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## COMMENTS

# **“It’s Not Polite to Ask Questions”<sup>1</sup> in the Boardroom: *Van Gorkom’s Due Care Standard Minimized in *Paramount v. QVC****

PATRICIA A. TERIAN†

### I. INTRODUCTION

Ownership and control. In publicly held corporations,<sup>2</sup> these attributes are separated: shareholders own the corporation; directors, in theory, manage the corporation; and the chief executive officer and his management team run the day-to-day operations of the corporation.<sup>3</sup> In most corporations, however, control is vested in the hands of management, not the board of directors. The problem lies in the distinction between authority and power.<sup>4</sup> While directors of a Delaware corporation are given statutory authority to manage the corporation,<sup>5</sup> for the most part

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1. Myron Magnet, *Directors, Wake Up!*, FORTUNE, June 15, 1992, at 85, 86 (quoting California Public Employees’ Retirement System General Counsel Richard Koppes, and explaining that “a culture of quietism reigns in many boardrooms”) [hereinafter Magnet].

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2. For a general discussion of the fiduciary standards for directors of nonprofit corporations, see David W. Barrett, *A Call for More Lenient Director Liability Standards for Small, Charitable Nonprofit Corporations*, 71 IND. L.J. 967 (1996).

3. Of course some directors and managers own shares in the corporation.

4. The distinction between authority (“*autoritas*”) and power (“*potestas*”) can be traced to the Romans. Hugh Parker, *Re-Empowering the Board*, DIRECTORS & BDS., Winter 1996, at 4.

5. DEL. CODE ANN. tit. 8, § 141(a) (1991). See *infra* note 33 for the text of this provision. While reference to various state laws are made herein, Delaware law provides the focus for this comment.

The state of Delaware has long been the leader in corporate law because of its progressive approach to corporate governance. See ROBERT W. HAMILTON, FUNDAMENTALS OF MODERN BUSINESS § 13.6.2 (1989) (explaining that the “core of uniformity” in state corporation statutes is partially due to Delaware’s leadership “in developing significant principles of corporation law”) [hereinafter HAMILTON]; David A. Vise, *Delaware Court Changes*

the authority is unexercised. For a number of reasons, corporate boards have not taken an active role in governance, permitting management to usurp the actual power to manage the corporation.<sup>6</sup>

A director's failure to actively participate often surfaces in the form of a failure to become adequately informed prior to engaging in board action, and this failure constitutes a breach of the duty of care.<sup>7</sup> The task of becoming informed is fundamental to the director's actions, because the best interests of the shareholders cannot possibly be protected unless the director is informed about the matter to be decided. Traditionally, the duty of care played a secondary role to the duty of loyalty and, to a certain extent, was "intended primarily as an aspirational statement."<sup>8</sup> Courts were primarily concerned with actions of the corporate director that evidenced self-dealing,<sup>9</sup> and absent such acts, the courts would apply the deferential business judgment

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*Rules of Takeover Game*, WASH. POST, June 16, 1985, Business Section, at F1 (noting the Delaware Supreme Court's "unique position of rendering opinions that have a powerful national impact"). For an interesting analysis of roles played by strategic design and historical chance in the development of Delaware's corporate leadership, see Leo Herzel & Laura D. Richman, *Foreword to R. FRANKLIN BALOTTI & JESSE A. FINKELSTEIN, THE DELAWARE LAW OF CORPORATIONS AND BUSINESS ORGANIZATIONS* lix, lxiv-lxv (1988 & Supp. 1989) (observing that the three ingredients of Delaware's "design" include a pro-transaction corporation law, liberal jurisdictional rules that extend personal jurisdiction to reach prime defendants and a specialized court system that handles neither criminal nor tort cases). This warm corporate climate has made Delaware the state of incorporation for a majority of major U.S. companies. Pat Widder, *Time Inc. Case Another Test for Outside Directors*, CHL. TRIB., July 9, 1989, § 7, at 1 (noting that "when Delaware rules, boardrooms listen") [hereinafter Widder]. Roughly one-half of companies listed on the New York Stock Exchange ("NYSE") are incorporated in Delaware. Milo Geyelin, *Delaware Proposes Business Court to Speed Resolution of Disputes*, WALL ST. J., Dec. 10, 1993, at B3.

6. For an in-depth discussion of the reasons for board inaction, see *infra* Part IV.

7. *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984). Directors of corporate boards are fiduciaries to both the company and the shareholders, and as such, owe two primary fiduciary duties — the duty of care and the duty of loyalty. See DENNIS J. BLOCK ET AL., *THE BUSINESS JUDGMENT RULE: FIDUCIARY DUTIES OF CORPORATE DIRECTORS* 1 (3d ed. 1989 & Supp. 1991) ("In the simplest terms, the duty of care requires that directors exercise the care that an ordinarily prudent person would exercise under similar circumstances, and the duty of loyalty prohibits faithlessness and self-dealing.") [hereinafter BLOCK].

8. WILLIAM A. KLEIN & JOHN C. COFFEE, JR., *BUSINESS ORGANIZATION AND FINANCE: LEGAL AND ECONOMIC PRINCIPLES* 150 (5th ed. 1993); see also Lawrence A. Cunningham & Charles M. Yablon, *Delaware Fiduciary Duty Law After QVC and Technicolor: A Unified Standard (and the End of Revlon Duties?)*, 49 BUS. LAW. 1593, 1597 (1994) (contending that "everyone knew that only the duty of loyalty mattered") [hereinafter Cunningham & Yablon].

9. See generally *Guth v. Loft*, 5 A.2d 503, 510 (Del. 1939).

rule.<sup>10</sup> This deferential treatment arose out of the judiciary's recognition that corporate directors were much better equipped to make complex corporate decisions.<sup>11</sup>

*Smith v. Van Gorkom*<sup>12</sup> represents the Delaware Supreme Court's clearest expression of the duty to become informed and offers strong support for board activism. Strangely, however, *Van Gorkom* and the need for information were overlooked by the Delaware Supreme Court in *Paramount Communications, Inc. v. QVC Network, Inc.*<sup>13</sup> In *Van Gorkom*, directors of the Chicago-based Trans Union Corp. were held personally liable for violating their duty of care in authorizing a friendly all-cash buyout.<sup>14</sup> The court found the Board members grossly negligent for failing to "inform themselves of all information reasonably available to them . . ." <sup>15</sup> Emphasizing the decision-making process, the court condemned the procedures as hasty and uninformed<sup>16</sup> and remanded to the Delaware Chancery Court to determine the appropriate damages.<sup>17</sup>

The Delaware Legislature responded to the *Van Gorkom* decision by enacting a law which allows a Delaware corporation to amend or draft its certificate of incorporation to limit or eliminate a director's personal liability in damages for duty of care violations.<sup>18</sup> Such amendments require approval of shareholders<sup>19</sup> and do not affect a shareholder's ability to sue for damages

10. The business judgment rule is a presumption that board decisions are made "on an informed basis, in good faith and in the honest belief that [an] action [is] in the best interests of the company." Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984). See also Herbert S. Wander & Alain G. LeCoque, *Boardroom Jitters: Corporate Control Transactions and Today's Business Judgment Rule*, 42 BUS. LAW. 29, 30 (1986) ("The traditional application of the business judgment rule reflects the hesitancy of the courts, in the absence of self-dealing, to become involved in board decision-making . . .") [hereinafter Wander & LeCoque]. See discussion *infra* Part II.

11. Wander & LeCoque, *supra* note 10, at 29-30.

12. 488 A.2d 858 (Del. 1985).

13. 637 A.2d 34 (Del. 1993).

14. William B. Glaberson & William J. Powell, Jr., *A Landmark Ruling That Puts Board Members in Peril: They're Being Held Accountable—Even Financially—for Bad Corporate Decisions*, BUS. WEEK, Mar. 18, 1985, at 56.

15. *Van Gorkom*, 488 A.2d at 893.

16. *Id.* at 875.

17. *Id.* at 893 (requiring the Court of Chancery to "conduct an evidentiary hearing to determine the fair value of the shares . . . [and enter] an award of damages . . . to the extent that the fair value of Trans Union exceeds \$55 per share").

18. DEL. CODE ANN. tit. 8, § 102(b)(7) (Supp. 1994). See *infra* note 130 for the text of this statutory provision.

19. Any amendment to the certificate of incorporation of a Delaware corporation requires the approval of a majority of shares. DEL. CODE ANN. tit. 8, § 242(b)(1) (1991).

for breach of loyalty.<sup>20</sup> Because the statute is phrased in terms of "monetary damages,"<sup>21</sup> however, suits seeking equitable relief for breaches of due care survive the statute. This fact is significant because injunctive relief is often the remedy of choice for shareholders who seek to enjoin a sale or merger.<sup>22</sup>

Rather than *Van Gorkom* and information, the *Paramount* court chose to focus on *Revlon Inc. v. MacAndrews & Forbes Holdings, Inc.*<sup>23</sup> and profit maximization. In *Revlon*, the Delaware Supreme Court enjoined certain defensive measures adopted by the target corporation, ruling that the measures constituted a breach of the duty owed to shareholders. Once a sale of the company became inevitable, the target's directors were transformed into "auctioneers charged with getting the best price for the stockholders. . . ."<sup>24</sup> Instead of taking that course of action, the Revlon directors locked in a particular bidder. The court held that the Board's action halted the auction without any substantial increase in benefits for the shareholders, and thus deprived the shareholders of the highest available share price. The directors were held to have violated their duty of loyalty because the merger agreement protected the interests of noteholders, while sacrificing the interests of the shareholders.<sup>25</sup>

In *Paramount v. QVC*,<sup>26</sup> the court emphasized the *Revlon* profit maximization duties,<sup>27</sup> and while chiding the Paramount Board's "deficient" process,<sup>28</sup> and charging them with a failure to become adequately informed,<sup>29</sup> the court failed to afford proper attention to this crucial and initial requirement. The references to the duty to become informed could have been consistently

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20. § 102(b)(7).

21. *Id.*

22. James J. Hanks, Jr., *Evaluating Recent State Legislation on Director and Officer Liability Limitation and Indemnification*, 43 BUS. LAW. 1207, 1215 (1988) [hereinafter Hanks].

23. 506 A.2d 173 (Del. 1986).

24. *Id.* at 182.

25. *Id.* The noteholders were those shareholders who agreed to sell their shares to Revlon in exchange for notes with restrictive covenants, as part of the company's stock repurchase plan. For a further description of the notes and their holders, see *infra* notes 148, 151, 153-54.

26. 637 A.2d 34 (Del. 1993).

27. In addition, the court took great pains to distinguish *Revlon* from *Paramount Communications, Inc. v. Time Inc.*, 571 A.2d 1140 (Del. 1990). Because the Time-Warner transaction did not involve a "fundamental change of corporate control," the enhanced judicial scrutiny of the *Revlon* line of cases did not come into play. *Paramount*, 637 A.2d at 46 (citing *Barkan v. Amsted Indus. Inc.*, 567 A.2d 1279, 1286 (Del. 1989)).

28. *Paramount*, 637 A.2d at 51.

29. *Id.* at 50.

based on *Smith v. Van Gorkom*, the court's most clear pronouncement of the duty of care. In fact, *Van Gorkom* could have been the key precedent upon which the *Paramount* court analyzed the Paramount Board's breach of fiduciary duty. Any question of profit maximization should have been secondary, because a target board of directors clearly cannot obtain the best price for its shareholders when it is ignorant as to which bidder is actually offering the best price. The court may have overlooked the strong connection between the actions of the Paramount Board and those of Jerome Van Gorkom and the Trans Union Board. It is also possible that the court decided to downplay the role of *Van Gorkom* because of the extensive negative attention that the decision generated.<sup>30</sup> It is certainly true, however, that the *Paramount* court's minimization of *Van Gorkom*'s due care precedent reflects the court's hesitancy to force outside directors to second guess the very executives and managers who placed them on the board.<sup>31</sup> It was easier for the court to condemn Board conduct that violated both due care and profit maximization duties, rather than condemn the directors for allowing corporate managers to convince them that the hostile bid was unworthy of consideration.<sup>32</sup>

## II. THE BUSINESS JUDGMENT RULE

In *Smith*, *Revlon* and *Paramount*, the Delaware Supreme Court was called upon to determine whether the decisions and related conduct of such boards would be protected by the business judgment rule. The business judgment rule has been described in varying forms in Delaware law, but is repeatedly referred to in connection with the statutory provision<sup>33</sup> which

30. See *infra* notes 116-25 and accompanying text.

31. But see *Cinerama, Inc. v. Technicolor, Inc.*, 663 A.2d 1134, 1141 & n.7 (Del. Ch. 1994), *aff'd*, 663 A.2d 1156 (Del. 1995) for the proposition that one of the Delaware Supreme Court's "clearest messages" is that blind reliance on top management by outside directors is risky business. Amazingly, the chancellor cites *Paramount* as support for this contention. *Id.* at n.7. See Parts V, VI and VII for analysis that squarely contradicts this view of the Supreme Court's message.

32. *QVC Network, Inc. v. Paramount Communications Inc.*, 635 A.2d 1245, 1257 (Del. Ch. 1993).

33. DEL. CODE ANN. tit. 8, § 141(a) (1991). Section 141(a) provides:

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

states that a corporation is to be managed by or under its board of directors.<sup>34</sup> Traditionally, the business judgment rule acted as a presumption that favored directors and protected them and their substantive business decisions from judicial scrutiny.<sup>35</sup> The rule presumes "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."<sup>36</sup> Under the traditional application, the party challenging a board's actions carries the initial burden of proving that the directors violated their fiduciary duties.<sup>37</sup> This evidentiary requirement has in the past "resulted in a rather lenient judicial review of business decisions."<sup>38</sup> If, however, the challenging party successfully rebuts the business judgment rule, the burden shifts to the directors who must show that their actions were entirely fair.<sup>39</sup>

The business judgment rule stems from the judicial recognition of the realities of business decisions.<sup>40</sup> The judiciary real-

as shall be provided in the certificate of incorporation.

