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Paramount Communications, Inc. v. Time Inc.: Taking the Teeth Out of Proportionality Review

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Notes

Paramount Communications, Inc. v. Time Inc.: Taking the Teeth Out of Proportionality Review

I. INTRODUCTION

The 1980s unleashed an unprecedented wave of hostile takeovers spurred by the proliferation of junk bonds and the widespread use of leveraged financing techniques.[1] This frenzied merger activity forced many companies to adopt takeover defenses to deflate their takeover attractiveness. The courts that evaluated the validity of these defensive measures struggled to find a standard by which to review these actions. The Delaware judiciary, the reigning authority of corporate law,[2] stepped forward and created the "proportionality standard of review."[3] Proportionality review requires a court to make a threshold determination—that the takeover defense is reasonable in relation to the threat posed—before it applies the business judgment rule to the directors' decision to implement the defense.[4]

As the takeover decade ended, however, it was unclear how much power the Delaware Supreme Court would pack into its new standard of review.[5] Court observers questioned whether the new standard of review would be a powerful constraint on defensive measures or a weak justification of defensive actions.[6] In *Paramount Communications, Inc., v. Time Inc.*,[7] the Delaware Supreme

1. INVESTOR RESPONSIBILITY RESEARCH CENTER, STATE TAKEOVER LAWS 1 (1989) [hereinafter IRRC].

2. *See* Meyers, *Showdown in Delaware: The Battle to Shape Takeover Law*, INSTITUTIONAL INVESTOR, Feb. 1989, at 64.

3. *See* Revlon Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1986); Moran v. Household Int'l, Inc., 500 A.2d 1346 (Del. 1985); Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985); Grand Metro. Pub. Ltd. v. Pillsbury Co., 558 A.2d 1049 (Del. Ch. 1988); City Capital Assocs. v. Interco Inc., 551 A.2d 787 (Del. Ch. 1988); AC Acquisitions Corp. v. Anderson, Clayton & Co., 519 A.2d 103 (Del. Ch. 1986).

4. *See infra* notes 25-67 and accompanying text.

5. Gilson & Kraakman, *Delaware's Intermediate Standard for Defensive Tactics: Is There Substance to Proportionality Review?*, 44 BUS. LAW. 247, 251 (1989).

6. *Id.*

7. 571 A.2d 1140 (Del. 1989).

Court was asked to decide whether Time's restructuring of a proposed merger with Warner Communication, Inc.—a defensive maneuver designed to preclude Time's shareholders from accepting a tender offer from Paramount—was a reasonable response in relation to any threat posed by the Paramount offer. The court upheld the defensive technique, and in the process, pulled the teeth out of proportionality review.

This Note traces the development of the business judgment rule and examines its evolution into proportionality review. This Note then discusses *Paramount*, summarizing the relevant facts of the case and the court's opinion. The court's opinion is then analyzed, focusing on three points: (1) the proper definition of a "threat" in proportionality review; (2) whether the court incorrectly applied the business judgment rule at the threshold level of analysis; and (3) whether the court should have recognized the shareholders' interest in choosing their own fate. Finally, the Note discusses *Paramount*'s negative impact on Time's shareholders and the shareholders of all companies faced with a hostile, but lucrative, tender offer.

II. BACKGROUND

A. *The Business Judgment Rule*

A corporation's board of directors has a fiduciary duty to act in the best interests of the corporation's stockholders.[8] The business judgment rule presumes that directors' actions comport with this duty.[9] The rule protects disinterested directors from incurring liability for a poor business decision if the directors acted on an informed basis and with an honest belief that the decision was in the company's best interest.[10] The rule's rationale derives from the Delaware General Corporation Law,[11] which grants the board of directors broad powers of corporate governance.[12] By applying this rule, "a court [avoids] substitut[ing] its judgment for that of

8. *See* Grand Metro. Pub. Ltd. v. Pillsbury Co., 558 A.2d 1049, 1053 (Del. Ch. 1988).

9. Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984). The business judgment rule is a "presumption that in making a business decision the directors of the corporation acted on an informed basis, in good faith and in the best interest of the company." *Id.* (citing Kaplan v. Centex Corp., 284 A.2d 119, 124 (Del. Ch. 1971); Robinson v. Pittsburgh Oil Refinery Corp., 14 Del. Ch. 193, 126 A. 46 (1924)).

10. *Id.*

11. DEL. CODE ANN. tit. 8, §§ 101-398 (1987).

12. Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 953 (Del. 1985); Pogostin v. Rice, 480 A.2d 619, 624 (Del. 1984). The Delaware Corporation Act 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

the board of directors if the [board's] decision can be 'attributed to any rational business purpose.' "[13] Therefore, a company's directors will not be held liable for a harmful business decision unless it is established that the directors were acting for personal benefit or did not have a rational basis for their decision.

The business judgment rule is the main protection for directors facing liability for their corporate decisions. The Delaware Supreme Court has held that this rule also should protect directors from incurring liability for deciding to invoke certain takeover defenses.[14] The court views the defensive decision as it would any other board decision and, thus, presumes that it is made in the shareholder's best interests.[15] Legal scholars and practitioners, however, have debated over how much deference the court should give to directors when reviewing the directors' defensive actions.[16]

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this chapter or in its certificate of incorporation." DEL. CODE ANN. tit. 8, § 141(a) (1987).

13. *Unocal*, 493 A.2d at 954 (quoting Sinclair Oil Corp. v. Levien, 280 A.2d 717, 720 (Del. 1971)).

14. *See Pogostin*, 480 A.2d at 627. In *Pogostin*, stockholders of City Investing Company (City) brought a derivative suit charging City's board with wrongfully rejecting a tender offer for City's shares. This rejection allegedly caused City's shareholders to lose a premium over market value. *Id.* at 622. The court held that the business judgment rule was applicable in the context of a takeover; therefore, the directors' decision could not be questioned. *Id.* at 627 (citing Aronson v. Lewis, 473 A.2d 805, 812-16 (Del. 1984); Gimbel v. Signal Cos., 316 A.2d 599 (Del. Ch.), *aff'd*, 316 A.2d 619 (Del. 1974).

