that it expressed no opinion on whether such stockholder protective devices would have changed its decision, it certainly left the matter open to consideration. Inclusion of, for example, a supermajority vote provision, likely would have some impact on a court’s decision as to whether or not a change of control has occurred. To an average shareholder, however, such a provision is not very meaningful. This is because the owner of a large block of shares would still wield considerably greater influence on the outcome of any decision than an average shareholder. Beyond voting power, an average shareholder would receive more protection from actual limitations on what a board of directors or controlling shareholder could do to affect the corporation after the merger. If the limitations were significant enough to guarantee a long-term interest in the corporation for the minority, non-controlling stockholder, then a board would be justified in accepting a transaction that offers better long-term prospects for the corporation, despite a change in control. A merger structured as a pooling of interests fits this description.

A. The Pooling Criteria

A pooling of interests is a special form of stock-for-stock merger that provides significant financial advantages to the combined entity. Before a transaction qualifies for treatment as a pooling of interests, it must meet several conditions. Accounting Principles Board Opinion No. 16, Business Combinations, describes these requirements. These criteria are divided into three groups: (1) attributes of the combining companies; (2) manner of combining interests; and (3) absence of planned transactions. The Attributes Criteria

144. Paramount Communications Inc v. QVC Network, Inc., 637 A.2d 34, 42 n.11 (Del. 1994) (citing instances where Delaware’s courts have acted to protect shareholder voting rights).
145. Id. at 42 n.12.
146. This Note assumes that the “average shareholder” is an individual investor, as opposed to a professional or institutional investor.
148. In particular, poolings allow corporations to record their combined assets at historical values. This allows the surviving entity to avoid recording goodwill—the fair value of acquired assets over their historical cost—which, if recorded, must be amortized against earnings over a specified period of time, up to 40 years. This results in greater annual earnings than if the corporations had merged by means of a business combination requiring the recognition of goodwill.
150. Id.
are: (a) each of the combining companies is autonomous and has not been a subsidiary of another corporation within two years before the plan of combination is initiated;\textsuperscript{151} and, (b) each of the combining companies is independent of the other combining companies.\textsuperscript{152}

The Combining Criteria are: (a) the combination must be effected in a single transaction or completed in accordance with a specific plan within one year of the plan's initiation;\textsuperscript{153} (b) one corporation (the issuing corporation) must offer and issue only common stock in exchange for substantially all (ninety percent) of the outstanding voting stock of the combining company at the date the plan is consummated;\textsuperscript{154} (c) none of the combining companies changes the equity interest of the voting common stock in contemplation of effecting the combination within two years before initiation of the plan of consummation or between the dates of initiation or consummation;\textsuperscript{155} (d) none of the combining companies may reacquire shares of voting common stock except for purposes other than the business combination, and no company reacquires more than a normal number of shares between the dates of the plan's initiation and consummation;\textsuperscript{156} (e) the ratio of the interest of an individual common stockholder to those of other common stockholders in a combining company remains the same as a result of the exchange of stock to effect the combination;\textsuperscript{157} (f) the voting rights in the combined corporation are immediately exercisable by the stockholders; and\textsuperscript{158} (g) the combination must be completed at the specified date of consummation with no provisions pending with respect to the issue of securities or other consideration.\textsuperscript{159}

Absence of Planned Transactions requires that: (a) the combined corporation may not agree, directly or indirectly, to retire or reacquire stock issued to effect the combination;\textsuperscript{160} (b) the combined corporation must not enter into other financial arrangements for the benefit of former stockholders of a combining company; and,\textsuperscript{161} (c) the combined corporation must not plan to dispose of a significant part of the assets of the combining companies within two years after the combination, unless the assets represent duplicate facilities.\textsuperscript{162}

\textsuperscript{151} Id. \textsuperscript{166} 46.  
\textsuperscript{152} Id.  
\textsuperscript{153} Id. \textsuperscript{167} 47.  
\textsuperscript{154} Id.  
\textsuperscript{155} Id.  
\textsuperscript{156} Id.  
\textsuperscript{157} Id.  
\textsuperscript{158} Id.  
\textsuperscript{159} Id.  
\textsuperscript{160} Id. \textsuperscript{168} 48.  
\textsuperscript{161} Id.  
\textsuperscript{162} Id.
These conditions ensure the independence of the constituent corporations prior to the merger. They also provide extra protection to stockholders by ensuring that stockholder equity interests are not diminished before the transaction is consummated. Also, the absence of plans to dispose of corporate assets (Group 3) automatically removes the transaction from the second Revlon category—transactions resulting in the breakup of the company.