34. See *Zapata Corp. v. Maldonado*, 430 A.2d 779, 782 (Del. 1980) ("[T]he 'business judgment' rule evolved to give recognition and deference to directors' business expertise when exercising their managerial power under [section] 141(a)."); *Aronson v. Lewis*, 473 A.2d. 805, 812 (Del. 1984) ("The business judgment rule is an acknowledgment of the managerial prerogatives of Delaware directors under Section 141(a)."); *Smith v. Van Gorkom*, 488 A.2d 858, 872 (Del. 1985) ("Under Delaware law, the business judgment rule is the offspring of the fundamental principle, codified in . . . § 141(a) . . ."); *Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345, 360 (Del. 1993) ("The business judgment rule is an extension of these basic principles.") (referring to DEL. CODE ANN. tit. 8, § 141(a)).

35. *Aronson*, 473 A.2d at 812.

36. *Id.* See also *BLOCK*, *supra* note 7, at 12 ("The business judgment rule's presumption shields corporate decision-makers and their decisions from judicial second-guessing where the [rule's elements] are present - (1) a business decision, (2) disinterestedness, (3) due care, (4) good faith, and (5) according to some courts and commentators, no abuse of discretion or waste of corporate assets.").

37. *Cheff v. Mathes*, 199 A.2d 548, 554 (Del. 1964). See *Allaun v. Consolidated Oil Co.*, 143 A. 257, 261 (Del. Ch. 1929) ("The judgment of the directors in fixing the terms and conditions of [a] sale is entitled to the presumption in its favor that it was exercised honestly and in good faith.").

38. *Wander & LeCoque*, *supra* note 10, at 30.

39. *Mills Acquisition Co. v. Macmillan, Inc.*, 559 A.2d 1261, 1264 (Del. 1988); *Weinberger v. UOP, Inc.*, 457 A.2d 701, 703 (Del. 1983).

40. *Wander & LeCoque*, *supra* note 10, at 29. Some critics of the business judgment rule argue that a complex business decision, by its very nature, is not something that can be reviewed. New York City attorney Bayless Manning sets forth his view of the "real-world conduct of directors," and maintains that most non-directors are completely ignorant as to the way the decisional process works. Bayless Manning, *The Business Judgment Rule and the Director's Duty of Attention: Time for Reality*, 39 BUS. LAW. 1477, 1480-83 (1984) [hereinafter Manning]. "Courts and the public must understand that quite commonly, a director will go along with a business proposal that he does not really

ized that it was unable to effectively assess complex corporate decisions in comparison to the corporation's directors.<sup>41</sup> Consequently, a Delaware court will not "substitute its own notions of what is or is not sound business judgment"<sup>42</sup> in place of the director's superior judgment.<sup>43</sup> The business judgment rule also recognizes the role of the outside director, and the fact that he or she may devote a limited amount of time to the company.<sup>44</sup> Consequently, these part-time directors are not held accountable merely because their decisions turn out badly.<sup>45</sup> The business judgment rule acknowledges that "risk evaluation and assumption" are inherent in business decisions<sup>46</sup> and both play an im-

like." *Id.* at 1490. Manning offers his version of the director's thought process:

"I do not like this proposal. It seems risky and I believe other uses for the same resources would be more promising. But I may be wrong; I respect the contrary views of my colleagues, and I have to accord great weight to the CEO's strong support for this project."

*Id.* Manning realizes that the public may be shocked by his revelations. *See id.* at 1480. This very element of surprise, however, is why Manning believes that the duty of care element of the business judgment rule is "analytically unsound." *Id.* at 1478. "The whole concept of negligence and of 'reasonable man' presupposes as a predicate a clear conception of what the person is doing, and a community understanding of normalcy about how he should do it. Both those pieces are missing in the case of the work of corporate directors." *Id.* at 1494. *See also* Daniel R. Fischel, *The Business Judgment Rule and the Trans Union Case*, 40 BUS. LAW. 1437, 1441 (1985) (asserting that information gathering is costly and that "investors want managers to spend an additional dollar on information acquisition only to the point where there is an additional dollar generated from better decision making") [hereinafter Fischel].

41. *See* Wander & LeCoque, *supra* note 10, at 30.

42. *Sinclair Oil Corp. v. Levien*, 280 A.2d 717, 720 (Del. 1971) ("A board of directors enjoys a presumption of sound business judgment, and its decisions will not be disturbed if they can be attributed to any rational business purpose.").

43. Kristin A. Linsley, *Statutory Limitations on Directors' Liability in Delaware: A New Look at Conflicts of Interest and the Business Judgment Rule*, 24 HARV. J. ON LEGIS. 527, 534 (1987) [hereinafter Linsley].

44. Generally speaking, inside directors are those directors who also serve as officers of the company, while the involvement of outside directors is limited to their service on the board. *See* Wander & LeCoque, *supra* note 10, at 29 ("Because the corporate director does not make a full-time commitment to the operation and affairs of the corporation, he may make decisions in good faith and in the best interest of the corporation that eventually prove to be erroneous.") (citation omitted). Bayless Manning recognizes the same restraints on a director's time, but argues that the duty of care element of the business judgment rule does not realistically account for those limitations. Manning, *supra* note 40, at 1481. Manning cites a 1982 survey that depicts the average director of a publicly held company as devoting roughly 1.5 working days per month to his board position. *Id.* (citing KORN FERRY INT'L BD. OF DIRECTORS, Tenth Annual Study 9 (1983)).

45. *Cheff v. Mathes*, 199 A.2d 548, 555 (Del. 1964).

46. Wander & LeCoque, *supra* note 10, at 29. *But see* Fischel, *supra* note 40, at 1439 (arguing that the business judgment rule's justifications are inadequate and that the rule's rationale, and the "limited role of liability rules" in this arena rest on "several factors, including the cost of contracting which makes it extremely difficult to distin-



portant role in protecting decisions from review when they are made by informed and uninterested directors.<sup>47</sup>

While the traditional application of the business judgment rule placed the evidentiary burden on the party challenging a board's action,<sup>48</sup> the advent of complex business transactions resulted in a shift of that burden with respect to certain transactions. *Cheff v. Mathes*<sup>49</sup> held that when a board of directors used corporate funds to purchase corporate shares, the directors must initially justify that such action was taken primarily to benefit the corporation.<sup>50</sup> The directors must prove that there was "reasonable grounds to believe a danger to corporate policy and effectiveness existed" because of the stock ownership of a particular party.<sup>51</sup> That burden is satisfied by "a showing of good faith and reasonable investigation."<sup>52</sup> In *Unocal Corp. v. Mesa Petroleum Co.*,<sup>53</sup> the Delaware Supreme Court added to the nature of this threshold burden by requiring that the board of directors prove that the defensive measure was "reasonable in relation to the threat posed."<sup>54</sup> Directors are called upon to satisfy this burden "because of the omnipresent specter that a board may be acting primarily in its own interest, rather than those of the corporation and its shareholders."<sup>55</sup> Upon satisfaction of this threshold burden, the board's decision and related conduct will be measured by the business judgment rule and the evidentiary burden shifts back to the challenging party.<sup>56</sup>

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guish adequate or reasonable performance from a breach of fiduciary duty"); see also Manning, *supra* note 40, at 1482, for his assertion that the business judgment rule's duty of care cannot possibly be flexible enough to allow for the excessive uncertainty and risk-taking that is inherent in every business decision. "The decisions that the businessman must make are fraught with risk, and he is quite accustomed to making these decisions in a hurry on the basis of hunch and manifestly sparse data. The businessman and the board of directors thrive or die in a sea of uncertainty." *Id.*

47. *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984).

48. See *supra* notes 37-38.

49. 199 A.2d 548 (Del. 1964).

50. *Id.* at 554. The rationale behind the burden shift is that using corporate funds to eliminate a threat to control of the corporation requires that directors show that they were not motivated solely by a desire to remain entrenched in their positions. *Id.*; accord *Bennett v. Propp*, 187 A.2d 405, 409 (Del. 1962).

51. *Cheff v. Mathes*, 199 A.2d 548, 555 (Del. 1964).

52. *Id.*

53. 493 A.2d 946 (Del. 1985). The *Unocal* decision was handed down on May 17, 1985, *id.*, just months after the *Van Gorkom* opinion of Jan. 29, 1985. *Smith v. Van Gorkom*, 488 A.2d 858 (Del. 1985).

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

55. *Id.* at 954.

56. *Id.* at 958.

The business judgment rule is by no means a stagnant principle as can be seen by the changes in its application. Commentators have attributed the modifications in part to the increased confidence on the part of the Delaware judges who have become "more willing to insert themselves into corporate decisionmaking . . . ."<sup>57</sup> Others have concluded that "[w]hereas once the courts would have deferred to directors' decisions as sacrosanct business judgments and questioned them only if the outcome were egregiously bad, the courts have now begun to look at directors' decisions as punctiliously as they might a criminal conviction and find fault with them almost eagerly."<sup>58</sup> This latter characterization refers to the landmark *Smith v. Van Gorkom* case.<sup>59</sup>

### III. THE DUTY TO BECOME INFORMED: *SMITH V. VAN GORKOM*

As a condition precedent to securing the protection of the business judgment rule, directors must satisfy the "duty to inform themselves, prior to making a business decision, of all material information reasonably available to them."<sup>60</sup> Delaware law measures the performance of this duty by a gross negligence standard.<sup>61</sup> It is by this standard that the actions of the Trans Union directors were condemned by the Delaware Supreme Court in *Smith v. Van Gorkom*.<sup>62</sup>

Trans Union was a diversified holding company involved in the rail car leasing business that faced the problem of insufficient taxable income to offset its large investment tax credits.<sup>63</sup> Trans Union's chief financial officer suggested the idea of a leveraged buy-out and the figure of \$50 to \$60 per share was suggested as a price at which such a transaction would be financially feasible, in light of the cash flow necessary to service the debt that would likely result.<sup>64</sup> Without consulting the board of

57. Hanks, *supra* note 22, at 1208.

58. Leo Herzel et. al., *Next to Last Word on Endangered Directors*, HARV. BUS. REV., Jan.-Feb. 1987, at 38.

59. *Smith v. Van Gorkom*, 488 A.2d 858 (Del. 1985). See also A.A. Sommer Jr., *Directors Under Fire*, A.B.A. J., June 1992, at 94.

60. *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984).

61. *Id.* Other jurisdictions that apply the gross negligence standard include Maryland, *Arconti & Sons, Inc. v. Ames-Ennis, Inc.*, 340 A.2d 225, 236 (Md. 1975) ("gross or culpable negligence"), and New York, *Amdur v. Meyer*, 224 N.Y.S.2d 440, 443 (App. Div. 1962) ("negligence so gross as to amount to a breach of trust").

62. 488 A.2d at 873. This decision reversed a Chancery Court determination that the business judgment rule had been satisfied. *Smith v. Pritzker*, No. 6342, 1982 WL 8774, at \*6-7 (Del. Ch. July 6, 1982).

63. *Van Gorkom*, 488 A.2d at 864.

64. *Id.* at 865.

directors, Jerome W. Van Gorkom,<sup>65</sup> Trans Union's Chairman and CEO, approached an acquaintance and corporate acquisition expert, Jay A. Pritzker, and proposed \$55 per share as a feasible buyout price.<sup>66</sup> In negotiating the deal, Van Gorkom requested that Trans Union be free to accept any better offer and Pritzker acquiesced, conditioned upon a treasury stock purchase agreement that allowed him to buy 1,750,000 new Trans Union shares at market price<sup>67</sup> and sell at a higher price if any other bidder acquired the company.<sup>68</sup> After a series of meetings between Van Gorkom and Pritzker, Van Gorkom scheduled a special Board meeting for Saturday, September 20, responding to Pritzker's demand that the Trans Union Board act on his offer by September 21.<sup>69</sup> Just prior to the Board meeting, Van Gorkom called a senior management meeting where he disclosed the offer and its terms, but provided no written copies of the merger agreement.<sup>70</sup> Management's reaction was negative; the price was criticized as low, the treasury stock agreement as a lock-up and the all-cash terms as having potentially adverse tax consequences for low-basis shareholders.<sup>71</sup>

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65. Jerome Van Gorkom was a certified public accountant and an attorney. *Id.* Ironically, the Chancery decision highlighted Van Gorkom's extensive acquisition experience and thorough familiarity "with acquisition procedures, valuation methods" and pre-merger negotiations. *Pritzker*, 1982 WL 8774 at \*1. The Delaware Supreme Court found it "noteworthy" that Van Gorkom was "then approaching 65 years of age and mandatory retirement." *Van Gorkom*, 488 A.2d at 866.

66. *Van Gorkom*, 488 A.2d at 864. Note, however, Van Gorkom's contention that he did not initially intend to elicit an offer from Pritzker; "rather, he says, he wanted Pritzker to either confirm or dispel Van Gorkom's own views as to the attractiveness of Trans Union to someone like Pritzker." David Elsner, *Ruling In, Jury Still Out on Trans Union: Van Gorkom Makes His Case*, CHI. TRIB., Feb. 8, 1987, § 7, at 9 [hereinafter *Elsner*]. Such a contention seems unlikely, since the court found that Van Gorkom had instructed Trans Union's controller to calculate the feasibility of a buyout at an assumed per share price of \$55 and specifically told him "that he wanted no other person on his staff to know what he was doing." *Van Gorkom*, 488 A.2d at 866.

67. "The common stock of Trans Union was traded on the New York Stock Exchange. . . . Its high and low range for 1980 through September 19 (the last trading day before announcement of the merger) was \$38½-\$29½." *Van Gorkom*, 488 A.2d 858, 866, n.5. After negotiation, Pritzker agreed to lower the Trans Union treasury stock purchase agreement to one million new shares at a price of \$38, seventy-five cents above the close of market price on Sept. 19. *Id.* at 867.

68. *Id.* at 866.

69. *Id.* at 867.

70. *Id.* Pritzker's attorney drafted the merger agreement, which was to be reviewed by Van Gorkom's attorney, "sometimes with discussion and sometimes not, in the haste to get it finished." *Id.*

71. *Id.* at 867-88. A "lock up" is corporate jargon for "the setting aside of securities for purchase by friendly interests in order to defeat or make more difficult a takeover attempt." BLACK'S LAW DICTIONARY 940 (6th ed. 1990).