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

16. *See* Loewenstein, *Toward an Auction Market for Corporate Control and the Demise of the Business Judgment Rule*, 63 S. CAL. L. REV. 65, 66 n.7 (1989). Professor Loewenstein classifies the debates over the directors' role in takeover bids into three categories: (1) the passive role, allowing for maximization of shareholder wealth; (2) the auctioneer's role, encouraging an auction of the target's shares at the highest possible price; and (3) the active role, giving the directors great deference in deciding how to respond to a hostile offer. *Id.*

The argument in favor of director passivity is based on the premise that directors must always operate to maximize shareholder wealth. *See* Easterbrook & Fischel, *The Proper Role of a Target's Management in Responding to a Tender Offer*, 94 HARV. L. REV. 1161 (1981). This argument states that shareholder welfare is not increased when defensive tactics defeat a takeover, thereby forcing shareholders to forego a control premium. *Id.* at 1164. Rather, shareholder welfare is maximized by considering the market value of the stock if the offer is not successful, the price of successful future tender offers, and the probable occurrence of one of these two events. *Id.*

Professor Gilson and Lucian Bebchuk argue that shareholder wealth in a takeover situation is best maximized if the target management assumes an auctioneer's role. *See* Bebchuk, *The Case for Facilitating Competing Tender Offers: A Reply and Extension*, 35 STAN. L. REV. 23 (1982); Bebchuk, *The Case for Facilitating Competing Tender Offers*, 95 HARV. L. REV. 1028 (1982); Gilson, *Seeking Competitive Bids Versus Pure Passivity in Tender Offer Defenses*, 35 STAN. L. REV. 51 (1982).

The final position argues that the directors' broad power of corporate governance requires the court to grant corporate directors great deference in implementing takeover defenses. *See* Lipton, *Takeover Bids in the Target's Boardroom: An Update After One*

The Delaware Supreme Court also has recognized that takeover bids present a caveat to a board's traditionally unfettered discretionary exercise of its business judgment.[17] The court, however, has struggled to develop a standard by which to review such actions.

Cheff v. Mathes[18] offered the Delaware Supreme Court one of its first opportunities to review a defensive action.[19] In *Cheff*, the court focused on the directors' motives in deciding whether the business judgment rule protected the directors' takeover defense.[20] The court stated that the business judgment rule protects directors' defensive actions if the directors prove that they had reasonable grounds for believing that another person's stock ownership threatened corporate policy and effectiveness.[21] The directors satisfied this burden of proof by showing good faith and reasonable investigation into the threat presented by the new stockholder.[22] *Cheff*'s implicit message was that target managers need to find only a policy conflict with the would-be acquirer to invoke the protection of the business judgment rule.[23] Because it is very easy to doc-

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Year, 36 BUS. LAW. 1017 (1981); Lipton, *Takeover Bids in the Target's Boardroom: A Response to Professors Easterbrook and Fischel*, 55 N.Y.U. L. REV. 1231 (1980); Lipton, *Takeover Bids in the Target's Boardroom*, 35 BUS. LAW. 101 (1979).

17. *Unocal*, 493 A.2d at 954. In *Unocal*, the Delaware Supreme Court recognized that the takeover situation entails an "omnipresent specter that a board may be acting in its own interests rather than those of the corporation and its shareholders." *Id.* Therefore, the court held that "there is an enhanced duty which calls for judicial examination at the threshold before the protection of the business judgment rule may be conferred." *Id.* For a complete discussion of *Unocal*, see *infra* notes 25-40 and accompanying text.

18. 41 Del. Ch. 494, 199 A.2d 548 (Del. 1964).

19. In *Cheff*, a reputed corporate liquidator, Maremont, acquired a controlling interest in Holland Furnace Co. *Id.* at 499, 199 A.2d at 551. Holland's directors offered to buy out Maremont's interest in Holland at an above-market price. *Id.* at 502, 199 A.2d at 553. A group of Holland's shareholders challenged the board's action as an improper use of corporate funds. *Id.* The Delaware Court of Chancery found the directors liable because the purpose behind the transaction was the perpetuation of control of incumbent management. *Id.* at 508, 199 A.2d at 556. The Delaware Supreme Court reversed, holding that its review of the record led:

> inevitably to the conclusion that the board of directors, based upon direct investigation, receipt of professional advice, and personal observations of the contradictory action of Maremont and his explanation of corporate purpose, believed, with justification, that there was a reasonable threat to the continued existence of Holland, or at least existence in its present form, by the plan of Maremont to continue building up his stock holdings.

Id. Therefore, the court held that the directors' decision was protected by the business judgment rule. *Id.* at 508, 199 A.2d at 556-57.

20. *See id.* at 506, 199 A.2d at 555. Some commentators call the *Cheff* test the "conflict/primary purpose" test. *See* Gilson & Kraakman, *supra* note 5, at 249.

21. *Cheff*, 41 Del. Ch. at 506, 199 A.2d at 555.

22. *Id.*

23. Gilson & Kraakman, *supra* note 5, at 249-50.

ument such a policy conflict, the *Cheff* test boiled down to a routine application of the business judgment rule broadly protecting defensive actions.[24]

B. Proportionality Review

1. Development of the Standard in *Unocal*

The *Cheff* approach was criticized widely for giving directors unrestrained freedom to defeat takeover attempts.[25] The Delaware Supreme Court recognized *Cheff*'s deficiencies and reconsidered its implications in *Unocal Corp. v. Mesa Petroleum Co.*[26] In *Unocal*, Mesa[27] offered to purchase 37% of Unocal's stock to gain control of the company.[28] Mesa indicated that if its tender offer were successful, it would cash-out the nontendering shares for highly subordinated bonds.[29] Thus, Unocal's shareholders would be coerced into tendering their shares to Mesa to avoid receiving the worthless bonds.[30] Unocal countered with its own offer to repurchase all of the company's shares at a higher price than offered by Mesa.[31] The terms of Unocal's offer, however, precluded Mesa from tendering its Unocal shares back to Unocal.[32] Mesa challenged Unocal's power to engage in any defensive measure, especially a selective repurchase program.[33]

In deciding the case, the Delaware Supreme Court stated that Unocal's defensive measure would be protected by the business judgment rule only if it were "reasonable in relation to the threat posed."[34] The court recognized *Cheff*'s rationale, but held that

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24. *Id.*

25. *Id.* at 250; *see also* Bebchuk, *The Case For Facilitating Competing Tender Offers*, 95 HARV. L. REV. 1028 (1982); Gelfond & Sebastian, *Reevaluating the Duties of Target Management in a Hostile Tender Offer*, 60 B.U.L. REV. 1161 (1981); Gilson, *A Structural Approach to Corporations: The Case Against Defensive Tactics in Tender Offers*, 33 STAN. L. REV. 81 (1981); Lynch & Steinberg, *The Legitimacy of Defensive Tactics in Tender Offers*, 64 CORNELL L. REV. 901 (1979).