B. Enforceability of a Pooling Agreement

While a pooling of interests is an accounting concept, the legal documents memorializing the agreement ensure compliance with the criteria to preserve the pooling treatment. A merger agreement, like any other contract, is a set of conditions, promises, and representations. When a board insists that the merger be structured as a pooling of interests, it incorporates the conditions, promises, and representations required for a pooling into the agreement itself. Because a

163. Professor Floyd Beams most clearly described these criteria as follows:

**Attributes of Combining Companies:**
1. Autonomous ("two year" rule)
2. Independent ("10% rule")

**Manner of Combining Interests:**
1. Single transaction (or completed within one year after initiation)
2. Exchange of common stock (90% "substantially all" rule)
3. No equity changes in contemplation of combination ("two year" rule)
4. Shares reacquired only for purposes other than combination
5. No change in proportionate equity interests
6. Voting rights immediately exercisable
7. Combination resolved at consummation (no pending provisions)

**Absence of Planned Transactions:**
1. Issuing company does not agree to reacquire shares
2. Issuing company does not make deals to benefit former stockholders
3. Issuing company does not plan to dispose of assets within two years


164. The twelve criteria were established to prevent abuse of the special features of the pooling of interests method of combining corporations. One such feature is the requirement that the corporate financial statements reflect consolidated activity for the combined corporation for the full reporting period, as opposed to reporting combined results from the date of combination. Prior to APB Opinion No. 16, aggressive corporations would acquire other corporations with income during the annual period and consolidate the combined corporation by the pooling method, thus creating "instant earnings" for the acquiring corporation.

Another abuse included the practice of immediately selling off the assets of acquired corporations to recognize a gain on the sale, again distorting actual income from operations. Finally, prior to APB Opinion No. 16, accounting professionals disagreed as to whether all twelve criteria must be met to allow a merger to be accounted for as a pooling of interests. This resulted in some business combinations being accounted for as "partial poolings" while others were being accounted for as poolings because some, although not all, of the criteria were present. Telephone Interview with Donald F. Moran, Partner, Coopers & Lybrand, New York, N.Y. (Sept. 8, 1994).

165. See infra text accompanying note 175.

166. For example, for the initial merger contemplated between Time and Warner, Warner's board reportedly was prepared to insist on a pooling transaction. Para-
promise is a statement of intention coupled with a commitment to act in accordance with that statement, making a promise to comply with the pooling criteria with an intent not to do so is a misrepresentation of fact.\textsuperscript{167} A majority shareholder of the corporation issuing the shares to effect the transaction is bound by the pooling conditions because the conditions are material to the agreement.\textsuperscript{168} The threat of damages or rescission due to a breach of the representations required to qualify for a pooling ensures that the majority shareholder will not disavow the transaction's conditions.\textsuperscript{169}

C. Pooling Criteria and "Change of Control"

The pooling of interests requirements should protect a transaction from the "change of control" test that triggered \textit{Revlon} duties in the \textit{QVC} case. While "control" in some contexts is easy to define, when considering "control" of a public corporation the definition is necessarily more complicated. It is unlikely that the \textit{QVC} court contemplated that a change of control could consist of a simple change in management akin to, for example, the removal of a chief executive officer in response to complaints from dissident shareholders.\textsuperscript{168} More likely, the court was concerned with "unfettered" control, or control without limitation, such as Mr. Redstone would have had if the \textit{QVC}-Paramount merger had been consummated. Thus, considering the Delaware Supreme Court's concerns with the sale of control in \textit{QVC}, a pooling of interests survives this test by reducing the court's fear that the rights of minority stockholders would be ignored by a majority block. The \textit{QVC} court listed several concerns:


169. \textit{See supra} note 168.