Minutes later, Van Gorkom made a twenty minute oral presentation to the board of directors, in which he reviewed the tax problem, discussed his initial meeting with Pritzker and outlined the proposed merger.<sup>72</sup> He did not, however, reveal how the price was derived or his role in suggesting it to Pritzker.<sup>73</sup> Copies of the merger agreement were supplied, but their delayed delivery prohibited any review prior to the meeting.<sup>74</sup> Rather, Van Gorkom related the offer's terms. Van Gorkom framed the issue for the Board as not whether \$55 was the highest price obtainable, but whether it was a fair price about which the shareholders should be given the chance to vote.<sup>75</sup> Furthermore, outside legal counsel retained by Van Gorkom advised the Board that they could be subject to legal action for failing to accept the offer and that they were not legally required to obtain an outside fairness opinion.<sup>76</sup> Trans Union's chief financial officer disclaimed prior knowledge of the proposal and indicated that his own feasibility study did not constitute a fair price finding, while the Trans Union president offered support for Van Gorkom's presentation.<sup>77</sup> The Board consequently voted to approve the merger agreement after only two hours of debate.<sup>78</sup> That same evening, while at a social event, Van

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The tax concerns proved to be significant, particularly to Alden Smith, the *Smith v. Van Gorkom* plaintiff, who was a low-basis shareholder. He "had sold his business to Trans Union in 1960 for 150,000 shares of Trans Union stock . . . For him, the all-cash deal meant having to pay mammoth capital gains taxes." Elsner, *supra* note 66, at 9.

72. *Van Gorkom*, 488 A.2d at 868.

73. *Id.*

74. *Id.* Pritzker was to pay \$55 per share for all of the outstanding Trans Union shares, contingent on Pritzker's financing by October 10. *Id.* at 878. According to Van Gorkom, Trans Union could receive other bids for ninety days, but could not actively solicit such bids and could not provide competing bidders with proprietary information. *Id.* The court found, however, that the provision allowing the receipt of competing bids was not proven to be a term of the agreement, because defendants were guilty of an "unexplained failure to produce and identify the original merger agreement." *Id.* For authority, the court cited the "well established principle," similar to the best evidence rule, "that the production of weak evidence when strong is, or should have been, available can lead only to the conclusion that the strong would have been adverse." *Id.* (citations omitted).

75. *Id.* at 868.

76. *Id.* The court noted that if given, this advice was "of no consequence." *Id.* at 881. The court explained that: (1) directors are often subjected to legal action, but will be protected from judicial scrutiny when acting "within the ambit of the business judgment rule" and that the fear of a lawsuit is no justification for "permitting itself to be stamped into a patently unadvised act;" and (2) the advice that a fairness opinion is not required is only meaningful if the directors possessed other adequate valuation information. *Id.*

77. *Id.* at 868-69.

78. *Id.* at 869.

Gorkom executed the agreement which had not been read by either himself or any Trans Union director.<sup>79</sup>

While the Delaware Court of Chancery found that the Trans Union Board "had given sufficient time and attention to the [merger] transaction,"<sup>80</sup> the Delaware Supreme Court reversed, concluding that the Board had not acted on an informed basis and therefore, the decision was not protected by the business judgment rule.<sup>81</sup> The Delaware Supreme Court's analysis measured the Board's conduct against three standards: the fiduciary duty of care,<sup>82</sup> the standard of gross negligence<sup>83</sup> and the statutory duties that govern a board's adoption of a proposed merger.<sup>84</sup> The court's finding that the Board acted on an uninformed basis refers both to the September 20 meeting<sup>85</sup> and subsequent Board actions.<sup>86</sup>

The September 20 decision failed to satisfy the informed business judgment standard because the Board was inadequately informed about (1) Van Gorkom's role in procuring the merger and suggesting the price, and (2) the intrinsic value of Trans Union shares.<sup>87</sup> The court focused on the lack of prior notice as to the meeting's subject matter and the extent to which the Board's decision was based solely on Van Gorkom representations, without review of the agreement or any written summary of its terms.<sup>88</sup> The court stressed that while Delaware law fully protects a director's good faith reliance on officer-generated

79. *Id.*

80. *Id.* at 870.

81. *Id.* at 893.

82. *Id.* at 872.

83. *Id.* at 873.

84. *Id.* The court refers to section 251(b) of the Delaware Code as the source for the duty "to act in an informed and deliberate manner in determining whether to approve an agreement of merger before submitting the proposal to the stockholders." *Van Gorkom*, 488 A.2d at 873 (citing DEL. CODE ANN. tit. 8, § 251(b) (1983)). The statute provides:

The board of directors of each corporation which desires to merge or consolidate shall adopt a resolution approving an agreement of merger or consolidation. The agreement shall state: (1) The terms and conditions of the merger or consolidation; (2) the mode of carrying the same into effect . . . (5) the manner of converting the shares of each of the constituent corporations into shares or other securities of the corporation surviving or resulting from the merger or consolidation . . . and (6) such other details or provisions as are deemed desirable . . . .

DEL. CODE ANN. tit. 8, § 251(b) (1983).

85. *Van Gorkom*, 488 A.2d at 878.

86. *Id.* at 888. See *infra* notes 94-103 and accompanying text.

87. *Van Gorkom*, 488 A.2d at 874.

88. *Id.*

reports,<sup>89</sup> no such report was presented to the Trans Union directors.<sup>90</sup> Any statutory reliance is conditioned on the requirement that the opinion relied upon "was reached on a sound basis."<sup>91</sup> The issue, as stated by the court, was whether the directors had accessed and analyzed "all information that was reasonably available to them. Had they done so, they would have learned of the source and derivation of the \$55 price and could not reasonably have relied thereupon in good faith."<sup>92</sup> Defendants offered several arguments for application of the business judgment rule to their actions at the September 20 meeting, but each was rejected by the court.<sup>93</sup>

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89. DEL. CODE ANN. tit. 8, § 141(e) (1983). This section provides:

A member of the board of directors, or a member of any committee designated by the board of directors, shall, in the performance of his duties, be fully protected in relying in good faith upon the records of the corporation and upon such information, opinions, reports or statements presented to the corporation by any of the corporation's officers or employees, or committees of the board of directors, or by any other person as to matters the member reasonably believes are within such other person's professional or expert competence and who has been selected with reasonable care by or on behalf of the corporation.

*Id.*

90. *Van Gorkom*, 488 A.2d at 874-75 ("At a minimum for a report to enjoy the status conferred by § 141(e), it must be pertinent to the subject matter upon which a board is called to act, and otherwise be entitled to good faith, not *blind, reliance.*") (emphasis added).

91. *Id.* at 877.

92. *Id.*

93. The following summary of defendants' arguments is taken in part from Barry F. Schwartz & James G. Wiles, *Trans Union: Neither 'New' Law nor 'Bad' Law*, 10 DEL. J. CORP. L. 429, 436 (1985) [hereinafter Schwartz & Wiles]: (1) Reliance on the market price was based on a faulty premise. *Id.* The court extensively analyzed the role that the "historically depressed" market played in the Board's acceptance of the \$55 per share price. *Van Gorkom*, 488 A.2d at 875-78. In particular, the court was distressed by the Board's apparent contradiction in repeatedly referring to the market's undervaluing of Trans Union stock while at the same time relying on that market figure to assess the sufficiency of the \$55 offer. *Id.* at 876. Additionally, the Board "accepted without scrutiny" the \$55 per share price and failed to discover the crucial fact that the price had been "based on calculations designed solely to determine the feasibility of a leveraged buy-out." *Id.* at 877; (2) "The so-called ninety day market test to determine the fairness of the price was largely illusory." Schwartz & Wiles, *supra* at 436. See *supra* note 74 and accompanying text; (3) The Board's "collective experience," standing alone, could not render the September 20 decision informed and reasonable. Schwartz & Wiles, *supra* at 436; (4) Any legal advice regarding the optional nature of a fairness opinion was irrelevant to the question of the adequacy of the valuation information that the directors actually possessed. *Id.* See *supra* note 76 and accompanying text; (5) Equally irrelevant was "counsel's advice that the Board would be subject to stockholder lawsuits if it rejected the \$55 per share price" because such advice "could not constitute . . . [a] valid basis on which to pursue an uninformed course." Schwartz & Wiles, *supra* at 436. See *supra* note 76 and accompanying text.

With regard to the Board's actions subsequent to September 20, the court again found the conduct grossly negligent, uninformed, and therefore not curative of the deficient September 20 decision.<sup>94</sup> On October 8, the Board met to amend the merger agreement so as to permit a market test.<sup>95</sup> Van Gorkom apparently believed that the amendments permitted Trans Union to openly solicit competitive bids and he represented this term to his fellow directors.<sup>96</sup> On that basis alone, the Board authorized Van Gorkom to execute the yet undrafted amending documents when he obtained them.<sup>97</sup> In reality, however, Trans Union's rights were restricted by the amendments. The company could now solicit offers, but in order for Trans Union to withdraw from the merger agreement, a competing offer had to be superior to Pritzker's and finalized by February 10, 1981, subject only to shareholder approval.<sup>98</sup> In addition, contrary to Van Gorkom's belief, "the market test period was effectively reduced," rather than extended, because Trans Union was required to file its preliminary proxy statement by December 5, fifteen days shorter than the alleged market test period under the original merger agreement.<sup>99</sup> The court was also critical of Van Gorkom's response to the KKR proposal—a leveraged buy-out proposed by senior management members minus Van Gorkom.<sup>100</sup> He was "completely negative," refused to allow a press release announcing the offer<sup>101</sup> and denied any responsibility for the offer's withdrawal, though he had conversed hours earlier with a member of the senior management purchasing

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94. *Van Gorkom*, 488 A.2d at 888.

95. This meeting was in response to the uproar by senior management following the September 22 press release announcing a "definitive [merger] agreement[ ]." *Id.* at 881-82.

96. *Id.* at 882.

97. *Id.* at 883. Again Van Gorkom signed the documents "without reviewing [them] . . . to determine if they were consistent with the authority previously granted him by the Board." *Id.*

98. *Id.*

99. *Id.* The original merger agreement called for a 90 day period from September 20 to December 20. *Id.* at 868. The original agreement's market test period is "alleged" because the agreement was never offered into evidence. See *supra* note 74.

100. KKR is more formally known as Kohlberg Kravis Roberts & Co., the Wall Street investment firm that made millions from leveraged buyouts in the 1980s. For a fascinating account of KKR's rise and fall, see GEORGE ANDERS, *MERCHANTS OF DEBT* (1992).

101. Van Gorkom stated his concern that such a release would "chill" other possible offers, but the court noted that this concern contradicted Van Gorkom's advocacy of the press release of Pritzker, which he believed would encourage other offers. *Van Gorkom*, 488 A.2d at 884-85 & n.27.

group.<sup>102</sup> Finally, the court concluded that the Board's January 26 meeting had no curative effect because "the Board was mistaken as a matter of law regarding its available courses of action."<sup>103</sup> Consequently, the court held that the Trans Union directors "breached their fiduciary duty to their stockholders . . . by their failure to inform themselves of all information reasonably available to them and relevant to their decision to recommend the Pritzker merger."<sup>104</sup>

On October 11, 1985, the Court of Chancery accepted the \$23.5 million damage settlement,<sup>105</sup> but, while the litigation had ended, the impact of the decision was only beginning to surface. Most of the commentary from practitioners and scholars was highly negative.<sup>106</sup> Some of the harshest and most sardonic criticism came from Justice McNeilly's dissent.<sup>107</sup> Likening the majority decision to "an advocate's closing address to a hostile jury"<sup>108</sup> and labeling it a "comedy of errors,"<sup>109</sup> McNeilly criticized the majority's factual findings with respect to the Trans Union Board's knowledge and ability.<sup>110</sup> He referred to the majority's analysis as an "exploitation of the negative . . . [that fails to] giv[e] credit to the positive."<sup>111</sup> McNeilly began his dissent by broadening the time frame of review to include an em-

102. *Id.* at 885.

103. *Id.* at 888. The minutes of the meeting reveal that the Board considered (1) continued recommendation of the agreement, (2) a recommendation that the shareholders vote against the agreement, (3) and a noncommittal position. *Id.* at 887-88. The court concluded that option two would violate the merger agreement. *Id.* Additionally, the court found choice three to be inconsistent with the pertinent Delaware statute since the statute requires that corporate directors who "desire[ ] to merge or consolidate shall adopt a resolution *approving* an agreement of merger or consolidation." *Id.* (emphasis added) (citing DEL. CODE ANN. tit. 8, § 251(b) (1974), *amended by* 70 Del. Laws 349 (1996)). Thus, the Trans Union Board could not remain uncommitted under § 251. See *supra* note 84 for text of this provision.

104. *Van Gorkom*, 488 A.2d at 893. The court also held that the directors breached their duty of disclosure to the shareholders. *Id.*

105. *Smith v. Van Gorkom*, No. 6342, 1985 WL 22040, at \*1 (Del. Ch. 1985) (on remand from the Delaware Supreme Court).

106. See Schwartz & Wiles, *supra* note 93, at 429 ("The condemnation appears to be virtually unanimous."). But see *id.* at 430-31 ("We . . . take issue with Professor Fischel's claim that the decision in *Trans Union* constitutes 'bad law' and, in particular, that the rule announced is contrary to the interests of stockholders.").

107. Justice Christie also offered a brief dissent, stating his belief that the actions of the Trans Union Board were protected by the business judgment rule. *Van Gorkom*, 488 A.2d at 898 (Christie, J., dissenting).

108. *Van Gorkom*, 488 A.2d at 893 (McNeilly, J., dissenting).

109. *Id.* at 894.

110. *Id.*

111. *Id.* at 897.



phasis on the educational and professional backgrounds of each of the directors, noting that "[d]irectors of this caliber are not ordinarily taken in by a 'fast shuffle.'"<sup>112</sup> Next, McNeilly extolled the Board's familiarity with the company itself,<sup>113</sup> and only after laying that foundation did he address the specifics of the Pritzker merger. McNeilly stressed the significance of the Board's "discussion" and their insistence on two modifications of the agreement.<sup>114</sup> This reference is peculiar, since the majority repeatedly stated that the original September 20 merger agreement was never offered into evidence.<sup>115</sup> The impact of any Board demands is weakened by the fact, not mentioned by the dissent, that the Board failed to take any precaution to ensure that their intent was carried out; that is, they never requested or viewed any written documentation of the terms.