26. 493 A.2d 946 (Del. 1985).

27. Mesa is the Arizona shell corporation of the well known corporate raider, T. Boone Pickens. *Id.* at 949 n.1.

28. *Id.* at 949. Mesa acquired 13% of Unocal's stock before making the offer. *Id.*

29. *Id.* at 949-50. Unocal labeled the securities to be received in the second part of the deal as "junk bonds." *Id.* at 950.

30. This is the classic two-tier, front-end-loaded, coercive tender offer. For a discussion of the two-tier offer, see Newell Co. v. Vermont Am. Corp., 725 F. Supp. 351, 372 (N.D. Ill. 1989) and Lederman, *Tender Offer Bidding Strategy*, 17 REV. SEC. REG. 917 (1983).

31. *Unocal*, 493 A.2d at 951.

32. *Id.*

33. *Id.*

34. *Id.* at 955.

before applying the business judgment rule to a defensive action, the court first must consider the reasonableness of the defensive measure in relation to the threat posed by the hostile tender offer.[35] Thus, the court created proportionality review.[36]

Using this newly established rule, the court embarked upon a two-part analysis: (1) to define the threat presented by the tender offer, and (2) to examine the reasonableness of Unocal's defensive action in relation to that threat. The court found that Mesa's offer constituted a threat because it was a "grossly inadequate two-tier coercive tender offer coupled with the threat of greenmail."[37] The court also found Unocal's repurchase program reasonable because the program ensured that minority shareholders were receiving equivalent value for the stock that they held prior to the tender offer.[38] The selective repurchase aspect of Unocal's tender offer

35. *Id.*

36. This standard of review is also known as "intermediate review." *See* Gilson & Kraakman, *supra* note 5, at 250-51. This title apparently derives from the options that were available to the court when it reformulated the *Cheff* standard. The court could have adopted a less deferential standard that emphasized the shareholders' interest in deciding whether the tender offer should be accepted or rejected. Alternatively, the court could have adopted a very deferential standard similar to *Cheff*. The court accepted an intermediate standard, thereby attempting to distinguish defensive tactics designed to entrench management from those tactics designed to benefit shareholders. *Id.*; *see Unocal*, 493 A.2d at 956.

Judge William Duffy summarized proportionality review in the following five part test: (1) the board must show reasonable grounds for believing that a danger to corporate policy and effectiveness exists; (2) the board must show that it acted in good faith; (3) the board must show that it made a reasonable investigation; (4) the majority of the board must consist of independent outside directors; and (5) the board's defensive action must be reasonable in relation to the threat posed. Grand Metro. Pub. Ltd. v. Pillsbury Co., 558 A.2d 1049, 1056 (Del. Ch. 1988).

37. *Unocal*, 493 A.2d at 956. In defining what may constitute a threat, the court held that directors may analyze the nature of the takeover bid and its effect on the corporate enterprise considering the following factors: "inadequacy of the price offered, nature and timing of the offer, questions of illegality, the impact on 'constituencies' other than shareholders (i.e., creditors, customers, employees, and perhaps even the community generally), the risk of nonconsummation, and the quality of the security being offered in the exchange." *Id.* at 955 (citing Lipton & Brownstein, *Takeover Responses and Directors Responsibility: An Update*, A.B.A. NAT'L INST. ON DYNAMICS CORP. CONTROL, Dec. 8, 1983, at 7).

"Greenmail" refers to prevention of a takeover by having the target purchase its shares back from the would-be acquirer at a premium that is not available to other shareholders. *Unocal*, 493 A.2d at 956 n.13.

38. *Unocal*, 493 A.2d 956; *see also* Sterling v. Mayflower Hotel Corp., 33 Del. Ch. 293, 306, 93 A.2d 107, 114 (1952) (fairness of merger depends upon whether minority shareholders receive the substantial equivalent in value of what [they] had before"), *quoted in* Rosenblatt v. Getty Oil Co., 493 A.2d 929, 940 (Del. 1985).

In *Unocal*, the court held that this principle of fairness is also applicable to a tender offer. *Unocal*, 493 A.2d at 956-57. Unocal's minority shareholders, forced to accept the junk bonds if Mesa's offer were successful, would have received securities worth less than

was also reasonable because Mesa's participation in the offer would have undermined its purpose.[39]

In *Unocal*, the court recognized that takeover targets do not "have unbridled discretion to defeat any perceived threat by any Draconian means."[40] The Delaware Supreme Court subsequently applied this new standard to review shareholder rights repurchase plans in *Moran v. Household International, Inc.*[41] and *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*[42]

2. Fine Tuning the *Unocal* Threats

In the late 1980s, the Delaware Chancery Court attempted to solidify the intermediacy of proportionality review by constraining the definition of threat.[43] In *City Capital Associates v. Interco Inc.*,[44] the Delaware Court of Chancery reviewed whether Interco's

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the value of their shares. *Id.* at 957. By offering to purchase these shares, Unocal ensured that the minority shareholders would receive equal value for their shares. *Id.*

39. The board's objective in enacting the selective exchange offer was twofold: (1) defeat the inadequate Mesa offer, or (2) provide valuable securities to the minority shareholders who otherwise would have been forced to accept junk bonds. *Unocal*, 493 A.2d at 956. Allowing Mesa to participate in the offer would have subsidized Mesa's continuing effort to buy Unocal stock. *Id.* at 955.

40. *Id.*

41. 500 A.2d 1346 (Del. 1985). In *Moran*, the Delaware Supreme Court relied on *Unocal* to invoke the business judgment rule to protect a board of directors decision to implement a preferred share purchase rights plan — also known as a "poison pill" — as a defensive mechanism. *Id.* at 1348, 1350.