170. For example, when Laurence Tisch became the CEO at CBS, no one argued that any resulting change in management philosophy entitled the shareholders to immediate maximization of the value of their shares. Ken Auletta, \textit{Three Blind Mice} 136-85 (1st ed. 1991). The only time the "change of control" issue came into play was when CBS was considering whether ownership by Tisch of over 25% would affect CBS' ability to continue owning more than one radio station, television station, or newspaper in any one market. \textit{Id.} at 151.
Following [the] consummation, there will be a controlling shareholder who will have the voting power to: [1] elect directors; [2] cause a break-up of the corporation; [3] merge it with another company; [4] cash-out the public stockholders; [5] amend the certificate of incorporation; [6] sell all or substantially all of the corporate assets; or [7] otherwise alter materially the nature of the corporation and the public stockholders’ interests. Irrespective of the present . . . Board’s vision of a long-term strategic alliance . . . the new controlling stockholder [could] alter that vision.\textsuperscript{171}

As for the first and last concerns, director election and the nature of the corporate vision, any influential shareholder, not necessarily a controlling shareholder, could wield the power to affect the composition of the merged entity’s board of directors or its strategic vision. For instance, less than two years after the Time-Warner merger (the one that actually was consummated), Steven J. Ross led a boardroom coup d’etat at Time-Warner resulting in the resignation of co-Chief Executive and board member N. J. Nicholas.\textsuperscript{172} The irony is, of course, that the Delaware Supreme Court blessed this merger in the Time case. In fact, in most large corporations, control stems not from ownership, but rather from incumbency and control of the proxy machinery.\textsuperscript{173} This is because not all stockholders participate in the voting process and because controlling persons generally command the loyalty of other stockholders.\textsuperscript{174}

Considering the court’s second and sixth concerns—break-up of the corporation and sale of corporate assets—the unique nature of a pooling prohibits plans to sell non-duplicate corporate assets of the combining companies for two years after the merger. By seeking a pooling, the combining corporations represent that such transactions are not planned or intended for the new entity.\textsuperscript{175}

The QVC court expressed concern that the controlling shareholder could cash-out the public stockholders. In a pooling of interests, however, the combined corporation may not agree, directly or indirectly, to retire or reacquire all or part of the common stock issued to effect the combination. By meeting this requirement the parties represent that a “cash-out” will not occur.\textsuperscript{176} In the Chancery Court’s QVC

\begin{itemize}
\item 171. Paramount Communications Inc. v. QVC Network, Inc., 637 A.2d 34, 43 (Del. 1994).
\item 172. Paul Farhi & Steven Mufson, \textit{Time Warner Co-CEO Quits in Abrupt Move; Nicholas Disagreed on Strategic Vision}, Wash. Post, February 21, 1992, at F1:
\begin{quote}
Nicholas’ departure was officially termed a resignation, but people at the company said the 52 year-old executive was forced out by the company’s board following an extraordinary meeting. . . . Nicholas has repeatedly clashed with Time-Warner Chairman and co-CEO Steven J. Ross over the company’s direction and ways to boost its sluggish stock price.
\end{quote}
\item 173. Lewis D. Solomon et. al., Corporations 748 (2d ed. 1988)
\item 174. \textit{Id.}
\item 175. \textit{See supra} text accompanying note 162.
\item 176. \textit{See supra} text accompanying note 160.
\end{itemize}
opinion, Chancellor Jacobs emphasized the fact that Paramount's board had not obtained, or even bargained for, any structural protection to ensure the continuity of Paramount's current shareholders (or their successors) in a merged enterprise.\textsuperscript{177} The Delaware Supreme Court's \textit{QVC} decision reiterated this theme.\textsuperscript{178} If the merger was structured as a pooling of interests, however, such actions would jeopardize the pooling treatment and result in a material breach of the agreement to merge.

In SEC Accounting Series Release 146-A, the SEC states that if an entity were to complete a pooling and a very short time thereafter repurchase an equivalent amount of shares, such a purchase could affect the status of the combination and bar pooling accounting.\textsuperscript{179} Admittedly, the SEC's failure to define "a very short time" makes this guideline somewhat vague; however, this lack of specificity reflects the SEC's preference for the private sector to develop and establish accounting principles.\textsuperscript{180} Still, from this language it is apparent that the SEC requires close scrutiny of a stock reacquisition to ensure that the substance of the transaction is not in fact a "cash out," as such action is evidence of an attempt to circumvent the pooling criteria.\textsuperscript{181} This would also defeat the stated purpose of a pooling, that is "the sharing of \textit{rights and risks} among constituent shareholder groups."\textsuperscript{182} Because failure to comply with the pooling criteria and representations after the merger is consummated (1) is a material breach of the merger agreement, and (2) would raise concern at the SEC, a majority shareholder would be foolish to take such a risk.