The commentary spurred by *Smith v. Van Gorkom* can be divided into two basic categories: those that condemn the decision and forecast the grave consequences of a clearly erroneous decision, and those that characterize the decision as a firm reiteration of existing Delaware precedent. The commentary ranges from immediate, impassioned reactions from corporate practitioners and involved parties, to reasoned, thorough analysis from scholars.<sup>116</sup> A review of the negative commentary is signifi-

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112. *Id.* at 894.

113. *Id.* at 895.

114. *Id.* Any interested bidder was to be given access to Trans Union information on the same footing as Pritzker. *Id.* In addition, the directors would be free to accept and recommend to the shareholders any offer that was better than the Pritzker offer. *Id.*

115. *See id.* at 868 n.7, 878.

The Merger Agreement, specifically identified as that originally presented to the Board on September 20, has never been produced by the defendants, notwithstanding the plaintiffs' several demands for production before as well as during trial. No acceptable explanation of this failure has been given either to the Trial Court or this Court. . . . Thus, the Court is deprived of the best evidence on which to judge the merits of the defendants' position as to the care and attention which they gave to the terms of the Agreement on September 20.

*Id.* at 878. In addition, the majority stated that the Board meeting minutes did not support the Board's contention that the right to accept better offers had been reserved. *Id.* at 869. "No reference to either of the so-called 'conditions' or of Trans Union's reserved right to test the market appears in any notes of the Board meeting or in the Board Resolution accepting the Pritzker offer or in the Minutes of the meeting itself." *Id.* at 879.

116. The *Chicago Tribune* captured some first-hand reactions from the parties themselves. Mary Holm Ansley, *Trans Union Shareholders Win Round One*, CHI. TRIB., Feb. 1, 1985, § 3, at 2. The following are the most notable reactions. *Id.* Days after the Delaware Supreme Court decision, Jerome Van Gorkom had few words: "I really don't have anything to say at this point, except that I know the decision is totally at variance with the law and the facts." *Id.* Jay Pritzker was a bit more critical following finalization of the settlement: "It's a terrible decision; it was ridiculous . . . . The upper court

cant because it tracks the controversy that has attached itself to the decision. This controversy may have been a reason behind the Delaware Supreme Court's unwillingness to measure the Board's action in *Paramount v. QVC*<sup>117</sup> against the stringent *Van Gorkom* standard.<sup>118</sup>

Because the *Van Gorkom* gross negligence holding rested predominantly on the court's finding of deficient procedure prior to a business decision, much of the criticism attacks the court as ignorant to the ways of the business world.<sup>119</sup> The court was obviously concerned with the hastiness and informality of the decision to accept Pritzker's merger. Some argue that this concern was unwarranted. Chicago attorneys Leo Herzel and Leo Katz assert that caution can be a "costly vice" in the boardroom because it limits a director's ability to take bold moves.<sup>120</sup> Herzel and Katz argue that a publicly held corporation is a particularly objectionable atmosphere for excess caution because shareholders with "diversified portfolio[s] would do best if every corporation they invest in would maximize its expected gain instead of minimizing its risks."<sup>121</sup> In essence, Herzel and Katz profess that "[a] company need not protect shareholders from risk" because the shareholders can easily do this themselves by diversifying their holdings.<sup>122</sup>

The majority's focus on the procedures, or lack thereof, involved in a single transaction has been criticized as unreasona-

missed the whole dynamics of the case." Bill Barnhart & Sally Saville Hodge, *Pritzker Less than Charitable to the Court*, CHI. TRIB., Aug. 7, 1985, § 4, at 1 [hereinafter Barnhart & Hodge]. Two years after the momentous ruling, Van Gorkom spoke about the difficulty in dealing with injustices in the world: "Now, because of [the decision], people who don't know me think of me as the guy who sold his company in two hours." See Elsner, *supra* note 66, at 1. "The worst thing about this is the case is always referred to as *Smith v. Van Gorkom* . . . I really wish they would call it something else." *Id.* at 9.

117. 637 A.2d 34 (Del. 1993).

118. See *infra* Part VI.

119. Leo Herzel et al., *'Smith' Brings Whip Down on Directors' Backs*, LEGAL TIMES, May 13, 1985, at 14 ("The court's review of the chancery court's findings of fact demonstrates the arrogance of appellate courts at their worst. . . . [T]he court's observations about the way in which the business world works are frequently wildly wrong.") [hereinafter Herzel].

120. Leo Herzel & Leo Katz, *Smith v. Van Gorkom: The Business of Judging Business Judgment*, 41 BUS. LAW. 1187, 1189 (1986) (explaining that marketing researchers refer to excess caution in business as "the fallacy of conservatism," and that this phenomenon has caused a host of U.S. companies to lose out to competitors) [hereinafter Herzel & Katz].

121. *Id.* at 1190.

122. *Id.* This view seems to ignore the difference between risk and unnecessary risk. Even the shareholder without diverse holdings who has invested in one corporation should be entitled to maximize gain without being subjected to unnecessary risk.

bly narrow.<sup>123</sup> The assessment that results from such a restricted view, it is argued, is inferior to the market's ability to measure a director's caliber based on a career of business decisions. Herzel and Katz criticize the court system as an inadequate means for evaluating the conduct of directors, because of a court's very inability to review more than one piece at a time.<sup>124</sup> The market is a more effective instrument for such measurements, they contend, because the market monitors a corporate director's conduct over time, during which "good luck and bad luck cancel out."<sup>125</sup> Perhaps what the court is asserting, however, is that the market test is not stringent enough because it punishes the incompetent director by leaving him unemployed, but fails to reimburse the shareholder who suffers from such incompetence.

While the court disapproved of Van Gorkom's role in suggesting a workable price rather than the best price and his failure to reveal this role to the directors, some critics of the decision have commended Van Gorkom's conduct. Illinois attorney and University of Chicago law professor Daniel R. Fischel maintains that the *Van Gorkom* facts as found by the Delaware Supreme Court may be interpreted in a very different, and much more plausible, way.<sup>126</sup> Focusing on Van Gorkom's conduct, Fischel inquires, "why does this conduct not instead demonstrate Van Gorkom's skill as a negotiator in putting together a deal and convincing the other party that the deal made sense from his perspective as well?"<sup>127</sup> Others characterize Van Gorkom's actions as "common technique for clever sellers because it immediately gets the buyer on the seller's side."<sup>128</sup> It is important, however, to recognize the distinction between the foci of the court and the critics. On the one hand, commentators emphasize the

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123. Like such critics, Justice McNeilly's dissent preferred a broadened view that considered the background and general knowledge of the directors. See *Smith v. Van Gorkom*, 488 A.2d 856, 894-95 (Del. 1985) (McNeilly, J., dissenting) and *supra* notes 109, 110 and accompanying text.

124. Herzel & Katz, *supra* note 120, at 1189 (contending that courts have great difficulty determining "whether the litigated misfortune is due to bad luck or bad decision making"). On the topic of distinguishing performance of fiduciary duty from breach, see Fischel, *supra* note 40 at 1440-41.

125. Herzel & Katz, *supra* note 120, at 1189 (comparing a judge's "single swing of the bat" to the market's view of "the batting average[s]").

126. Fischel, *supra* note 40, at 1446.

127. *Id.* Additionally, one commentary notes that the majority opinion ignores the fact that Trans Union's \$700 million price tag limited the number of available buyers, thus making Van Gorkom's solicitation of Pritzker necessary. Herzel, *supra* note 119, at 14.

128. Herzel, *supra* note 119, at 14.

validity of Van Gorkom's reasons for approaching Pritzker as well as his marketing prowess. The court, on the other hand, seems most disturbed by (1) Van Gorkom's failure to reveal to the Trans Union Board the exact nature of his participation and (2) the fact that the price suggested to Pritzker was a figure most workable for a buyer wishing to avoid long-term debt without documented consideration of the best price for the shareholders.

In addition to criticizing the merits of the *Van Gorkom* decision, much of the negative commentary warned of its grave consequences.<sup>129</sup> Most fears were calmed, however, when the Delaware legislature amended an existing statute to allow corporations to adopt provisions that limit or eliminate director liability for duty of care violations.<sup>130</sup> The amendment "essen-

129. One such commentary was by Leo Herzel and Leo Katz:

[C]ourts will have to decide in every case whether the matter in issue is the "product" of a board decision and hence entitled to a lot of respect, or an aspect of its decision-making procedure entitled to no respect. And who's to know how the court will draw that distinction in a given case? The result: randomness and unpredictability galore. Randomness, in turn, brings with it more litigation.

Herzel & Katz, *supra* note 120, at 1191; see also Fischel, *supra* note 40, at 1454 (maintaining that directors will not be as willing to sit on corporate boards and that when they do so, will be more risk averse); Barnhart & Hodge, *supra* note 116, at 8 ("Pritzker agrees with those who say the ruling will have a chilling effect on corporate directors everywhere."); Elsner, *supra* note 66, at 9 (quoting a Chicago venture capitalist who complained: "Now we need 'expert opinions' and long, formal meetings with attorneys present to decide on things we used to be able to do over the telephone."). In addition, many fears focused on the inevitability of increased director and officer ("D&O") insurance rates. For a discussion of this phenomenon, see generally Lynn A. Howell, *Post Smith v. Van Gorkom Director Liability Legislation with a Proactive Perspective*, 36 CLEV. ST. L. REV. 559, 566-68 (1988) ("Following *Van Gorkom*, D & O policies almost became extinct.").

130. DEL. CODE ANN. tit. 8, § 102(b)(7)(1986). This subsection permits the articles of incorporation to include:

A provision eliminating or limiting the personal liability of a director to the corporation or its stockholders for monetary damages for breach of fiduciary duty as a director, provided that such provision shall not eliminate or limit the liability of a director: (i) For any breach of the director's duty of loyalty to the corporation or its stockholders; (ii) for acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law; (iii) under § 174 of this title [relating to unlawful distributions]; or (iv) for any transaction from which the director derived an improper personal benefit. No such provision shall eliminate or limit the liability of a director for any act or omission occurring prior to the date when such provision becomes effective.

*Id.* This type of legislative enactment permits the shareholder to predetermine the limits of director liability. "If shareholders want protection from gross negligence . . . they can reject proposals to limit director liability. If they prefer to give directors the discretion to take business risks without having to fear monetary loss for negligence, they can ap-

tially allows a corporation to fill in the gap in the business judgment rule left open by Van Gorkom.<sup>131</sup>

Though filling in a gap, the statute also creates some of its own. Equitable relief survives in the statute for breaches of both loyalty and care.<sup>132</sup> Further, while due care breaches may be exempted from liability, the statute provides for six particular instances in which liability may not be limited, most notably, breaches of duty of loyalty.<sup>133</sup> Thus, when faced with a breach of fiduciary duty case, the award of money damages will depend solely on the court's determination as to which duty is involved.<sup>134</sup> The exception for breach of loyalty has been noted for its problematic nature.<sup>135</sup> One reason for the confusion is that the phrase "duty of loyalty" is not defined by any Delaware statute.<sup>136</sup> As such, the duty can be maneuvered to include or exclude the situation at hand. The ease of manipulation would have been of utmost importance in *Revlon* if the suit had been brought by a dissatisfied shareholder following shareholder approval of the liability limiting provision. The court could not have been so imprecise in naming the particular duty involved if monetary damages had been at stake.

prove such proposals." Linsley, *supra* note 43, at 533 (footnotes omitted).

131. See Linsley, *supra* note 43, at 527-28.

132. § 102(b)(7). Equitable remedies include either an injunction or rescission. Hanks, *supra* note 22, at 1215.

In fact, if money damages are not available, a court may be more likely to grant equitable relief. Thus, for example, a suit to enjoin directors from voting in favor of a merger would not be dismissed if the directors were preparing to act in violation of their duty of care.

*Id.*

133. § 102(b)(7)(i).

134. Douglas S. Wilson, *Director and Officer Liability: State Legislative Reaction to Smith v. Van Gorkom*, 22 CREIGHTON L. REV. 747, 755 (1989) [hereinafter Wilson]. This issue is even more significant in light of the recognition:

that courts have occasionally invoked the duty of care when in fact their main concern has been potential disloyalty. . . . [W]here the court senses underlying loyalty problems but the plaintiff is unable to prove them, the court can allow the case to proceed on duty of care grounds, thereby avoiding the evidentiary difficulties involved in a duty of loyalty approach.

Linsley, *supra* note 43, at 552.

135. See, e.g., Hanks, *supra* note 22, at 1212; Linsley, *supra* note 43, at 535; Wilson, *supra* note 134, at 755.

136. Hanks, *supra* note 22, at 1212 ("The fact that one of the other exceptions . . . is for 'improper personal benefit' suggests that breach of the duty of loyalty means something more than just self-dealing.")

IV. THE DUTY TO MAXIMIZE SHAREHOLDER PROFIT:  
*REVLON V. MACANDREWS & FORBES HOLDINGS*

While *Van Gorkom's* duty to become informed can clearly be characterized as a duty of care, the duty to maximize shareholder profits can arguably be classified as either a duty of care or a duty of loyalty.<sup>137</sup> Even the Delaware courts have had difficulty in this regard<sup>138</sup> and have been criticized for their inconsistency.<sup>139</sup> Regardless of the terminology used to describe the obligation, *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*<sup>140</sup> added to Delaware law the concept that when a company is for sale, that company's board of directors must act as auctioneers to insure that shareholders receive the best possible price for their shares.<sup>141</sup>

The *Revlon* suit challenged certain actions taken by the Revlon Board to aid its friendly bidder, Forstmann Little & Co. ("Forstmann"), and thwart the unwelcome overtures of Pantry Pride, Inc.<sup>142</sup> Unlike *Smith v. Van Gorkom*, where a target shareholder sought damages, the *Revlon* plaintiff was a hostile bidder requesting injunctive relief.<sup>143</sup> While Pantry Pride's status

137. See Linsley, *supra* note 43, at 549.

138. Specifically, the Delaware Chancery Court ruled that the Revlon Board had violated its duty of loyalty by placing other interests—their own and those of the noteholders—above the interests of the shareholders. *MacAndrews & Forbes Holdings Inc. v. Revlon Inc.*, 501 A.2d 1239, 1250 (Del. Ch. 1985). The Delaware Supreme Court, on the other hand, held that the duty breached was the duty of care. *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 184-85 (Del. 1986). See *infra* notes 177-88 and accompanying text.