42. 506 A.2d 173 (Del. 1986). In *Revlon*, the court evaluated the validity of two defensive measures implemented by Revlon to thwart a hostile takeover attempt by Pantry Pride, Inc. Revlon's first defensive measure was a poison pill. *Id.* at 180; *see supra* note 41. Relying on *Moran*, the court held that the board had the power to adopt such a measure. *Revlon*, 506 A.2d at 180. The court also found the poison pill to be reasonable in light of the grossly inadequate Pantry Pride offer. *Id.* Additionally, Revlon offered to repurchase ten million of its outstanding shares in exchange for senior subordinated notes. *Id.* at 177. The court also found this action to be reasonable in relation to the threat posed by the Pantry Pride offer and, thus, protected by the business judgment rule. *Id.* at 181. These defensive measures, however, did not dissuade Pantry Pride from its takeover attempt, and it continued to increase the price of its per share offer. *Id.* at 182. Accordingly, the court concluded that the break-up of Revlon was inevitable and that the duty of Revlon's board "changed from the preservation of Revlon as a corporate entity to the maximization of the company's value at a sale for the stockholders' benefit." *Id.*

43. In City Capital Assocs. v. Interco Inc., 551 A.2d 787, 796-98 (Del. Ch. 1988) and Grand Metro. Pub. Ltd. v. Pillsbury Co., 558 A.2d 1049, 1056-58 (Del. Ch. 1988), the chancery court refused to uphold defensive measures because the circumstances of each case did not create an adequate threat to survive a *Unocal* analysis. *See supra* notes 26-42 and accompanying text. The chancery court also concentrated upon the reasonableness aspect of the *Unocal* test to strike down defensive actions in AC Acquisitions Corp. v. Anderson, Clayton & Co., 519 A.2d 103, 112 (Del. Ch. 1986) and Robert M. Bass Group, Inc. v. Evans, [1988-1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 93,924 (Del. Ch. 1988).

44. 551 A.2d 787 (Del. Ch. 1988).

directors breached their fiduciary duty to Interco's shareholders by maintaining a poison pill[45] designed to defeat a noncoercive tender offer. The tender offer was for all of Interco's outstanding shares at $74 per share conditioned upon removal of the poison pill.[46] Interco's board rejected this offer as inadequate, left the poison pill in place, and adopted a restructuring plan with a claimed value of at least $76 per share.[47] By maintaining the poison pill, the board precluded Interco's shareholders from choosing between these two alternatives.

The court, applying the *Unocal* test, held that the poison pill was not a reasonable defense in relation to the threat posed, because the tender offer did not threaten shareholder interests.[48] The court held that only two types of tender offers can threaten shareholder interests: (1) coercive offers,[49] and (2) noncoercive but inadequately priced offers.[50] The offer in *Interco* was obviously noncoercive, but the board argued that it was inadequate because its per share price was comparatively low in relation to the value of a proposed restructuring plan.[51]

The court concluded that, when faced with an inadequate offer, the business judgment rule allowed *Interco*'s board temporarily to leave the poison pill in place while taking steps to protect shareholder interests as the offer developed.[52] Once this period ended, however, the poison pill no longer protected shareholder inter-

45. The poison pill adopted by Interco's board was a shareholders rights plan containing both "flip-in" and "flip-over" rights. *Id.* at 791. The flip-in provision allowed each right holder to purchase a share of the company's stock with a market value of twice the exercise price of the right. *Id.* This right was triggered if any person obtained 15% of Interco's outstanding common stock. *Id.* The flip-over provision allowed right holders to purchase the common stock of an acquiring company. This stock would have twice the value of the exercise price of the right. *Id.* at 791-92. This right was triggered by a merger or acquisition of 50% or more of Interco's assets or earning power. *Id.* at 792.

46. *Id.* at 793.

47. *Id.*

48. *Id.* at 797-800.

49. The most extreme case of a coercive offer is the two-tiered front-end-loaded offer such as was used in *Unocal*. *See supra* notes 27-30 and accompanying text.

50. *Interco*, 551 A.2d at 797. The court held that noncoercive offers can threaten shareholder interests because an active negotiator may be able to achieve a more valuable proposal or arrange an alternative transaction. *Id.* at 798. *See also, e.g.*, CFRT v. Federated Dep't Stores, Inc., 683 F. Supp. 422 (S.D.N.Y. 1988); *In re* J.P. Stevens & Co. Shareholders Litig., 542 A.2d 770 (Del. Ch. 1988).

51. *Interco*, 551 A.2d at 792-93.

52. *Id.* at 798. Such steps include, but are not limited to, negotiating with the offeror on behalf of the shareholders, proceeding with a *Revlon*-style auction, or recapitalizing or restructuring of the company. *Id.* For a discussion of the *Revlon* auction, see *supra* note 42.

ests.[53] Allowing the poison pill to remain in place at the final stage of the noncoercive offer, therefore, precluded the shareholders from exercising their own independent judgment about their own interests.[54] The court recognized that "a shareholder could prefer a $74 [per share] cash payment now to the complex future consideration offered through the restructuring."[55] The court declared that the claimed threat of inadequate value was "too mild" to justify maintaining the poison pill.[56] Thus, the board's action did not pass the *Unocal* threshold and did not merit the business judgment rule's protection.[57]

The Delaware Court of Chancery strengthened *Interco*'s rationale in *Grand Metropolitan Public Ltd. v. Pillsbury Co.*[58] In *Grand Metropolitan*, Pillsbury enacted a poison pill and other defensive measures as preemptive defenses against any future, unforeseen takeover attempts.[59] More than two years after Pillsbury adopted this defensive stance, Grand Metropolitan (Grand Met) made an all-cash offer for all of Pillsbury's outstanding shares, conditioned upon removal of the poison pill.[60] Pillsbury's board refused to remove the poison pill, claiming that Grand Met's offer was inadequate and not in the best interest of the company.[61] By maintaining the poison pill, Pillsbury's shareholders were precluded from accepting Grand Met's offer to buy Pillsbury stock at approximately a 60% premium over the market price.[62]

Grand Met argued that the Pillsbury directors' actions violated fundamental rules of corporate governance and democracy because board members must act as fiduciaries on behalf of the stockhold-

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53. *Interco*, 551 A.2d at 798.

54. *Id.*

55. *Id.* at 799.

56. *Id.* at 798. Specifically, the court stated:

> To acknowledge that directors may employ the recent innovation of 'poison pills' to deprive shareholders of the ability effectively to choose to accept a noncoercive offer, after the board has had a reasonable opportunity to explore or create alternatives, or attempt to negotiate on the shareholders' behalf, would, it seems to me, be so inconsistent with widely shared notions of appropriate corporate governance as to threaten to diminish the legitimacy and authority of our corporation law.

Id. at 799-800.

57. *Id.*

58. 558 A.2d 1049 (Del. Ch. 1988). The *Grand Metro.* opinion was authored by the retired Delaware Supreme Court Justice William Duffy sitting by assignment under DEL. CONST. art. IV and DEL. CODE ANN. tit. 29, § 5610 (1987).

59. *Grand Metro.*, 558 A.2d at 1051.

60. *Id.* at 1052.