\textsuperscript{177} QVC Network, Inc. v. Paramount Communications Inc., 635 A.2d 1245, 1267 n.42 (Del. Ch. 1993), \textit{aff'd}, 637 A.2d 34 (Del. 1994) (citing the types of protection contemplated).

\textsuperscript{178} This theme was stated best in the appellee's brief: "Here there is no 'long term' for the stockholders. A majority of their equity is being cashed out now, and the minority remnant can be extinguished by Redstone unilaterally or transformed into something completely different whenever he so desires." Brief for Appellee at 32, Paramount Communications Inc. v. QVC Network, Inc., 635 A.2d 1245 (Del. Ch. 1993) (Nos. 427 & 428).


\textsuperscript{180} See Ronald J. Murray et al., The Coopers & Lybrand SEC Manual § 14030 (6th ed. 1993) (quoting SEC Accounting Series Release No. 150 which states: "[T]he Commission intends to continue its policy of looking to the private sector for leadership in establishing and improving accounting principles and standards through FASB [Financial Accounting Standards Board] with the expectation that the body's conclusions will promote the interests of investors.").

\textsuperscript{181} A stock repurchase that is part of a "systematic pattern of reacquisition," for example, the performance of a contractual obligation that requires a contribution of stock to a union pension plan, would not be a violation of the criteria.

\textsuperscript{182} SEC Accounting Series Release No. 130, \textit{reprinted in} Ronald J. Murray et al., The Coopers & Lybrand SEC Manual § 50334 (6th ed. 1993). While most of the commentary on the purpose of a pooling focuses on "risk sharing," in this context we are focusing on "right sharing."
The pooling criteria do not specifically address the remaining concerns, that the controlling shareholder will amend the certificate of incorporation or seek out another merger. The limitation on planned transactions, however, still applies to any contemplated entity for the prescribed time period.  

In addition, compliance with the pooling criteria assures that the value of the stock issued to consummate the merger has not been manipulated in contemplation of the merger. News reports and QVC's attorneys highlighted the fact that Redstone had purchased Viacom stock in the months preceding the agreement with Paramount. It was alleged that heavy trading of Viacom stock by Redstone helped boost the price of the stock and artificially increased the value of the merger package offered to Paramount's stockholders. Apparently Paramount's board was not aware of these transactions despite a study by the investment banking firm of Smith Barney that analyzed the effect of the purchases on Viacom's stock price. This type of trading activity disqualifies a transaction from pooling treatment because it violates the requirement that neither of the combining companies may reacquire shares of the stock to be issued to effect the combination except for purposes other than the business combination.

Moreover, although the shareholders would be turning over managing control to the controlling shareholder, they would not be required to do so without having approved this decision. Besides ensuring a long-term commitment to the shareholders, a pooling of interests transaction requires a vote by the shareholders because their stock would be converted into the stock of the issuing corporation. It

183. See supra notes 160-62 and accompanying text.
184. See supra text accompanying note 156.
186. Smith & Roberts, supra note 185.
187. QVC Network, Inc. v. Paramount Communications Inc., 635 A.2d 1245, 1249 n.6 (Del. Ch. 1993), aff'd, 637 A.2d 34 (Del. 1994). The report concluded that the trading had no material effect on the price of the shares offered to Paramount's shareholders. Id.
188. See supra text accompanying note 156.
189. Section 251(c) of Delaware's General Corporation Law provides in relevant part: "The agreement [of merger or consolidation] . . . shall be submitted to the stockholders of each constituent corporation . . . for the purpose of acting on the agreement. . . . The agreement shall be considered and a vote taken for its adoption or rejection." Del. Code. Ann. tit. 8 § 251(c) (1993). Section 251(f), however, creates exceptions to this requirement if:
(1) the agreement or merger does not amend in any respect the certificate of incorporation of [the] constituent corporation[s], (2) each share of stock of [the] constituent corporation[s] outstanding immediately prior to the effective date of the merger is to be an identical outstanding or treasury share of the surviving corporation after the effective date of the merger, and (3) . . . the authorized unissued shares or the treasury shares of common stock of
would be disingenuous of the Delaware Supreme Court to suggest, as