139. Linsley, *supra* note 43, at 549-50.

140. 506 A.2d 173 (Del. 1986).

141. For a unique discussion of the identity of shareholders in a takeover context, see Jon K. Grant, *Mergers and Acquisitions: Leveling the Playing Field*, BUS. Q., Spring 1996, at 17, 19 ("Unfortunately, by the time the best price is obtained, the shareholders are a transient collection of arbitrageurs who are gambling on the company's shares.").

142. "The nominal plaintiff, MacAndrews & Forbes Holdings, Inc., is the controlling stockholder of Pantry Pride." *Revlon*, 506 A.2d at 175 n.1. Pantry Pride is hereinafter treated as the plaintiff. Pantry Pride, based in Fort Lauderdale, operates supermarkets, drug stores and furniture and appliance outlets. *Beauty-Products Firm Plans to Pay Premium for 10 Million of Own Shares: Revlon Rejects Pantry Pride's Takeover Offer*, L. A. TIMES, Aug. 27, 1985, Part IV, at 1 [hereinafter *Beauty-Products*].

The general fact pattern involved in most "takeover litigation" is that a 'hostile' or unsolicited bid has been made for the company. The bid has an immediate market value potentially exceeding the immediate value of an alternative transaction or course of action preferred by the board of directors, but the bid cannot be accepted by the shareholders because of board action or inaction. David C. McBride, *Paramount and QVC - An Encore for Mergers and Acquisitions*, 866 PLI CORP. L. & PRAC. COURSE HANDBOOK SERIES, No. B4-7068, 839, 843 (1994) [hereinafter McBride].

143. *Revlon*, 506 A.2d at 175.

as a hostile bidder is crucial to the events that followed, the relationship between Revlon and Pantry Pride was not necessarily hostile at the outset. As soon as Pantry Pride revealed its bid, however, the hostility was apparent.

In June of 1985, Ronald O. Perelman, Chairman of the Board and CEO of Pantry Pride<sup>144</sup> approached Revlon Board Chairman and CEO Michel C. Bergerac to discuss the prospect of a friendly acquisition of Revlon by Pantry Pride.<sup>145</sup> Bergerac rejected as inadequate Pantry Pride's suggested \$40 to \$50 per share price and "rebuffed" all subsequent Pantry Pride proposals and bids.<sup>146</sup> In August, Perelman again approached Bergerac to consider alternative buyout methods, but Bergerac was unresponsive and in fact required that Perelman sign a standstill agreement as a precondition to any further talks.<sup>147</sup>

In response to the possibility of a hostile bid by Pantry Pride, the Revlon Board adopted defensive measures designed to prevent the success of any insufficient unwelcome bid.<sup>148</sup> When

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144. Perelman was also Pantry Pride's controlling shareholder. Paul Richter, *Pantry Pride Expects to Sell Health-Care Units of Revlon If Bid Wins*, L. A. TIMES, Aug. 24, 1985, Part IV, at 1.

145. *Revlon*, 506 A.2d at 176. However, the objective friendliness of Pantry Pride's intentions is debatable. The \$42-\$43 price originally offered was deemed grossly inadequate by Revlon's investment banker, *id.* at 176-77, and was much lower than Pantry Pride's hostile bid of \$58 per share only four months later on October 22. *Id.* at 179.

146. *Id.* at 176. The court suggested that Bergerac's discourteous treatment of Pantry Pride might have been due in part to Bergerac's personal aversion for Perelman. *Id.*

147. *Id.* "The standstill agreement [would] have prohibit[ed] [Pantry Pride] from acquiring Revlon without the latter's prior approval." *Id.*

148. *Id.* at 177. At the August 19 meeting, the Revlon Board followed the advice of Martin Lipton, special counsel, and adopted (1) a "Notes" plan for Revlon to repurchase up to roughly seventeen percent of its outstanding shares with newly issued notes and (2) a "Rights" plan, under which each Revlon shareholder could exchange one common share for a one-year Revlon note with a face value of \$65 and bearing twelve percent interest. *Id.* at 176-77. "The Rights would become effective whenever anyone acquired beneficial ownership of 20% or more of Revlon's shares, unless the purchaser acquired all the company stock for cash at \$65 or more per share." *Id.* at 177. In addition, before the rights became effective, they could be abrogated by the Board for ten cents each. *Id.* The rights plan was Revlon's "Poison-Pill," that acted as a kill-switch in the event of an inadequate hostile bid. Poison pills

are special issues of preferred stock or debt securities issued by potential target companies with rights that are designed specifically to make unwanted takeover attempts difficult, impractical, or impossible. . . . The unique characteristic of a poison pill is that additional rights are granted to shareholders when an aggressor makes a public tender offer for target shares or acquires a specified percentage of the target's shares.

HAMILTON, *supra* note 5, at § 17.13. The court defined poison pill as "a plan by which shareholders receive the right to be bought out by the corporation at a substantial premium on the occurrence of a stated triggering event." *Revlon*, 506 A.2d at 180 (citing

Pantry Pride made its first hostile bid,<sup>149</sup> the Board began its repurchase plan, exchanging newly issued notes<sup>150</sup> for the tendered shares and thus made any hostile takeover a difficult task.<sup>151</sup> On September 24, the Revlon Board gave management the authorization to negotiate a sale with other interested parties, but a determined Pantry Pride continued to increase its bid.<sup>152</sup> On October 3, following negotiations with Forstmann, the Revlon board of directors voted unanimously in support of a leveraged buyout by Forstmann.<sup>153</sup> The public announcement of the merger and its terms had an adverse impact on the notes, causing them to trade at a value much lower than when

Moran v. Household Int'l, Inc., 500 A.2d 1346 (Del. 1985)). Revlon's investment banker condemned the Pantry Pride offer because "Pantry Pride's financial strategy for acquiring Revlon would be through 'junk bond' financing followed by a break-up of Revlon and the disposition of its assets." *Id.* at 177. These very features were an integral part of the Forstmann deal. The merger agreement with Forstmann called for a pre-merger sale of two divisions to an investment group as well as Forstmann's post-merger sale of two more divisions. *Id.* at 178. In addition, Forstmann announced that it planned to finance the purchase of Revlon with "a sizable chunk of borrowed funds." Dean Rotbart, *Some Revlon Investors Say Company's Moves Could Cost Them Millions of Dollars in Losses*, WALL ST. J., Oct. 10, 1985, § 2, at 63 [hereinafter Rotbart].

149. Pantry Pride offered \$47.50 cash for each common share and \$26.67 per preferred share, subject to financing and the Revlon Board's redemption of the rights plan. *Revlon*, 506 A.2d at 177. On August 22, Pantry Pride filed suit against Revlon seeking to enjoin the Board's implementation of the rights plan. *Id.* at 179. The complaint alleged that the poison pill "alter[ed] the terms of the Revlon common stock without the approval of stockholders' in violation of Delaware law." *Beauty-Products*, *supra* note 142, Part IV, at 11. Later Pantry Pride amended its complaint to challenge the lock-up, cancellation fee and notes covenants. *Revlon*, 506 A.2d at 179.

150. 506 A.2d at 179. Commenting on Revlon's stock repurchase plan, Revlon CEO Bergerac used strong words to describe the Pantry Pride bid: "[o]ur board believes that the Revlon exchange offer provides our shareholders a far better alternative to the highly conditional and totally inadequate offer by Pantry Pride . . ." *Beauty-Products*, *supra* note 139, Part IV, at 1.

151. The notes contained restrictive covenants "which limited Revlon's ability to incur additional debt, sell assets, or pay dividends unless otherwise approved by the 'independent' (non-management) members of the board." *Revlon*, 506 A.2d at 177. Revlon's defensive measures did cool Pantry Pride's interest slightly. Pantry Pride decreased its bid to \$42, and conditioned it upon the tender of at least ninety percent of the outstanding shares. *Id.*

152. *Id.* On September 27, Pantry Pride's bid rose to \$50, \$53 on October 1 and \$56.25 on October 7. *Id.*

153. *Id.* at 178. The basic terms involved at the \$56 cash per share price were that management was to receive stock in the new company, as a bonus or "golden parachute," and the Revlon Board agreed to redeem the rights and waive the notes covenants. *Id.* "Golden parachutes are lucrative severance contracts for top management whose employment with the corporation may be terminated upon successful takeover." HAMILTON, *supra* note 5, at § 17.12.1.



issued.<sup>154</sup>

Pantry Pride's increased bid of \$56.25<sup>155</sup> was matched by a Forstmann offer of \$57.25, but this Forstmann bid was subject to several new conditions.<sup>156</sup> As consideration for these conditions, Forstmann agreed to issue new notes in exchange for those previously issued by Revlon that had suffered a decrease in value.<sup>157</sup> The Revlon Board again voted unanimously in approval of the Forstmann proposal "because: (1) it was for a higher price than the Pantry Pride bid, (2) it protected the Noteholders, and (3) Forstmann's financing was firmly in place."<sup>158</sup> Days later, Pantry Pride again raised its bid to \$58 conditioned

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154. *Revlon*, 506 A.2d at 178. In a *Wall Street Journal* article mentioned by the court, *id.*, noteholders expressed their shock and dismay about the Forstmann merger and the extent to which Forstmann planned to increase the company's debt. *See* Rotbart, *supra* note 148, at 63. Investors characterized the situation as a bait and switch and were surprised by the announcement "because of Revlon's previous vow not to sell to a 'bust-up artist' and because materials for Revlon's exchange offer . . . gave no indication that such a transaction might occur." *Id.* The decreased value of the notes "reflects the market's fear that if either Pantry Pride's or Forstmann Little's latest offers succeed, Revlon's balance sheet will be further burdened with debt, effectively lowering the quality of the company's existing debt issues." *Id.* Some larger investors considered legal action against Revlon based on full disclosure issues, since "[d]eals just don't get put together from start to finish in seven days, even if your work 24 hours a day . . ." *Id.*

155. This Pantry Pride offer was conditioned on redemption of the rights and waiver of the notes, as was Forstmann's offer. *Revlon*, 506 A.2d at 178. In addition, Pantry Pride sought to have three of its own directors elected to the Revlon Board. *Id.*

156. *Id.* In particular, Forstmann required that Revlon management no longer participate in the merger and demanded: (1) a lock-up option to purchase two key Revlon divisions should another acquirer prove successful; (2) a no-shop provision; and (3) a \$25 million cancellation fee. *Id.* at 178. A no shop provision is an agreement between the target company and a friendly bidder that requires the target to refrain from solicitation, negotiations or otherwise entering into competing merger agreements. *See* Judi G. Sorensen, *Revlon, Inc. v. MacAndrews and Forbes Holdings, Inc.: Do Suitors of a Target Corporation Have a "Right to Compete?"*, 25 IDAHO L. REV. 441, 451 (1988/1989). These provisions are usually worded so as to allow the board members to adhere to the agreement, yet fulfill their fiduciary duties. *Id.* The cancellation fee was to be placed in escrow and paid to Forstmann if the agreement fell through or if another bidder acquired more than 19.9% of Revlon shares. *Revlon*, 506 A.2d at 178.

157. *Id.* at 178-79. The effect of the exchange was that Forstmann was supporting the par value of the Revlon notes. *Id.*

158. *Id.* at 179. The court noted, however, that at the time the Revlon Board approved the Forstmann bid, "about \$400 million of Forstmann's funding" was not yet secured. *Id.* Pantry Pride's financing was similarly conditional, "although Pantry Pride represented in an October 11 letter to [Revlon's investment banker] that [Pantry Pride's] investment banker . . . was highly confident of its ability to raise the balance of \$350 million." *Id.* at 179 n.7. Only days later, Pantry Pride's investment banker "had a firm commitment for this sum . . ." *Id.* Pantry Pride amended its August 22 complaint seeking to join the lock-up, cancellation fee and notes covenants, in addition to the rights plan. *Id.* at 179.

on the nullification of the above terms.<sup>159</sup>

The Delaware Supreme Court affirmed the Chancery's grant of injunctive relief, holding that the Revlon directors failed to maximize shareholder profits by ending an active auction on an insubstantial basis.<sup>160</sup> The court upheld the Board's initial adoption of the rights plan, under Unocal<sup>161</sup> analysis, but found that it was rendered ineffective by the Board's subsequent actions.<sup>162</sup> While the court also upheld the Revlon Board's adoption of the repurchase and notes plan,<sup>163</sup> it ruled that all inquires regarding defensive measures became moot when the Board authorized management to negotiate with third parties.<sup>164</sup> The granting of this authorization was, the court held, "a recognition that the company was for sale"<sup>165</sup> and such recognition altered the Board's duty "from the preservation of Revlon as a corporate entity to the maximization of the company's value at a sale for the stockholders' benefit."<sup>166</sup>

The lock-up option granted to Forstmann was the Delaware Supreme Court's crucial point of contention. Because this option was granted after the decision to sell had been made, the only permissible purpose for ending the active bidding was maximization of shareholder profits; protection of the noteholders was not a proper objective.<sup>167</sup> The emphasis of the option agreement was "on shoring up the sagging market value of the notes in the face of threatened litigation by [its] holders."<sup>168</sup> By acting

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159. *Id.*

160. *Id.* at 185.

161. Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985). See *supra* note 55 and accompanying text for a description of Unocal's objective standard regarding the reasonableness of a defensive measure.

162. The court noted that on October 3, the Board redeemed the rights plan as a term of the Forstmann merger and on October 12, passed a resolution that called for redemption of the rights for any cash offer of \$57.25 or more. *Revlon*, 506 A.2d at 181. Since both bidders eventually surpassed \$57.25, the rights plan proved useless. *Id.*

163. *Id.*

164. *Id.* at 182.

165. *Id.*

166. *Id.*

167. *Id.* As the court observed, the noteholders had contracts with Revlon and thus had fixed rights. *Id.* "While Revlon's exchange offering materials didn't foreshadow Revlon's arrangement with Forstmann Little, the company didn't preclude it either." See Rotbart, *supra* note 148, at 63. The contracts permitted waiver of the restrictive covenants if the outside directors granted their approval and "the Notes were accepted by the holders on that basis, including the risk of an adverse market effect stemming from a waiver." *Revlon*, 506 A.2d at 182.