61. *Id.*

62. *Id.*

ers.[63] The court accepted this argument and, citing *Interco*, ruled that Pillsbury's shareholders should be allowed to make an informed choice.[64] The court held that Pillsbury's claimed threats of inadequate value and coercion were not substantial enough to justify maintenance of the poison pill.[65] Thus, the directors' actions were not protected by the business judgment rule.[66]

Interco and *Grand Metropolitan* strengthened proportionality review by limiting the types of threats that would justify defensive actions. It appeared that this standard remedied the defects of the *Cheff* standard. The Delaware Supreme Court, however, rejected these chancery court opinions in *Paramount* and, thus, reduced proportionality review to mere rhetoric.

III. PARAMOUNT COMMUNICATIONS, INC. V. TIME INC.[67]

A. *Factual Background*

In 1987, Time Inc. (Time) established a special committee of executives to consider expanding Time's operations into the entertainment field.[68] This committee eventually recommended a merger with Warner Communication, Inc. (Warner), and the two companies agreed to merge by 1989.[69] The merger was to be executed by a stock swap between the two companies.[70] This transaction required the approval of both Time and Warner

63. *Id.* at 1053.
64. *Id.* at 1060.
65. *Id.*
66. *Id.*
67. 571 A.2d 1140 (Del. 1989).
68. *Id.* at 1143. Time is a Delaware corporation with its principle offices in New York City. Although the company's main business is publishing books and magazines, it also provides pay television programming through its Home Box Office and Cinemax subsidiaries. *Id.*
69. *Id.* at 1144-46. A planned merger with Warner was abandoned in late 1987 for tax reasons. *Id.* The merger contested in the Delaware courts arose from a board meeting on July 21, 1988. *Id.* at 1145. At that meeting, management reported that it had reviewed many entertainment companies, including Paramount, as merger candidates. The board decided that Warner was the most desirable company with which it should merge for the following reasons: (1) the success of the Warner movie studios, Warner Brothers; (2) the synergy between Warner's and Time's cable operations; (3) Warner's music business; and (4) Warner's international distribution. Paramount Communications, Inc., v. Time Inc., No. 10866 (Del. Ch. July 14, 1989) (WESTLAW, States library, DE-CS file).
70. *Paramount*, 571 A.2d at 1146. Under the agreement, Warner would merge into a wholly owned Time subsidiary from which Warner would become the surviving corporation. *Id.* Warner's common stock would then be converted into Time stock at the agreed-upon ratio. *Id.* Time's name would then be changed to Time-Warner, Inc. *Id.* The stock exchange ratio eventually agreed upon by the parties was .465 in favor of Warner. *Id.* At the time of the merger, the market exchange rate was .38 in favor of

shareholders.[71]

The Time-Warner merger was suddenly postponed on June 7, 1989, when movie industry competitor Paramount Communications, Inc. (Paramount) made an all-cash tender for 100% of Time's outstanding shares.[72] Paramount's $175 per share offer was considerably higher than the $126 per share price at which the stock was trading during the period immediately preceding the offer.[73] The offer, however, was conditioned on Time abandoning its planned merger with Warner.[74] Time's board rejected Paramount's initial offer as inadequate.[75] Paramount then raised its offer to $200 per share.[76] The second offer also was formally rejected by Time's board. The board reasoned that the Warner merger offered greater long-term value for the stockholders.[77] Time's board also stated that Paramount presented a threat to Time's survival and corporate culture.[78]

Time responded to Paramount's offer by restructuring the Warner deal from a stock swap to "an outright cash and securities acquisition of Warner."[79] By restructuring the deal to a cash acquisition, Time eliminated the need for stockholder approval because it no longer needed to issue new stock. The down side of the restructuring was that Time was forced to take on seven to ten billion dollars worth of debt to finance the acquisition.[80] The restructuring of the deal effectively forced Time's shareholders to forego a large cash buy-out of their interests in favor of a deal that would strap their company with a tremendous debt load. Paramount and a group of Time shareholders challenged the action of Time's board and asked the Delaware Court of Chancery to enjoin

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Warner. *Id.* Time's board decided to pay a premium over the market rate to compensate for Warner's recent rapid growth and to protect the "Time Culture." *Id.*

71. *Id.* The rules of the New York Stock Exchange required Time's shareholders to approve the transaction because Time needed to issue a large amount of new shares. *Id.* Warner's shareholders also had to approve the transaction under the Delaware General Corporation Law. *Id.*; *see* DEL. CODE ANN. tit. 8, § 251 (1987).

72. *Paramount*, 571 A.2d at 1147.

73. *Id.*

74. *Id.*

75. *Id.* at 1148. Time's financial advisors declared that the firm's value on an auction basis was materially higher than the value of Paramount's per share offer. *Id.*

76. *Id.* at 1149. This offer was made on June 23, 1989. *Id.*

77. *Id.*

78. *Id.*

79. *Id.* at 1148. Under the restructured deal, Time would make an all-cash offer to purchase 51% of Warner's outstanding shares for $70 per share. *Id.* The remaining 49% of the shares would be purchased later for a mixture of cash and securities worth $70 per share. *Id.*

80. *Id.*

the Time-Warner merger.[81] The chancery court denied this request for relief holding that Time's merger restructuring was a reasonable response in relation to the threat posed by the Paramount offer.[82] The Delaware Supreme Court affirmed the chancellor's decision.[83]

B. Delaware Supreme Court Opinion

In reviewing the chancellor's decision, the Delaware Supreme Court divided its analysis into three segments. First, the court considered whether Time put itself up for sale by entering into the proposed merger with Warner, thus invoking *Revlon* duties.[84] Second, the court examined the validity of the chancellor's conclusion that the business judgment rule protected Time's original decision to enter into the Warner merger.[85] Finally, the court analyzed whether the board's defensive measure of restructuring the deal satisfied the proportionality review test established in *Unocal*.[86]

The court found that the Time-Warner merger did not invoke *Revlon* duties.[87] Additionally, the court concluded that the busi-

81. *Id.* at 1141-42. The claims of Paramount and the individual shareholders were filed separately and consolidated by the chancellor. *Id.* at 1142.