the surviving corporation to be issued or delivered under the plan of merger plus those initially issuable upon conversion of any other shares, securities or obligations to be issued or delivered under such plan do not exceed 20% of the shares of common stock of such constituent corporation outstanding immediately prior to the effective date of the merger.


Recall that the only reason Time's shareholders would have had an opportunity to approve the merger is because New York Stock Exchange rules required a shareholder vote for the issuance of so many shares. See supra note 72. Delaware law did not require a vote because Time's certificate of incorporation would not have been amended, and the outstanding stock held by Time's shareholders would not have been altered by the transaction. Time, however, would have issued more stock to Warner's shareholders than were actually outstanding. Thus the only plausible explanation for why Delaware law would not have required approval of the merger by Time's shareholders under § 251(f)(3) is because Time would not have been deemed the surviving corporation in the deal.

In the Time case, Warner was designated as the surviving corporation. In other words, Delaware law would have protected the interests of Time's shareholders by allowing them to approve the transaction if Time had been deemed the surviving corporation. This is because Time would have delivered to Warner's stockholders more than 20% of its outstanding shares (measured on the day before the merger) to complete the transaction.

By requiring shareholder approval of mergers in § 251(c) but providing for exemptions in § 251(f), the drafters of Delaware's General Corporation Law acknowledged that issuing 20% of a company's outstanding shares is a significant enough transaction to require that the will of the shareholders should trump the directors' discretion. Contrary to the Time Chancery opinion that "[t]he shareholders of Time would have 'suffered' dilution, of course, but they would suffer the same type of dilution upon the [sic] public distribution of new stock," Fed. Sec. L. Rep. (CCH) 94,514, at 93,280 (Del. Ch. 1989), the provision in the statute is evidence that the Delaware legislature considered dilution in excess of 20% to be something more than that suffered upon the issuance of new stock.

The Delaware courts should address this issue by recognizing the right to a shareholder vote in either constituent corporation (not only the designated survivor), if either one issues shares in excess of 20% of shares outstanding. There is ample support for imposing this requirement. First, Delaware's corporation statute recognizes that an acquisition effected in such a manner is more than simple dilution of shareholder interests akin to the public issuance of new stock. The Delaware courts or legislature might note that the New York Stock Exchange also recognizes that a transaction of this magnitude is significant enough to require a shareholder vote. See supra note 72.

Additionally, it is possible that the drafters of § 251(f) did not foresee that an issuing corporation might not be the surviving corporation. Nevertheless, the constituent corporations' boards should not be able to circumvent the stockholder approval requirement simply by deeming the non-issuing entity as the survivor. Circumvention of a shareholder vote in this manner would be a triumph of form over substance, yet, without the New York Stock Exchange requirements, this is what would have occurred if the original Time-Warner agreement had survived. Specifically, shareholder approval should be required for:

- Any issuance of securities where the total voting power of the [constituent] corporation's outstanding securities after the issuance exceeds by twenty percent or more the total voting power of securities outstanding immediately prior to the transaction [had the constituent remained an independent entity].

it did in *QVC*, that provisions protecting the voting power of minority shareholders could prevent the auction duty from being triggered if the courts would not respect the validity of an actual shareholder vote approving a merger with the controlling shareholder's corporation. If a majority of the non-controlling shareholders approved such a transaction by an informed vote, then such a transaction must be presumed to be fair.

Compliance with the pooling criteria protects the long-term interests of the non-controlling shareholders, and the shareholder vote gives these shareholders a say in approval of the transaction. These protective measures should be enough to allow a board to preserve its protective devices to fend off a hostile bidder should one enter the scene. After *QVC*, however, it is uncertain that a board could even present a plan for such a merger to the shareholders, as the auction duty automatically requires the board to shop the company for the highest bid. For this reason a safe harbor is necessary.