168. *Revlon*, 506 A.2d at 182. Not only the noteholders benefitted from the protections in the option agreement. *Id.* at 184. The Revlon Board derived the principal benefit, since they avoided any litigation suggesting their personal liability to the notehold-

to protect themselves from litigation, the Board failed to "withstand the enhanced scrutiny which Unocal<sup>169</sup> requires of director conduct."<sup>170</sup> The "omnipresent specter"<sup>171</sup> was in fact more than an apparition because, in this case, the Revlon directors breached their duty of loyalty "when [they] entered into an auction-ending lock-up agreement with Forstmann on the basis of impermissible considerations at the expense of the shareholders

...<sup>172</sup>

The Delaware Supreme Court's ruling with respect to the no-shop provision required that a level playing field be established when competing offers are relatively similar.<sup>173</sup> "Market forces must be allowed to operate freely to bring the target's shareholders the best price available for their equity."<sup>174</sup> The court thereby affirmed the Chancery's injunction of the no-shop provision.<sup>175</sup> With Forstmann virtually paralyzed by the injunction, Pantry Pride swiftly began buying Revlon shares and announced that their \$58 cash offer had resulted in the tender of eighty-eight percent of Revlon's outstanding common shares.<sup>176</sup>

While the bulk of the Delaware Supreme Court's analysis in *Revlon* was in fact based on the fiduciary duty of loyalty, the decision makes awkward references to the duty of care. There are no facts in *Revlon*, however, that warrant duty of care analysis. There is no allegation that the Revlon directors failed to inform themselves about the competing bids. The Revlon directors were very much aware regarding what and with whom<sup>177</sup> they were

ers. *Id.*

169. *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946 (Del. 1985). See *supra* notes 53-56 and accompanying text.

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

171. *Unocal*, 493 A.2d at 954. See *supra* note 55.

172. *Revlon*, 506 A.2d at 182. "[T]he result of the lock-up was not to foster bidding, but to destroy it." *Id.* at 183.

173. *Id.* at 184. The court stated that favoritism for a particular bidder would be justified if the hostile offer actually threatened shareholders' interests. *Id.* Here, however, the bidders were engaged in fractional bidding and both bidders intended to sell divisions of Revlon. *Id.*

174. *Id.*

175. *Id.* The court also found that the Delaware Chancery Court had not abused its discretion in enjoining the cancellation fee "because the fee was part of the overall plan to thwart Pantry Pride's efforts." *Id.*

176. *Pantry Pride's Plans for Revlon Still Undisclosed*, L. A. TIMES, Nov. 5, 1985, Part IV, at 4. To show their willingness to cooperate with Pantry Pride, Revlon announced that Revlon directors and officers would tender their shares. *Revlon Bows to Suitor in Hostile Fight: Firm Prepares for Orderly Transition to Pantry Pride*, L. A. TIMES, Nov. 2, 1985, Part IV, at 1.

177. Recall the Delaware Supreme Court's reference to the fact that Revlon's Bergerac had a strong distaste for Perelman of Pantry Pride. *Revlon*, 506 A.2d at 176.

dealing. Rather than an uninformed decision, *Revlon* was a case of an informed but impermissibly self-interested decision.

The Delaware Court of Chancery accurately analyzed the Revlon Board's conduct by exclusively focusing on duty of loyalty, but this focus was blurred by the Delaware Supreme Court decision. The Chancery Court held that:

By agreeing to a lock-up and no shop clause in exchange for protecting the rights of the Noteholders, the Revlon Board failed in its fiduciary duty to the shareholders. The board may have been informed, but its performance did not conform to the other component of the business judgment rule – the duty of loyalty.<sup>178</sup>

In affirming the Chancery's decision, the Delaware Supreme Court held, quite to the contrary, that the duty breached was the duty of care. Rather than explain its divergence from the Chancery's holding, the Delaware Supreme Court grievously misstated that holding in its opening paragraph: "The Court of Chancery found that the Revlon directors had breached their duty of care by entering into the foregoing transactions [with Forstmann] and effectively ending an active auction for the company."<sup>179</sup> Apparently using the terms interchangeably, the Supreme Court opinion further states that "the trial court concluded that the Revlon directors had breached their duty of loyalty by making concessions to Forstmann."<sup>180</sup> In the last pages of the decision, the court reverts to its duty of care lexicon, holding that:

[t]he principal object [of the Revlon board's granting the lockup option to the friendly bidder], contrary to the board's duty of care, appears to have been protection of the noteholders over the shareholders' interests. . . . No such defensive measure can be sustained when it represents a breach of the directors' fundamental duty of care.<sup>181</sup>

This oddity in the court's terminology might have been explained as a simple oversight by the court. While that may have been the case when *Revlon* was handed down, the Delaware Supreme Court took advantage of subsequent opportunities to profess that the *Revlon* duty to maximize shareholder profit did in-

See *supra* note 146.

178. *MacAndrews & Forbes Holdings Inc. v. Revlon Inc.*, 501 A.2d 1239, 1250 (Del. Ch.), *aff'd*, 505 A.2d 454 (Del. 1985).

179. *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 175 (Del. 1986).

180. *Id.* at 179; see Linsley, *supra* note 43, at 549 n.99.

181. *Revlon*, 506 A.2d at 184-85.

deed involve the duty of care. In *Ivanhoe Partners v. Newmont Mining Corp.*,<sup>182</sup> the Delaware Supreme Court stated that a director's role as an auctioneer "involves duties of loyalty and care."<sup>183</sup> Elaborating on this combination of duties, the court cited two traditional authorities: *Guth v. Loft*<sup>184</sup>—the traditional authority that condemned self-dealing—and *Smith v. Van Gorkom*<sup>185</sup>—the duty of informed process precedent.<sup>186</sup> The latter reference, again, is unwarranted because *Revlon* involved a self-ish auctioneer, not an uninformed one.

The duty to maximize profits is clearly a goal-oriented obligation; when all is said and done, the deal must be formulated so as to secure for the shareholder the highest possible per share price. Despite the Supreme Court's "duty of care" terminology in *Revlon*, this result-focused obligation was the crucial obligation set forth in *Revlon* when a Delaware corporation is for sale. The *Revlon* court may have wanted to specifically include the requirement of informed process in the auctioneer's checklist of duties, but that is not what they did. Only a year later, in *Ivanhoe*, did the Delaware Supreme Court characterize the *Revlon* duty as one of process and result. This subsequent characterization becomes highly significant in *Paramount Communications, Inc. v. QVC Network, Inc.*,<sup>187</sup> because it allows the court to focus on the duty of care without resting solely on the

182. 535 A.2d 1334, 1345 (Del. 1987).

183. *Id.* (emphasis added).

184. The *Revlon* court explained:

The former embodies not only an affirmative duty to protect the interests of the corporation, but also an obligation to refrain from conduct which would injure the corporation and its stockholders or deprive them of profit or advantage. In short, directors must eschew any conflict between duty and self-interest. . . . On the other hand, the duty of care requires a director, when making a business decision, to proceed with a 'critical eye' by acting in an informed and deliberate manner respecting the corporate merits of an issue before the board.

*Id.* (citations omitted). Subsequently, in *Mills Acquisition Co. v. Macmillan, Inc.*, 559 A.2d 1261 (Del. 1988), the court reiterated its dual-duty holding:

Following *Revlon*, there appeared to be a degree of "scholarly" debate about the particular fiduciary duty that had been breached in that case, i.e. the duty of care or the duty of loyalty. In *Ivanhoe* we made it abundantly clear that both duties were involved in *Revlon*, and that both had been breached.

*Id.* at 1284 n.34 (citation omitted). While the content of the court's holding was made "abundantly clear" in post-*Revlon* decisions, the underlying reasoning was not. *See generally* Linsley, *supra* note 43.

185. 5 A.2d 503, 510 (Del. 1939).

186. 488 A.2d 858, 872-73 (Del. 1985).

187. 637 A.2d 34 (Del. 1993).

controversial *Van Gorkom* decision.<sup>188</sup>

### V. PARAMOUNT COMMUNICATIONS V. QVC

Beginning in the late 1980s, Paramount Communications, Inc.<sup>189</sup> sought to expand its operations and increase its competitive edge by merging with other entertainment and communications companies.<sup>190</sup> In 1993, serious negotiations between Paramount and Viacom, Inc.<sup>191</sup> were aimed at consummating a merger whereby Sumner M. Redstone, Viacom's Chairman and CEO, would be "the controlling stockholder" of the resulting company and his counterpart at Paramount, Martin S. Davis, would be CEO.<sup>192</sup> A potential third player, Barry Diller of QVC, Inc.,<sup>193</sup> was told by Davis that a QVC bid was unwelcome because "Paramount was not for sale."<sup>194</sup> The Paramount Board reviewed information provided by its financial advisors and unanimously approved the Paramount-Viacom merger agreement.<sup>195</sup>

188. By combining the duty of care and duty of loyalty in the director's obligation to maximize shareholder profits, the Delaware Supreme Court also leaves open the question as to the application of section 102(b)(7) to a director's failure to carry out his responsibilities as an auctioneer, since this provision allows corporations to limit or exempt liability for breaches of the duty of care, but not for failure of the duty of loyalty. DEL. CODE ANN. tit. 8, § 102(b)(7) (1986). See generally Linsley, *supra* note 43.

189. Paramount is incorporated in Delaware and headquartered in New York City. *Paramount*, 637 A.2d at 37.

190. *Id.* at 38. Notably, Paramount attempted to merge with Time, Inc., but was unsuccessful in its tender offer. See *Paramount Communications, Inc. v. Time Inc.*, 571 A.2d 1140 (Del. 1990).

191. Headquartered in Massachusetts, Viacom is also a Delaware corporation. *Paramount*, 637 A.2d at 37.

192. *Id.*

193. QVC, as well, is a Delaware corporation and its chief offices are located in West Chester, Pennsylvania. *Id.* Interestingly, until 1984, Diller served as CEO of Paramount Pictures Corporation, a subsidiary of Gulf & Western Inc., later renamed Paramount Communications, Inc. *QVC Network, Inc. v. Paramount Communications Inc.*, 635 A.2d 1245, 1273 n.4 (Del. Ch.), *aff'd*, 637 A.2d 34 (Del. 1993).

The Delaware Supreme Court decision included a brief summary of the facts drawn from the Chancery Court's findings as well as from the Supreme Court's own "independent review of the record." 637 A.2d at 37. The detailed findings of the Chancery decision, while not expressly adopted by the Delaware Supreme Court, are cited herein for additional insight. While the Supreme Court recounted only those facts deemed necessary for its opinion, this author prefers the detailed factual findings of the Chancery opinion, as they provide additional evidence of the Paramount Board's deficient process. "[T]he Delaware Chancery court . . . blasted the Paramount board of directors for not even meeting with QVC, let alone analyzing its bid." Ralph C. Ferrara and Bridget M. Bush, *The Year in Review*, 866 PLI CORP. L. & PRAC. COURSE HANDBOOK SERIES, No. B4-7068, 9, 95 (1994).

194. *Paramount*, 637 A.2d at 38.

195. *Id.* at 39. The terms included the following: a per share cash price plus a stock-

Following execution of the agreement, Paramount and Viacom publicly announced the proposed merger, informing all that "the pending transaction was a virtual certainty."<sup>196</sup>

Again, a personal call was made to Diller to convince him not to bid for Paramount.<sup>197</sup> That appeal was unsuccessful, however, and Diller contacted Davis to advise him of QVC's merger proposal and request a meeting.<sup>198</sup> At the Paramount Board's next meeting, the QVC proposal was discussed, but Davis advised the Board that any discussion or negotiation with any bidder would violate the Viacom merger agreement, unless the bid was proven to be free from financing contingencies.<sup>199</sup> When requested by Paramount, QVC supplied Paramount with information about its financing arrangements, but Paramount repeatedly delayed any negotiations with QVC.<sup>200</sup> Frustrated by their continued unsuccessful attempts at negotiation,<sup>201</sup> QVC filed for preliminary injunctive relief in Delaware Chancery Court<sup>202</sup> and publicly announced a tender offer.<sup>203</sup> Viacom responded to the

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for-stock exchange; an amendment to Paramount's rights agreement (their "Poison Pill") such that the Viacom merger would not constitute a triggering event; a no-shop provision; a \$100 million termination fee; and a stock option agreement. *Id.* See *supra* note 148 for explanations of the terms poison pill, no-shop provision and termination (or cancellation) fee. The stock option agreement, deemed by the court as the "most significant deterrent device," permitted Viacom to purchase twenty percent of Paramount's outstanding shares upon certain triggering events. *Paramount*, 637 A.2d at 39. The terms allowed Viacom to purchase the shares with "a senior subordinated note of questionable marketability" rather than cash and granted Viacom the right to require that Paramount pay Viacom a cash amount "equal to the difference between the purchase price and the market price of Paramount's stock." *Id.* The court found these two provisions "both unusual and highly beneficial to Viacom." *Id.*

196. *Id.* "Redstone described it as a 'marriage' that would 'never be torn asunder' and stated that only a 'nuclear attack' could break the deal." *Id.*

197. *Id.*

198. *Id.*

199. *Id.* at 39-40. QVC maintains that Davis' proof requirement was a fabrication, since the original merger agreement referred only to "an *unsolicited written, bona fide proposal, which is not subject to any material contingencies relating to financing.*" QVC, 635 A.2d at 1253 n.14 (citing Original Merger Agreement § 6.02).

200. *Paramount*, 637 A.2d at 40.

201. QVC waited five days for a response from Paramount on its initial proposal, QVC Network, Inc. v. Paramount Communications, Inc., 635 A.2d 1245, 1252 (Del. Ch.), *aff'd*, 637 A.2d 34 (Del. 1993), and a full week while Paramount signed a confidentiality agreement. *Id.* at 1254. Additionally, after complying with a Paramount request for documents, QVC was told that they would be contacted by Paramount "when Paramount was ready." *Id.*

202. QVC sought both preliminary and permanent injunctions to set aside the defensive measures adopted in the Paramount-Viacom merger agreement. *Paramount*, 637 A.2d at 36.