82. Paramount Communications, Inc. v. Time Inc., No. 10866 (Del. Ch. July 14, 1989) (WESTLAW, States library, DE-CS file). The chancellor's unpublished memorandum opinion discusses the definition of a *Unocal* threat. The chancellor recognized that *Interco* and *Grand Metro.* established a rule of law that an all-cash, all-shares tender offer falling within a certain range of values cannot be a justifiable *Unocal* threat if the offer is not deceptive and will promptly be followed by a second-step merger for cash. *Id.* at 62. The chancellor then distinguished Time's merger plan from the poison pills in *Interco* and *Grand Metro.* and refused to enjoin Time's action. Contrary to the situation in *Interco* and *Grand Metro.*, the chancellor found that Time's management was not trying to force Time's shareholders to accept the Warner merger as the "functional equivalent" of the Paramount offer. *Id.* at 64. The chancellor also found that, although Time's action was in reaction to the Paramount offer, it was grounded in "bona fide strategic business planning, and not in questions of corporate control." *Id.* at 63. The chancellor concluded that the corporation had a legally cognizable interest in achieving the planned merger with Warner and had established a valid *Unocal* threat. *Id.*

83. The Delaware Supreme Court orally affirmed the chancellor's decision on July 24, 1989. Paramount Communications, Inc. v. Time Inc., 565 A.2d 280 (Del. 1989). The Delaware Supreme Court's written opinion was issued on February 26, 1990 and revised on March 9, 1990. Paramount Communications, Inc. v. Time Inc., 571 A.2d 1140 (Del. 1989).

84. *Paramount*, 571 A.2d at 1150. For a discussion of *Revlon* duties, see *infra* note 87.

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

86. *Id.* at 1152. For a discussion of *Paramount*'s application of *Unocal*, see *infra* notes 90-106 and accompanying text.

87. *Paramount*, 571 A.2d at 1151. In *Revlon*, the court held that, when a breakup of a company becomes inevitable, the duty of the board changes from preservation of the corporate entity to maximization of shareholder wealth. Revlon, Inc. v. MacAndrews &

ness judgment rule protected the board's decision to merge with Warner.[88] After disposing of these issues, the court examined whether *Unocal* was the proper standard of review for the case. The court summarily dismissed this issue by declaring that the chancellor's decision to apply *Unocal* was clearly correct and undisputed.[89] The court then applied the *Unocal* test to the facts of the case and questioned whether the board's response was reasonable in relation to the threat posed by Paramount's offer.

Paramount and the Time shareholders argued that the restructuring of the Warner deal failed the *Unocal* test because Paramount's offer did not constitute a valid threat.[90] Paramount relied on the Delaware Court of Chancery cases which held that all-cash tender offers within a certain range of values cannot constitute a legally recognizable threat to shareholder interest sufficient to withstand a *Unocal* analysis.[91] Accordingly, Paramount argued that its all-cash tender offer threatened Time and its shareholders only if the value of its offer was clearly inferior to the estimated long-term wealth enhancement from the Warner merger.[92]

The Delaware Supreme Court rejected this argument and over-

Forbes Holdings, Inc., 506 A.2d 173, 182 (Del. 1986); *see supra* note 42. The shareholder plaintiffs in *Paramount* argued that the original Time-Warner merger agreement of March 24, 1989, effectively put Time up for sale, thus invoking *Revlon* duties. *Paramount*, 571 A.2d at 1149. This argument was based on two facts: (1) Warner shareholders received 62% of the combined company, and (2) statements by Time's directors that the market might perceive that Time was up for sale indicated the directors' subjective intent to sell the company. *Id.*

The court held that the record contained insufficient evidence to conclude that the Warner negotiations made the break-up of Time inevitable. *Id.* at 1151. The court explained that *Revlon* duties attach to a transaction in only two situations: (1) "when a corporation initiates an active bidding process seeking to sell itself or to effect a business reorganization involving a clear break-up of the company," or (2) when "in response to a bidder's offer, a target abandons its long-term strategy and seeks an alternative transaction involving the break-up of the company." *Id.* at 1150. The court held that it would not "extend *Revlon*'s application to corporate transactions simply because they might be construed as putting a corporation either 'in play' or 'up for sale.' " *Id.* at 1151.

88. *Paramount*, 571 A.2d at 1152. The court considered the following evidence in Time's favor: (1) Time decided to move into the entertainment industry as early as 1983; (2) the board examined the field of all available entertainment companies; (3) the board determined that Warner was the best "fit" for Time to achieve its strategic objectives; and (4) Time's board was zealous in seeking to preserve its corporate culture and journalistic integrity. *Id.*

89. *Id.*

90. *Id.*

91. *Id.* (citing Grand Metro. Pub. Ltd. v. Pillsbury Co., 558 A.2d 1049 (Del. Ch. 1988); City Capital Assocs. v. Interco Inc., 551 A.2d 787 (Del. Ch. 1988); AC Acquisitions Corp. v. Anderson, Clayton & Co., 519 A.2d 103 (Del. Ch. 1986)).

92. *Id.*

ruled the cases upon which it was based.[93] The court stated that Paramount's argument represented a fundamental misunderstanding of the Delaware standard of review.[94] According to the court, Paramount's argument assumed that a tender offer could pose only the two types of threats discussed in *Interco*: coercive tender offers and tender offers of inadequate value.[95] The court disapproved of this "narrow and rigid construction of *Unocal*."[96] Rather, the court stated that Paramount's tender offer posed another type of threat.[97]

Time argued that the threat posed by the Paramount offer was that Time's shareholders could be tricked into selling out for cash when they would be better off becoming stockholders in the new Time-Warner.[98] This type of threat is called "substantive coercion."[99] The court deferred to the directors' definition of threat by invoking the business judgment rule.[100]

After legitimizing this new threat, the court examined whether Time's defensive response of restructuring the deal was reasonable in relation to that threat. Paramount argued that the restructured deal was unreasonable because it precluded Time's shareholders from accepting the tender offer or receiving a control premium in the immediately foreseeable future.[101] The court rejected this argument, focusing instead on the power of corporate governance.[102] The court stated that a company's board of directors has the power to manage the corporate enterprise,[103] including the selection of a

93. *Id.* at 1153. For an interesting discussion of the history behind this ruling, and the Delaware Supreme Court's burning desire to overrule *Interco* and its progeny, see Meyers, *supra* note 2.

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

95. *Id.*

96. *Id.*

97. *Id.*

98. *Id.* This threat was defined by the court as the possibility that "Time shareholders might elect to tender into Paramount's cash offer in ignorance or mistaken belief of the strategic benefit which a business combination with Warner might produce." *Id.*

99. *Id.* at 1153 n.17 (quoting Gilson & Kraakman, *supra* note 5, at 267). Gilson & Kraakman define substantive coercion as the "risk that shareholders will mistakenly accept an underpriced offer because they disbelieve management's representations of intrinsic value." Gilson & Kraakman, *supra* note 5, at 267.