### D. Applying the Pooling Criteria

It is important to stress once again that a pooling would simply ensure that the board is not committed to a *Revlon* auction if a hostile party seeks to interfere with a merger where managing control would change hands. Under this theory the pooling structure provides a safe harbor for corporations with widely held public ownership that wish to participate in mergers with corporations controlled by majority shareholders without engaging in a costly bidding war.

Accordingly, where corporations agree to merge by a pooling of interests, any protective devices included in the agreement should not be disturbed. If a competing bid surfaces, the board should have all its defensive measures, within the limits of *Unocal*, available to it. If at this point the shareholders reject the proposed merger, then the board should not be committed to an auction of the company because the pooling criteria severely limited the "control" it offered to the other constituent.

For the above-mentioned reasons, *Revlon* duties should not be implicated where a transaction is structured as a pooling. Given the strict criteria for such transactions, shareholder interests are well-protected. Where majority shareholders are involved, managing control may shift, but this alone should not trigger *Revlon* without the addi-
tional factors that were present in QVC. Though the many prerequisites limit the applicability of a pooling of interests, this proposal nevertheless provides some room for corporations with controlling shareholders to participate in mergers and encourages such companies to continue seeking partners as part of their long-term strategies.

Query what would have occurred if the Paramount-Viacom transaction had been structured as a pooling of interests. Redstone would not have had the degree of control that the court suggested he would have had if the first agreement had survived. Paramount's shareholders might have rejected the merger, but such a decision by the shareholders should not have committed Paramount's directors to an auction. Finally, even if the stockholders rejected the first transaction, Paramount's board would have been free, under Unocal, to exercise its business judgment to defend against any hostile bid by QVC because Paramount's board would not have offered unfettered control to Redstone.

Not all stock-for-stock mergers qualify for pooling treatment. Given the QVC holding, however, it is likely that the number of poolings will increase in the future, if only because companies now know that a Paramount-Viacom type transaction could trigger Revlon, whereas the Time-Warner stock-for-stock agreement did not. After Time, some commentators suggested that stock-for-stock mergers were excluded from Revlon's reach, while others have disagreed with this hypothesis on the theory that excluding such mergers makes evasion of the auction duty a simple matter.

With respect to pooling of interest mergers, this "evasion argument" can be easily addressed. First, as mentioned, not every stock-for-stock merger will qualify for pooling treatment, as the requirements are very strict. Second, compliance with the pooling criteria

192. See supra text accompanying note 171.
193. For example one commentator suggested that: "In particular the Supreme Court's [Time] opinion would seem to exclude from Revlon's reach virtually any combination negotiated at arm's length where the consideration was principally stock." Gordon, supra note 98, at 1944 n.45.
194. For example it has been suggested that "if transaction planners knew they could avoid Revlon by structuring a negotiated acquisition as a stock for stock merger, rather than as a triangular acquisition or a two-party merger with cash or debt consideration, evading the duty to auction control would be a simple matter indeed." Bainbridge, supra note 98, at 311.
195. The following additional examples further demonstrate how poolings protect stockholders.

Hypothetical Case Number One

Macrowink Inc. has ten million shares of common stock outstanding, 60% of which is owned by its principal shareholder, Calvin. Macrowink's board has agreed that a strategic merger with Hobbes, Inc., which currently has four million shares spread among many small stockholders, would benefit both corporations in the long term. Hobbes' board agrees as well. Because of Calvin's majority interest, however, the Hobbes' board is fearful that the transaction might put the company "in play," leaving it to the highest bidder rather than the best long-term partner for the corporation.
Therefore, as a condition to the agreement, Hobbes' board insists that the merger be structured as a pooling of interests.

Macrowink agrees to issue four million authorized shares in exchange for substantially all of Hobbes four million outstanding shares. After the exchange is completed, Calvin will still own a controlling interest in the merged entity as his voting common stock will comprise approximately 43% of all the shares outstanding.

Applying the QVC definition of Revlon's trigger literally, Hobbes, Inc. most likely would trigger Revlon's requirements due to the great influence that Calvin would have on the combined company's board and management. A Revlon auction, however, is not necessary because, even if Calvin were to wield such influence, the company's activities would be limited by the pooling conditions. For example, the company would not be able to "cash out" the former Hobbes shareholders because this would cause the substance of the transaction to be a cash purchase of Hobbes, thus violating the tenth pooling condition which requires that the combined company must not agree, directly or indirectly, to reacquire or retire shares issued to effect the combination.