203. *Id.* at 40. "[A] corporation may be acquired by one of two means . . . tender of-

QVC bid by raising their bid and revising their agreement with Paramount.<sup>204</sup> When Paramount was ready to meet with QVC, the latter proposed fair bidding guidelines to govern both Viacom and QVC, but Paramount rejected them as inconsistent with their merger agreement with Viacom.<sup>205</sup> A round of increased bids followed, as did a Paramount Board meeting called to discuss the “‘conditions and uncertainties’ of QVC’s offer.”<sup>206</sup> At that meeting, the directors voted that the best interests of the shareholders would not be served by the QVC proposal, allegedly because the offer was “excessively conditional.”<sup>207</sup> “[W]ith this limited data regarding the conditions of QVC’s offer, the board simply followed management’s lead in rejecting the unwelcome offer.”<sup>208</sup>

The Delaware Supreme Court affirmed the Chancery Court’s grant of injunctive relief to QVC.<sup>209</sup> In doing so, the Supreme Court focused on the fact that the Paramount Board’s

fer or merger . . . A tender offer is addressed directly to the shareholders and is simply an offer to purchase their shares.” McBride, *supra* note 142, at 844.

204. *Paramount*, 637 A.2d at 40. The court noted that while Paramount brought newly-acquired leverage to the bargaining table, the amended merger agreement and original merger agreement were “essentially the same.” *Id.* The amended agreement altered the cash and stock portions of the price, allowed the Paramount Board to renew the applicability of the poison pill to the Viacom merger and to terminate or withdraw its recommendation of the Viacom merger, if such were necessary to fulfill fiduciary duties in the face of a “better alternative.” *Id.*

205. *Id.* at 41.

206. *Id.*

In anticipation of that meeting, Paramount sent to the board members’ homes and offices a three-page document which detailed the “Conditions and Uncertainties” of QVC’s offer without any mention of the financial terms of that offer. . . . That summary emphasized management’s view that the QVC offer was highly contingent . . . . One director, Mr. Pattison, testified that this document created a negative impression of the QVC offer from the outset of the meeting: “My reaction was that this was not what I consider a live offer. . . . [B]y the time I got through reading this, I was very negative on the whole subject.”

*QVC Network, Inc. v. Paramount Communications, Inc.*, 635 A.2d 1245, 1257 (Del. Ch.), *aff’d*, 637 A.2d 34 (Del. 1993). Notably, the materials furnished to the Board by management concentrated on the conditions of the QVC offer, “but omitted disclosure of several similar conditions in the Viacom offer.” *Id.*

207. *Paramount*, 637 A.2d at 41. The Board chose not to contact QVC regarding the financing conditions apparently because they believed that to do so would violate the no-shop provision of the Viacom merger agreement. *Id.*

208. *QVC*, 635 A.2d at 1258.

209. *Paramount*, 637 A.2d at 51. Following the Delaware Supreme Court decision, Paramount conducted a formal auction and for two months, Viacom and QVC continued to raise their bids. Meredith M. Brown & Gary W. Kubek, *The Paramount Duties of Directors*, *INSIGHTS*, March 1994, at 3 [hereinafter Brown & Kubek]. Finally, after a five-month struggle, Viacom won the “\$10 billion takeover battle.” Randall Smith, *Wall Street’s Final Analysis: Might Made Right*, *WALL ST. J.*, Feb. 16, 1994, at B1.



conduct involved a change in control.<sup>210</sup> Because such a change can have a profound and lasting effect on the rights of shareholders, the directors who negotiate and authorize it are subjected to enhanced scrutiny.<sup>211</sup> Under these circumstances, the Paramount Board's "primary objective [was] to secure the transaction offering the best value reasonably available for the stockholders."<sup>212</sup> In addition, the court required that the directors "be especially diligent" in pursuing this goal, stating that the Board's evaluative process must be informed.<sup>213</sup>

Having established the appropriate standards, the court measured the Paramount Board's actions and determined that the Board breached their fiduciary duties because neither the process nor the result was reasonable.<sup>214</sup> The court was particularly concerned with the "insufficient attention" paid by the Board to the consequences of the defensive measures.<sup>215</sup> Once QVC came into the picture, "[i]t should have been clear to the Paramount Board that the [defensive measures] were impeding the realization of the best value reasonably available to the Paramount stockholders."<sup>216</sup> In view of the fact that the QVC bid exceeded that of Viacom by a face value of over \$1 billion, the

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210. *Paramount*, 637 A.2d at 42. The court explained that a change in control of a corporation is important because it results in "a significant diminution in the voting power of those who thereby become minority stockholders." *Id.* When shareholders are reduced to minority status, their remaining investment "is subject to being 'cashed out' at any time" by the new controlling shareholder(s). McBride, *supra* note 142, at 851. As compensation for such a decrease in value, shareholders should receive a substantial per share price as a "control premium" or protective measures that ensure that the shareholders' equity interest will continue. *Paramount*, 637 A.2d at 42-43. Unless protective guarantees are in place, long-term goals should not be pursued at the expense of immediate per share gain. McBride, *supra* note 142, at 842. Since there were no "protective provisions in the Viacom-Paramount transaction, the Paramount directors had an obligation to take the maximum advantage of the current opportunity to realize for the stockholders the best value reasonably available." *Paramount*, 637 A.2d at 43.

211. *Paramount*, 637 A.2d at 43.

212. *Id.* at 43-44 (citing *Revlon v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 182 (Del. 1986)).

213. *Id.* at 44. Additionally, in a part of the decision not relevant here, the court distinguished between *Revlon* and *Paramount Communications, Inc. v. Time Inc.*, 571 A.2d 1140 (Del. 1990), on the basis that the former involved "a sale of corporate control," whereas the latter did not since "Time would be owned by a fluid aggregation of unaffiliated stockholders both before and after the merger." *Paramount*, 637 A.2d at 46.

214. *Paramount*, 637 A.2d at 49.

215. *Id.* "The Stock Option Merger Agreement . . . [was] potentially 'draconian,' . . . the Termination Fee . . . made Paramount less attractive to other bidders . . . [and] the No-Shop Provision inhibited the Paramount Board's ability to negotiate with other potential bidders, particularly QVC which had already expressed an interest in Paramount." *Id.*

216. *Id.* at 50.

court criticized the Paramount Board for adhering to their strategic vision of a merger with Viacom for two basic reasons: (1) the change in control would render the Paramount Board unable to guarantee that the strategic vision would continue after consummation of the merger and (2) the fact that the directors had failed to fully inform themselves about QVC's bid "deprived their strategic vision of much of its credibility."<sup>217</sup>

The Delaware Supreme Court decision produced the proper result: corporate directors were justly found to have violated their fiduciary duties to their shareholders. The means employed to reach that end, however, are curious. Instead of placing foremost emphasis on the Paramount Board's failure to ascertain the substantive terms and benefits of both competing bids, the court relied more heavily on the Board's failure to realize the best value available to the shareholders.<sup>218</sup> This fact is even more significant in light of the court's reluctance to rely on *Van Gorkom*<sup>219</sup> as the governing principle of the duty of care.

The most egregious deficiency on the part of the Paramount Board was their failure even to ascertain the substantive terms of the competing QVC offer.<sup>220</sup> Any other breach by the Paramount Board was secondary to this failure, because logic dictates that a corporate board that is uninformed cannot possibly act in the best interests of its shareholders. That is not to say that the court's discussion of breach of loyalty issues was inappropriate. By focusing on the impact that a change of control has on the corporation's shareholders,<sup>221</sup> the court clearly illustrated why the Board's failure to inform themselves was so grievous. Failure to maximize shareholder profit, however, should have been of lesser import.

When a corporate director fails to acquire the knowledge reasonably available to him and necessary to his ability to critically evaluate a situation, he has violated the fiduciary duty of care enunciated in *Smith v. Van Gorkom*.<sup>222</sup> Rather than cite to

217. *Id.*

218. "[T]he clear message of *Paramount* . . . is that the duty of a board in a sale or change of control is to obtain 'the best value reasonably available to the stockholders.'" Brown & Kubek, *supra* note 209, at 4 (noting that this principle is stated *ten* times in the decision).

219. 488 A.2d 858 (Del. 1985). The *Paramount* decision makes two cursory references to *Van Gorkom* but engages in no analysis of the *Van Gorkom* decision. *Paramount*, 637 A.2d at 44, 50.

220. *Paramount*, 637 A.2d at 36.

221. "Once control has shifted, the current Paramount stockholders will have no leverage in the future to demand another control premium." *Id.* at 43.

222. 488 A.2d 858.

this explicit authority, the Delaware Supreme Court chose to rely on *Barkan v. Amsted Indus., Inc.*<sup>223</sup> and the general principle that "directors must act in accordance with their fundamental duties of care and loyalty."<sup>224</sup> *Barkan* does involve a change of control and provides some new insight.<sup>225</sup> The fact pattern and the level of review, however, render the case of little relevance to *Paramount*. The *Barkan* case arose as a shareholder challenge to a class action settlement approved by the Delaware Court of Chancery. The Delaware Supreme Court expressly stated that its standard of review is limited to whether the lower court has abused its discretion<sup>226</sup> and ruled that no such

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223. *Paramount*, 637 A.2d at 43 (citing *Barkan v. Amsted Indus., Inc.*, 567 A.2d 1279 (Del. 1989)). The *Paramount* court's reliance on *Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345 (Del. 1993), is a definite step in the right direction, but, nonetheless, a mere substitute for the controlling *Van Gorkom* precedent.

In *Cede*, the Delaware Supreme Court held that the Technicolor Board's failure to satisfy its duty of care fell squarely under *Van Gorkom*. *Id.* at 367. Further, the court specifically stated that the duty of care and the duty of loyalty are "of equal and independent significance." *Id.* Then, however, the court "noted approvingly" the Chancellor's finding that the duty violated was that of *Revlon*. Ira N. Rosner, *Paramount Lessons*, 68 FLA. B. J. 51, 52 (1994) [hereinafter Rosner]. "The Chancellor wrote: . . . 'the due care theory and the *Revlon* theory do not present two separate legal theories justifying shareholder recovery . . . [B]oth theories reduce to a claim that directors were inadequately informed . . .'" *Cede*, 634 A.2d at 239 n.37 (citations omitted).

While it is true that the Delaware Supreme Court designated *Revlon* a due care case after the fact, that characterization was not warranted by the *Revlon* facts. See *supra* notes 177-88 and accompanying text; see also *infra* Part VI. The Supreme Court's strong *Van Gorkom* analysis in *Cede* is clouded by the *Revlon* reference which detracts from the decision's due care analysis. But see William Prickett & Ronald A. Brown, Jr., *Cede v. Technicolor: The Supreme Court Reilluminates Existing Lines of Delaware's Level Playing Field*, 19 DEL. J. CORP. L. 593, 613 (1994) (maintaining that "the entire [*Cede*] opinion is, in fact, a reaffirmation of *Van Gorkom*").

The 1993 Delaware Supreme Court *Cede* decision affirmed the Chancery Court decision in part, reversed it in part and remanded the case back to the Chancery Court. 634 A.2d at 345. On remand, the Chancery Court ruled that while the board's uninformed process was flawed, the directors successfully proved that the transactions were entirely fair to the shareholders. *Cinerama, Inc. v. Technicolor, Inc.*, 663 A.2d 1134 (Del. Ch. 1994). In July 1995, the Delaware Supreme Court affirmed that decision. 663 A.2d 1156 (Del. 1995).

224. *Barkan*, 567 A.2d at 1286, cited in *Paramount*, 637 A.2d at 43. "The court, perhaps influenced by criticism that Delaware law in this area had become unpredictable, took great pains to stress the consistency of its decisions in the *Paramount* case with the court's prior rulings in *Revlon*, *Macmillan*, *Time Warner* and other takeover battles during the 1980s." Brown & Kubeck, *supra* note 209, at 3.

225. One particular insight is worth mentioning: "Where a board has no reasonable basis upon which to judge the adequacy of a contemplated transaction, a no-shop restriction gives rise to the inference that the board seeks to forestall competing bids." *Barkan*, 567 A.2d at 1288.

226. *Id.* at 1284. "Because the Court of Chancery is in the best position to evaluate the factors that support a settlement, we will not second-guess its business judgment

abuse had occurred.<sup>227</sup> Furthermore, the directors in *Barkan* followed "a completely passive approach to acquiring . . . knowledge" and the Chancellor found the circumstances such that they did not require any active pursuit of information.<sup>228</sup> While *Barkan* characterizes the need for knowledge as "central to enlightened evaluation,"<sup>229</sup> the determinative facts take the case out of the *Paramount* arena.

One might ask what significance could attach to the *Paramount* court's choice of due care precedent. The answer, plenty. The facts of *Smith v. Van Gorkom*,<sup>230</sup> as found by the Delaware Supreme Court, were shocking.<sup>231</sup> Recall, however, the plethora of criticisms charging that the Supreme Court completely misconstrued the facts.<sup>232</sup> The propriety, or lack thereof, of the Supreme Court's factual findings is of limited significance. More important are the result of the Supreme Court's findings and the subsequent controversy that surrounded the decision. In the final analysis, the Trans Union Board was held financially accountable for its failure to question management in the context of a sale of control. Few cheered the result, but the public majority condemned it, hurling verbal assaults of judicial incompetence.<sup>233</sup>

When faced with the same situation nine years later, in *Paramount*, the Delaware Supreme Court took the easy way out. Relying on precedents much less explosive than *Van Gorkom*, the *Paramount* court managed to hold the *Paramount* Board liable for breaching their duty of care, while tempering the impact of that analysis with an examination of the duty of loyalty.<sup>234</sup> Of

upon appeal." *Id.*

227. *Id.* at 1288.

228. *Id.*

229. *Id.* at 1287.

230. 488 A.2d 858 (Del. 1985).

231. Rosner, *supra* note 223, at 52 & n.14 (noting, among other things, that Van Gorkom never read the merger agreement before signing it, that the price suggested by Van Gorkom was based upon bearable debt service, not valuation and that the short-lived two-hour meeting resulted in approval of the transaction, despite the fact that most directors were not even aware in advance of the meeting's agenda).