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

101. *Id.* at 1154. Paramount's tender offer was effective only if the Time-Warner merger agreement were terminated. *Id.* at 1147. Time's shareholders could have stopped the merger under the original plan by not approving the issuance of the new shares. The deal, however, was restructured to take this power away from the shareholders. *Id.*

102. *Id.*

103. *Id.*; *see* DEL. CODE ANN. tit. 8, § 141(a) (1987).

time frame for achievement of corporate goals.[104] Also, the court stated that the board has no per se duty to maximize short-term shareholder wealth.[105] A board's decision to forego a short-term profit in favor of future wealth maximization is unreasonable only if there is no clear basis for sustaining the corporate strategy.[106] Thus, the court found that the directors' response was reasonable in relation to the threat posed by the Paramount offer and refused to disturb the Time-Warner merger.

IV. ANALYSIS

Proportionality review emerged in response to the blanket protection of defensive measures under the standard of review developed in *Cheff*.[107] In *Unocal*, the Delaware Supreme Court recognized that such automatic approval of defensive actions is not in the best interests of shareholders. The court in *Unocal* stated that there is an "omnipresent specter" of impropriety when a board implements a takeover defense arising from incumbent management's desire to retain control of the company.[108]

In attempting to develop a tougher standard of review, the Delaware Supreme Court encountered a doctrinal roadblock. Judicial restraint is a fundamental principle of Delaware corporation law. To counteract the problems of *Cheff*, the court was forced to develop a more active standard contrary to its fundamental philosophy of judicial restraint. Accordingly, the court developed proportionality review. This standard is more stringent than the *Cheff* standard because it allows the court to evaluate the reasonableness of a board's defensive response in relation to a posed threat before the court will grant the protection of the business judgment rule. This standard subjects a defensive measure to limited scrutiny, and concurrently respects judicial restraint in that it prohibits the court from evaluating the merits of a board's decision. Thus, the standard is truly intermediate and provides an effective way for the court to distinguish takeover defenses that are beneficial to shareholders from those designed to entrench incumbent management.

Proportionality review asks reviewing courts to walk a fine line

104. *Paramount*, 571 A.2d at 1154.

105. *Id.*

106. *Id.*

107. Cheff v. Mathes, 41 Del. Ch. 494, 199 A.2d 548 (Del. 1964); *see supra* notes 18-26 and accompanying text.

108. Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 954 (Del. 1985); *see supra* notes 26-40 and accompanying text.

between judicial restraint and judicial activism. In *Paramount*, however, the court crossed both sides of this line and reduced proportionality review to a rhetorical justification of takeover defenses. The court accomplished this result by redefining the types of legitimate *Unocal* threats, by applying the business judgment rule at the threshold level, and by ignoring shareholders' rights to choose their own fate.

A. Redefining the Unocal *Threats*

For proportionality review to be truly an intermediate standard of review, the Delaware Supreme Court needed to identify the nature of all permissible threats and establish the boundaries for permissible defensive tactics.[109] Such standards would guide the court in the future while guarding against judicial second-guessing of board decisions. In *Interco*, the Delaware Court of Chancery defined two broad categories of threats posed by tender offers: (1) threats to voluntariness, and (2) threats from inadequate but noncoercive offers.[110] *Paramount* rejected this approach as "not in keeping with a proper *Unocal* analysis" and a "fundamental misconception" of *Unocal*.[111] If anyone has a misunderstanding of *Unocal*, however, it appears to be the Delaware Supreme Court.

In a footnote following the discussion of the two *Interco* threats, the *Paramount* court stated that commentators have suggested that there are not two, but three, types of *Unocal* threats.[112] Quoting an article by Professors Ronald Gilson and Reinier Kraakman,[113] the court classified the three types of threats as: (1) opportunity loss,[114] (2) structural coercion,[115] and (3) substantive coercion.[116] True,

109. *See* Gilson & Kraakman, *supra* note 5, at 266.

110. City Capital Assocs. v. Interco Inc., 551 A.2d 787, 797 (Del. 1988); *see supra* notes 43-57 and accompanying text.

111. Paramount Communications, Inc. v. Time Inc., 571 A.2d 1140, 1153 (Del. Ch. 1989).

112. *Id.* n.17.

113. *See* Gilson & Kraakman, *supra* note 5.

114. Opportunity loss is the threat that the hostile offer might deprive target shareholders of the opportunity to select management's superior alternative. *Paramount*, 571 A.2d at 1153 n.17 (citing Gilson & Kraakman, *supra* note 5, at 267). This threat was recognized in *Interco* as the threat from noncoercive but inadequate offers. *See supra* note 50 and accompanying text.

115. Structural coercion is the garden variety coercive tender offer recognized in *Interco*. *See supra* note 50 and accompanying text; *see also*, Gilson & Kraakman, *supra* note 5, at 267 (structural coercion is "the risk that disparate treatment of non-tendering shareholders might distort shareholders' tender decisions").

116. Substantive coercion is the "risk that shareholders will mistakenly accept an underpriced offer because they disbelieve management's representation of intrinsic value." Gilson & Kraakman, *supra*, note 5, at 267.

the court's only mention of the term "substantive coercion" was in a footnote. Nevertheless, the underlying principle of the new threat created in *Paramount* was essentially a threat of substantive coercion. The court defined the threat to Time's shareholders as the danger of "tender[ing] into Paramount's cash offer in ignorance or a mistaken belief of the strategic benefit which a business combination with Warner might produce."[117] The court adopted this new threat without the label of substantive coercion and thus obliquely legitimized substantive coercion as a valid *Unocal* threat.

The court was apparently persuaded by Professors Gilson and Kraakman's suggestion that the recognition of substantive coercion "would help guarantee that the *Unocal* standard becomes an effective intermediate standard of review."[118] The court, however, failed to explain or adhere to the authors' rationale for such a statement. Professors Gilson and Kraakman clearly explained that recognizing substantive coercion can lead to a meaningful standard of review only if the reviewing court examines "how and when management expects a target's shareholders to do better."[119] This standard requires more intervention by the reviewing court as well as target management.[120] Obviously, substantive coercion enhances the *Unocal* analysis only if the court takes a more active role in the reviewing process. Such activism exceeds the scope of proportionality review and forces the court to evaluate the merits of the board's decision. Ironically, the court instead used substantive coercion to create a more deferential standard of review.