Moreover, Macrowink is also limited by the requirement that the company must not plan to dispose of a significant part, except for duplicate assets, of the combining companies for at least two years after the combination. This means that Calvin, for all his influence, could not effect the breakup of the company or cause the sale of significant assets, at least for the prescribed time. This is certainly enough protection for the public stockholders because even in a widely-held corporation there is no guarantee that the company will not engage in such transactions over the long-term.

Because of the limitations on Calvin's control, and because, by definition, a pooling contemplates a continuing entity, there is no need to impose Revlon duties on Hobbes' board. In addition, the strict attributes and combining criteria required in a pooling ensure that the transaction is a good-faith, arms-length agreement. A board decision to enter a transaction meeting all these requirements should be accorded the protection of the business judgment rule as Calvin would not have the control that concerned the QVC court. Furthermore, this type of arms-length transaction would provide a safe harbor for corporations with controlling shareholders to participate in mergers without being committed to a bidding war.

Finally, the ultimate decision in a case like this is left to the shareholders of Hobbes, who must approve the transaction. If they disapprove of the arrangement, at worst control and ownership remain in the same position as before. If they approve of the arrangement, deciding that it is in their best interests to tie their fortunes to a talented executive who also happens to be a majority owner, then at least the cost of the transaction will not damage the new corporation.

Hypothetical Case Number Two

Assuming that poolings are exempt from Revlon requirements, company Alpha is 80% owned by a single shareholder, Powers, who commits his corporation to a stock-for-stock merger with Company Beta, a private corporation not subject to NYSE rules. Alpha will issue a combination of common and preferred stock to Beta's investors to effect the merger. Powers is a 15% owner of Beta's outstanding stock and votes it to provide the margin which approves the merger. After the stock swap Powers will own approximately 45% of the new entity's outstanding voting stock.

This transaction implicates Revlon even though it was purely a stock swap. First, there is a change of control in Beta. Second, there are no limitations to offset the change of control to protect the former Beta stockholders. This is because the transaction would not qualify for pooling treatment as the ownership of Beta shares by Powers violated the independence conditions for a pooling, and the manner in which the transaction would be consummated violates the combining requirements for a pooling. Although there is no per se rule as to the percentage of intercompany stock ownership that violates the independence criteria, it is likely that any amount over 10% fails to meet the requirement. Therefore, this transaction falls outside the safe harbor.
of either constituent. Therefore, while *Revlon* may be necessary to protect shareholders in some stock-for-stock transactions, it is unnecessary when the transaction is a pooling of interests; the protection is inherent in the nature of the pooling transaction.

**Conclusion**

The *QVC* decision has two consequences. First, directors must exercise more care when committing the stockholders to transactions that might adjust a corporation's control structure, as such transactions may implicate *Revlon* duties. Second, corporations with controlling shareholders will be unable to participate in standard merger transactions because of the risk that *Revlon* requirements will be implicated for the partner corporation.

As an alternative, these corporations should be able to avoid *Revlon*’s implications by structuring mergers as poolings of interests. In cases that challenge mergers structured as poolings, Delaware’s courts must not require corporate boards to meet *Revlon*’s threshold duties before according business judgment rule protection to their decisions. *Revlon*’s requirements are unnecessary in such transactions because the conditions required to treat the new entity as a pooling of interests protect the long-term interests of minority shareholders. Recognition that a pooling of interests merger will not implicate *Revlon* duties thus provides a safe harbor for corporations otherwise excluded by the *QVC* decision to participate in mergers without committing the partner corporation to an auction or causing a disabling bidding war. This safe-harbor will effectively protect the interests of the average investor while promoting fairness in the merger market for corporations controlled by shareholder blocks by preserving for them the same opportunities available to corporations with diffuse ownership.

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Other factors, such as dilution, tainted shares, and weakness in the value of the issuing corporation's stock may diminish the feasibility of a pooling of interests for many corporations. These problems are beyond the scope of this Note.