232. See *supra* notes 119, 120, and 126-128. The incongruity between the two *Van Gorkom* decisions is apparent from the opening lines of the Delaware Supreme Court decision. *Van Gorkom*, 488 A.2d at 864. While the Chancellor found that the Trans Union Board had "acted in an informed manner," the Supreme Court found that ruling "clearly erroneous." *Id.*

233. See *supra* Part III.

234. See *Paramount Communications, Inc. v. QVC Network, Inc.*, 637 A.2d 34, 43-51 (Del. 1993). Recall the traditional phenomenon that courts were concerned only with the duty of loyalty). See *supra* note 8. *Van Gorkom* was the case that originated judicial re-

course, such a juxtaposition of these duties was made possible only by post-*Revlon* manipulations that imposed a duty of care upon the loyalty-laden *Revlon* duties.<sup>235</sup> By creating this dual duty approach to the Paramount Board's actions, the *Paramount* court diminished the significance of the Board's failure to question management.

## VI. "IT'S NOT POLITE TO ASK QUESTIONS"<sup>236</sup>

Delaware law vests corporate directors with the power to manage or direct the management of the corporation.<sup>237</sup> It is too often the case, however, that management manages the corporation, while the board of directors merely grants approval.<sup>238</sup> The trend over the last few years is toward board activism, toward waking up boards "to confront inept, ossified managements, challenging them either to change or depart."<sup>239</sup> That this "new activist era"<sup>240</sup> has not yet reached the Delaware Supreme Court

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view based on gross negligence principles. *But see* Russell B. Stevenson, Jr. & David L. Haselkorn, *Paramount Communications v. QVC Network and the Fiduciary Duties of Directors of Public Companies That are the Subject of Merger or Takeover Offers*, C951 A.L.I.-A.B.A. 263, 269 (1994) ("The case rests primarily on the court's holding that the directors failed in their procedural obligations.").

235. *See supra* notes 177-88. Had the Delaware Supreme Court desired to effect a change in the law and subject profit maximizers to procedural requirements, it could have so ruled when facts implicating both care and loyalty issues came before them. Its chosen course of action, however, in subsequently adding due care requirements to *Revlon* duties severely reduces the impact of the duty to become informed, because no facts in *Revlon* give substance to that part of the holding. *But see* Cunningham & Yablon, *supra* note 8, at 1594 (asserting that *Technicolor* and *QVC* represent a movement toward a single standard and away from the separate duty of care and duty of loyalty approach).

236. Magnet, *supra* note 1, at 86.

237. DEL. CODE ANN. tit. 8, § 141(a) (1991). *See supra* note 33 for the text of this statute.

238. The structural makeup of board positions has been a principle reason for this phenomenon. Traditionally, the CEO also acts as the chairman of the board and thus as the figurehead of corporate operations. *See* Tanya Cordrey, *Who Rules the Boardroom?*, INT'L. MGMT., June 1994, at 32 [hereinafter Cordrey]. With this system in place, a director's ability to determine and/or respond to CEO incompetence is problematic at best. *See id.* A crisis is generally required to incite the board to confront management. Winder, *supra* note 5, § 7, at 1. But even "[w]hen a company hits a major problem, the board is loathe to act if acting means it must disagree with the strategies of the CEO." Cordrey, *supra* at 33.

239. Paul Ingrassia, *Memo to Board: Management Isn't Always Wrong*, WALL ST. J., Nov. 23, 1994, at A14 [hereinafter Ingrassia]. Activist institutional investors and other experts "predict . . . a shift by corporate America to smaller, more independent and diverse boards . . ." Marlene Givant Star, *Governance Now a Priority*, PENSIONS & INV., Nov. 1, 1993, at 28 [hereinafter Star].

240. Ingrassia, *supra* note 239, at A14.

is evidenced by the *Paramount* court's refusal to measure the Paramount Board's deficiencies by the stringent procedural standards of *Smith v. Van Gorkom*.<sup>241</sup>

In many American corporations, the functioning of the board of directors needs great improvement. Many directors passively accept that which occurs around them and fail to assert themselves.<sup>242</sup> One reason for this phenomenon is that passivity has been the boardroom etiquette for decades.<sup>243</sup> "Another factor that makes it difficult for directors to fulfill their responsibilities to shareholders is the 'golden rule' of the boardroom. Many outside directors are 'either current or past chief executive officers or are on a CEO path' . . . 'It's kind of a good old boy network'"<sup>244</sup> where "[b]acks get scratched."<sup>245</sup> Lack of information is another cause of board "impotence,"<sup>246</sup> in that the directors must often rely for information on those individuals whose conduct they are supposed to be monitoring. Lack of incentive is an additional reason for board "snoozing."<sup>247</sup> In many companies,

241. 488 A.2d 858 (Del. 1985).

242. "We always believed our role was to be supportive of management . . . Quiet counseling is very important to these chiefs. They don't need confrontation in public . . . ." Widder, *supra* note 5, at C1 (quoting James H. Evans, former chairman of Union Pacific Corp. and director of GM Corp., AT&T Co. and Metropolitan Life Insurance Co.). Delaware Supreme Court Judge Andrew G. T. Moore II characterized Evans' outlook as "pre Van Gorkom philosophy" . . . Post Van Gorkom . . . the world [has] changed." *Id.* Unfortunately, the *Van Gorkom* decision did not eradicate from corporate boards this type of attitude and the *Paramount* decision evidences the Delaware Supreme Court's reluctance to wipe it out.

243. Magnet, *supra* note 1, at 86.

Unmindful of th[e] rule of etiquette [that asking questions is impolite], a director who asked about press criticisms of one corporate giant's new product recalls that he drew looks of such shocked disbelief that he felt as if he had belched at the dinner table. . . . [When at] Nabisco Brands [a] director . . . couldn't restrain himself from blurting out that anyone would be preferable to the candidate named to succeed [the company's] president. Privately, he believed, his fellow outside directors shared this judgment. "Nobody spoke to me at the next two board meetings," [he] says. "It was a no-no. Socially, I'd pulled a tremendous gaffe."

*Id.*

244. Widder, *supra* note 5, at 8 (quoting Lowell E. Sachnoff of the Chicago law firm Sachnoff, Weaver & Rubenstein). In their capacity as outside directors, these CEO-types treat the CEO and chairman of the board as they wish to be treated by their own boards. *Id.*

245. *Redirecting Directors*, ECONOMIST, Nov. 17, 1990, at 19, 19 [hereinafter *Redirecting*].

246. *Id.* A May 1994 survey by KPMG Peat Marwick found that many outside directors are not provided with the information that they need to perform their duties. Cordrey, *supra* note 238, at 33.

247. Magnet, *supra* note 1, at 86. See also Widder, *supra* note 5, at 8 ("There is lit-

any particular shareholder seldom owns even one percent of the outstanding shares, and thus is much more abstract to the directors than the very real CEO, with whom it is necessary for the director to get along.<sup>248</sup>

Further, the respective personalities of board members have a significant impact on the board's functioning.<sup>249</sup> "The main problem is that boards are leaderless horses. Unless there's a director who wants to get in trouble, how do you start?"<sup>250</sup> To get such mischievous directors on the board requires the involvement of the CEO, but the present system is not the best vehicle for such changes, because those companies that have the greatest need for active directors are run by CEOs who do not possess the self-confidence to appoint them.<sup>251</sup>

Board activists offer many suggestions to combat poor director performance. Stock ownership by directors is one way to bring directors more in touch with the interests of shareholders.<sup>252</sup> Procedurally, board members must do "their homework—that is, helping management set strategy and then closely moni-

tle financial or legal pressure to perform effectively."); *Redirecting*, *supra* note 245, at 19 ("[T]he boards of directors [that shareholders] appoint to [run companies] for them are tempted to help the managers, not the owners."). Even if directors did have the necessary incentive to take action against poor management, such is not an easy task. *Id.* ("Like prime ministers, incumbent managers, no matter how bad, are hard to get rid of. Worse, it is hard to spot that they should be ousted until their company is in deep trouble.").

248. Magnet, *supra* note 1, at 86 ("[T]hey don't have proper incentives to take the hard actions."). But see Star, *supra* note 239 for a discussion of the successes achieved by institutional investors seeking to promote activist boards.

249. Magnet, *supra* note 1, at 86.

250. *Id.* at 86. One director noted:

"I was on that board for about six months, and I said to myself, 'Jesus, these executives don't know what the hell they're doing.' And I got on my airplane and went to see another director, the head of a big bank. He said, 'You're right — they don't know what the hell they're doing.' And I said, 'You've been on that board for five or six years. Why don't you do something about it?' He said, 'Well, we're waiting for some young tiger to come along. And here you are.'"

*Id.* at 87.

251. *Id.* at 88. Magnet describes a rare example of a newly-named CEO in a family-run business whose appointment was followed by a serious fall in profits and stock values. *Id.* at 87. Board members cornered the CEO with demanding and direct questions. *Id.* Rather than responding defensively, the CEO openly admitted his need for assistance and together they explored the issues and alternatives. *Id.*

252. Cordrey, *supra* note 235, at 33. But see Joann S. Lublin & Christina Duff, *How Do You Fire a CEO? Very, Very Slowly*, WALL ST. J., Jan. 20, 1995, at B1, B2 (explaining an ousted Westinghouse CEO's view that it is unwise to have directors who are motivated solely by their wallets).

toring its execution.<sup>253</sup> A director nominating committee<sup>254</sup> and corporate board composed of outside, non-management directors can help to ensure higher levels of independence.<sup>255</sup> Written CEO and management job descriptions and regularly scheduled written evaluations open up the lines of communication.<sup>256</sup> A relatively new concept, director self-evaluation is also useful on both the board and individual level.<sup>257</sup> An organized retreat for board members can provide an opportunity for prolonged meaningful exchange, something rarely accomplished at a rushed board meeting.<sup>258</sup> Intense training of new directors is another time consuming, but beneficial program.<sup>259</sup> Household International presents each new director with a detailed reference book covering various facets of the corporation and follows up with one-on-one review with the top executives responsible for each

253. Ingrassia, *supra* note 239, at A14 (contending that when such homework is performed directors will be agreeing with management, rather than disagreeing with them). Outside counsel to the General Motors directors, New York attorney Ira Millstein refers to a prepared board as a "Certifying Board," since they are well equipped to "certify to shareholders . . . and others that the company is on the right track." *Id.* The board of directors of Zenith Electronics Corp. has tightened control and tracks a variety of items, "from sales to liquidity." Richard A. Melcher & Judith H. Dobrzynski, 'A Short Leash' at Zenith, *BUS. WK.*, Jan. 31, 1994, at 31.

254. In addition, these committees should not include the corporation's "major suppliers, officials of nonprofit organizations that receive substantial donations from the corporations and the CEO's close friends." Joann S. Lublin, *How to Keep Directors' Eyes on the CEO*, *WALL ST. J.*, July 20, 1994, at B1 [hereinafter Lublin].

255. Magnet, *supra* note 1, at 89.

Above all, CEOs need directors who will help keep them from getting trapped within the closed worlds of their own companies. Never having to stand in line, flying on your own jet to your own limo waiting at your own company's own private hangar, it's easy to lose touch with certain realities. . . . [A CEO is] just too all-powerful. If [he is] not careful, [he] wind[s] up sitting at the top of this organization getting fed back only the things [the directors] think [he] want[s] to hear.

*Id.* at 88.

256. Lublin, *supra* note 254, at B1; *see also* Magnet, *supra* note 1, at 88. In mid 1994, the National Association of Corporate Directors published recommendations to help directors better monitor chief executives. Lublin, *supra* note 254, at B1. "A job description would help set performance objectives . . . and the annual evaluation should cover financial results as well as qualitative measures, such as integrity, vision, leadership and succession planning." *Id.* One job description that included "getting the best thinking of each board member" and "seeing that the board is kept fully informed" belonged to a chairman whose annual bonus was 30% dependent upon the appraisal by fellow directors. Magnet, *supra* note 1, at 88-89.

257. Lublin, *supra* note 254, at B1.

258. *See* Ada Demb, *A Framework for a Board Retreat*, *DIRECTORS & BDS.*, Fall 1994, at 12.

259. Cyrus F. Freidheim, Jr., *Preparing Your New Directors*, *DIRECTORS & BDS.*, Winter 1995, at 27.



facet.<sup>260</sup> Also, interestingly, Household International invites the executive assistants of each new director to spend a get-acquainted day at the corporation's offices.<sup>261</sup>

A movement toward board activism is not without its difficulties. Additional resources, staff and time commitments from directors will be required to perform these new functions.<sup>262</sup> More significant is the concern that "as directors become more intimately involved with the management of the corporation, they would lose their status as outsiders."<sup>263</sup> Further, because directors are routinely encouraged to become activists, some board members might overreact and wreak havoc on the board.<sup>264</sup> Despite these concerns, board activism is a step in the right direction and should be pursued by corporations and enforced by courts as an alternative to the traditional board ignorance approach.

#### CONCLUSION

*Paramount Communications, Inc. v. QVC Network, Inc.*<sup>265</sup> provided the Delaware Supreme Court with the perfect opportunity to poignantly reaffirm the corporate director's fiduciary duty to inform himself under *Smith v. Van Gorkom*.<sup>266</sup> The facts of Paramount clearly warranted due care analysis, since the Paramount directors virtually ignored the extremely competitive QVC bid.<sup>267</sup> The court did hold that the Paramount Board violated its duty of care, but that ruling's impact was unnecessarily limited because: (1) rather than steadfastly relying on *Van Gorkom*, the most on-point and applicable precedent, the court cited less controversial, and less applicable authority; and (2) rather than relying solely or predominantly on the Board's failure to become adequately informed, the court examined profit maximization duties under *Reylon*. The *Paramount* court was certainly concerned with the Paramount Board's failure to become informed, but that concern should have been the controlling, if not exclusive, basis for enjoining the Board's action. The

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260. *Id.* at 28.

261. *Id.*

262. James M. Tobin, *The Squeeze on Directors—Inside is Out*, 49 BUS. LAW. 1707, 1729 (1994).

263. *Id.*

264. Judith H. Dobrzynski, *Activist Boards, Yes. Panicky Boards, No*, BUS. WK., Dec. 28, 1992, at 40.

265. 637 A.2d 34 (Del. 1993).

266. 488 A.2d 858 (Del. 1985).

267. *Paramount*, 637 A.2d at 41.

*Paramount* court neglected an excellent opportunity to highlight, and advocate for, board activism. Consequently, corporate directors are reminded, that while moderately interested in the board's behavior, the Delaware Supreme Court will invariably allow quietude, snoozing and ignorant politeness.