B. Applying the Business Judgment Rule at the Threshold Level

The Delaware Supreme Court avoided evaluating the merits of Time's restructured merger plan by relying on the restraints of the business judgment rule. Time's directors defined a substantive coercion threat. The court deferred to the directors' judgment, claiming that the business judgment rule prohibited the court "from engaging in the process of attempting to appraise and evaluate the relative merits of a long-term versus short-term investment goal for shareholders."[121] Thus, the court adopted a type of threat that requires the most judicial intervention, but took a very passive

117. *Paramount*, 571 A.2d at 1153.
118. *Id.* n.17 (citing Gilson & Kraakman, *supra* note 5, at 267).
119. Gilson & Kraakman, *supra* note 5, at 268.
120. *Id.*
121. *Paramount*, 571 A.2d at 1153.

position under the guise of increasing the effectiveness of proportionality review.

The fundamental flaw in this opinion was mixing the business judgment rule into the threshold *Unocal* test. Proportionality review emerged as a threshold test to determine whether a board's defensive decision should be protected by the business judgment rule. This test must be passed "before the protection of the business judgment rule can be conferred."[122] In *Paramount*, the court applied the business judgment rule at the threshold level to help the directors pass the test and gain the protection of the business judgment rule. Such an analysis makes a mockery of proportionality review. The court used the business judgment rule in determining whether the directors actions should be protected by the business judgment rule. The court could have been more deferential only if it had let Time's directors write the opinion themselves. Such a result is contrary to *Unocal*'s concern about directors acting in their own interest when invoking a takeover defense.[123]

C. Substantive Coercion Precludes Shareholder Choice

The threat of substantive coercion exists only if shareholders eventually receive greater value from the continuing entity than they would have received by tendering their shares to the acquirer. Unfortunately, stockholders rarely benefit when a company successfully defeats a takeover attempt.[124] Even if a company eventually does provide a greater benefit to its shareholders after a successful takeover defense, *Paramount* incorrectly overlooks the shareholders' role in choosing their own fate. Former Delaware Supreme Court Justice William Duffy stated that it is a fundamental rule of corporate governance and democracy that the corporation is owned by its stockholders and the board has a fiduciary duty to act on behalf of the shareholders.[125] In *Paramount*, the board was controlling the shareholders rather than the shareholders controlling the board. If the board is allowed to enact programs for the specific and stated purpose of precluding shareholders from making a decision contrary to the board's deci-

122. Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 954 (Del. 1985).

123. *Id.*

124. *See* Easterbrook & Jarrell, *Do Targets Gain from Tender Offers?*, 59 N.Y.U. L. REV. 277 (1984); Jarrell, *The Wealth Effects of Litigation by Targets: Do Interests Diverge in a Merge*, 28 J.L. & ECON. 151 (1985). *But see* Lipton, *Takeover Bids in the Courtroom: An Update After One Year*, 36 BUS. LAW. 1017 (1980).

125. Grand Metro. Pub. Ltd. v. Pillsbury Co., 558 A.2d 1049, 1053 (Del. Ch. 1988); *see supra* text accompanying note 63.

sion, then it is impossible to say that the board is acting on behalf of the shareholders.

V. IMPACT

The immediate effect of the Delaware Supreme Court's decision in *Paramount* was to deprive Time's shareholders of the opportunity to sell their stock for $200 per share. Time restructured its merger agreement to preclude its shareholders from choosing the Paramount offer and realizing a $74 per share premium over the market price. In restructuring the deal, Time incurred seven to ten billion dollars of debt.[126] Time's investment bankers predicted that by the end of 1990, Time's stock would be trading in the $133 to $213 range, and that by 1993 these shares should be trading between $320 and $380.[127] Based on the current values of the stock and the company's incredible debt structure, those predictions seem unattainable.[128]

Paramount's broader effect is its disruption of the purpose underlying proportionality review. Proportionality review was adopted to unravel the blanket protection of takeover defenses provided by the *Cheff* decision.[129] In *Unocal*, the court recognized that "[a] corporation does not have unbridled discretion to defeat any perceived threat by any Draconian means available."[130] In *Paramount*, however, the court gave Time's directors the discretion to defeat Paramount's bid by incurring seven to ten billion dollars of debt. This was a Draconian response. By allowing directors such freedom, the Delaware Supreme Court returned to the *Cheff* policy that granted directors unfettered discretion to defeat any takeover attempt. After *Paramount*, incumbent management can prevent a court from disturbing its defensive tactics merely by claiming that implementing the board's stated goals will maximize

126. *See supra* text accompanying note 80.

127. Wall St. J., Mar. 7, 1990, at A19, col. 4.

128. For the second quarter of 1990, Time-Warner posted a $189 million loss after interest payments and dividends. *Id.* July 24, 1990, at B3, col. 5. Time-Warner's stock bottomed out at 65 1/8 in October 1990. The price, however, has rallied recently amid news that Time-Warner is soliciting companies in hopes of forming, in the words of Time-Warner chairman and chief executive officer Steven J. Ross: "strategic alliances." *Id.* Nov. 30, 1990, at A1, col. 1. It is not difficult to see that "strategic alliances" is, in fact, a clever euphimism for Time-Warner's desire to unload some of its debt. Perhaps not so ironically, Paramount, which is still cash rich and seeking aquisitions, has been mentioned as a potential partner for Time-Warner's startegic alliances. *Id.* at col.2.

129. Cheff v. Mathes, 41 Del. Ch. 494, 199 A.2d 548 (Del. 1964); *see supra* notes 18-26 and accompanying text.

130. Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 955 (Del. 1985); *see supra* text accompanying note 40.

shareholder wealth. Such a claim is similar to the easily documented policy conflict allegation formerly used to invoke the business judgment rule under *Cheff*. The court's functional return to *Cheff* is unfortunate. Under *Paramount*, defensive decisions are virtually immune from court challenge.

VI. CONCLUSION

The purpose of proportionality review is to allow a court to distinguish takeover defenses implemented to benefit shareholders from defenses implemented to entrench incumbent management. In *Paramount Communications, Inc. v. Time Inc.*, the Delaware Supreme Court reduced this standard of review to a rhetorical justification of all takeover defenses, even those implemented for directors' self-serving purposes.

The biggest blow to the effectiveness of the proportionality review standard was the *Paramount* court's adoption and misapplication of the threat of substantive coercion. Additionally, the court created an extremely deferential standard by applying the business judgment rule at the threshold level of analysis. Finally, the court ignored the shareholders' interest in freedom of choice and inverted the power relationship between shareholders and directors.

The immediate effects of this decision were to preclude Time's shareholders from accepting a large control premium and force them to retain ownership in a corporation of questionable profitability. The broader implication of the decision is its chilling effect on takeovers, even those that benefit shareholders.

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