Rethinking the Limits of *Revlon*'s General Prohibition: Exploring Interference in Corporate Auctions for Shareholder Value Maximization

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I. Introduction

In the realm of corporate governance and mergers and acquisitions, the *Revlon* standard has long been regarded as a guiding principle for corporate directors and officers. The *Revlon* doctrine, established by the Delaware Supreme Court in 1986, mandates that when a public company is in the process of an auction or sale, the board's primary fiduciary duty shifts from preserving the company's independence to maximizing shareholder value.[1] Under this standard, any actions taken by directors and officers that interfere with an active auction can be subject to legal scrutiny.[2]

However, in the evolving landscape of corporate transactions, questions have arisen as to whether there should be limits to *Revlon*'s general prohibition against such interference. Specifically, one may ponder whether there are circumstances in which the outcome achieved by director and officer interference could surpass what would be expected through the continuation of the auction process. Should market evidence supporting a superior outcome resulting from interference be considered? And to what extent should this assessment take into account the time value of money and cost savings associated with concluding the auction promptly?

These inquiries delve into a complex web of considerations, intertwining legal, economic, and strategic perspectives. The evaluation of auction outcomes extends beyond the mere financial metrics of bids to date; it demands a comprehensive examination of potential benefits and drawbacks. This article aims to explore the arguments for and against imposing limitations on *Revlon*'s general prohibition, while incorporating factors such as market evidence, the time value of money, and cost savings to provide a more nuanced perspective on the matter.

To address these inquiries, this article will delve into relevant legal precedents, explore economic theories, and examine practical implications through case studies and hypothetical scenarios. By shedding light on the various facets of this debate, this article seeks to contribute to a deeper understanding of the potential

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[1] Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 182 (Del. 1986).

[2] *See id.*

consequences and ramifications associated with introducing limits to *Revlon*'s general prohibition against directors and officers interfering with an active auction.

As the corporate landscape continues to evolve, it is imperative to critically evaluate established standards and adapt them to the complexities of modern business transactions. By engaging in a thorough analysis of the limits of *Revlon*'s general prohibition, one can gain valuable insights into how corporate governance practices can best serve the interests of shareholders while considering the unique circumstances surrounding each transaction.

II. ANALYSIS

A. Facts of *Revlon*

Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc. arose in the midst of two conflicting situations: "directors' attempts to preserve their gatekeeping role in the face of hostile tender offers and directors' attempts to limit the shareholders' effective voice in approving the sale or combination of their corporation."[3] Revlon's directors sought to preserve their role over the company's sale "by supporting a 'white knight' instead of a hostile bidder acquiring the corporation."[4] In doing so, the board stripped shareholders from the ability to decline the board-preferred bid.

In *Revlon*, Ronald Perelman made a hostile tender offer for Revlon.[5] Revlon's board believed Perelman's offer to be inadequate and adopted defensive measures to deter Perelman.[6] Perelman responded by increasing his offer.[7] Revlon's board responded by turning to Theodore Forstmann.[8] Perelman and Forstmann had created an auction. Both offers were solely for cash and involved the break-up of the company and the sale of its parts.[9] After the bidding war between Forstmann and Perelman, Revlon accepted

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[3] *See* Franklin A. Gevurtz, *Removing Revlon*, 70 WASH. & LEE L. REV. 1485, 1489–90 (2013).

[4] *Id.* at 1490.

[5] *Revlon*, 506 A.2d at 177.

[6] *Id.*

[7] *Id.*

[8] *Id.* at 178.

[9] *Id.* at 178–79.

Forstmann's offer despite Perelman offering more cash.[10] In addition, the Revlon board agreed to sell Forstmann an important Revlon asset at a price well below market value if anyone else acquired a substantial amount of Revlon shares.[11] Perelman subsequently sued to enjoin the deal.[12]

B. Standards of Review

To properly assess merger litigation, the standard of review is crucial. The outcome of a case often "depend[s] on what review standard is applied."[13] Most board decisions are insulated from judicial review by way of the business judgment rule, a presumption that in making a business decision, the directors of a corporation acted on a sufficiently informed basis, in good faith, and with the honest belief that the decision was in the best interest of the corporation and stockholders.[14] The business judgement rule is the most lenient standard of review. Under the business judgment rule, courts analyze a board's decisions under a procedural lens. In doing so, courts do not assess the substance or outcome of a decision, but rather the care taken in the process of making that decision.[15]

When an interested party, such as a controlling shareholder, stands on both sides of a transaction, courts invoke an entire fairness standard.[16] This standard of review is the most stringent, and considers both process and substance: fair dealing and fair price.[17] Fair dealing, the procedural aspect, includes "when the transaction was timed, how it was initiated, structured, negotiated, disclosed to the directors, and how the approvals of the directors

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[10] *Id.*

[11] *Revlon*, 506 A.2d at 178–79.

[12] *Id.*

[13] Jack B. Jacobs, *Fifty Years of Corporate Law Evolution: A Delaware Judge's Retrospective*, 5 HARV. BUS. L. REV. 141, 155 (2015); *see also* In re Cysive, Inc. Shareholders Litig., 836 A.2d 531, 547 (Del. Ch. 2003) ("[Delaware] law has so entangled the standard of review determination with the ultimate decision on the merits that the two inquiries are inseparable.").

[14] Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984).

[15] Brehm v. Eisner, 746 A.2d 244, 264 (Del. 2000).

[16] *See* Weinberger v. UOP, Inc., 457 A.2d 701, 710 (Del. 1983).

[17] *Id.* at 711.

and the stockholders were obtained."[18] Fair price "relates to the economic and financial considerations of the proposed merger, including all relevant factors: assets, market value, earnings, future prospects, and any other elements that affect the intrinsic or inherent value of a company's stock."[19]

Enhanced scrutiny is an intermediate standard of review. It applies in contexts "where application of the business judgement rule would consistently miss breaches of directors' fiduciary duties to shareholders."[20] Enhanced scrutiny most commonly applies when there is directorial resistance to a hostile takeover. Under *Unocal Corp v. Mesa Petroleum Co.*, directors who unilaterally adopt defensive measures against a hostile takeover must show "that they had reasonable grounds for believing that a danger to corporate policy and effectiveness existed"[21] and that the defensive measures adopted were "reasonable in relation to the threat posed."[22] Enhanced scrutiny also applies when a company is for sale, as seen in *Revlon*.[23] However, the *Revlon* court's analysis "can be understood as a special case of enhanced scrutiny applied to hostile takeovers."[24] Like *Unocal*, the *Revlon* decision "reiterated that boards rightfully could deploy defensive measures in response to a takeover attempt, but emphasized that there comes a time when the directors violate their fiduciary duties by continuing to employ said defensive measures."[25] *Revlon* established that a corporation's fiduciaries are required to get the "best price" for its stockholders.[26]

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[18] *Id.*

[19] *Id.*

[20] Morgan White-Smith, *Revisiting Revlon: Should Judicial Scrutiny of Mergers Depend on the Method of Payment?,* 79 U. CHI. L. REV. 1177, 1182 (2012).

[21] Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 955 (Del. 1985).

[22] *Id.*

[23] *See Revlon*, 506 A.2d at 182.

[24] *See* White-Smith, *supra* note 20, at 1183–84.

[25] Brandon Mordue, *The Revlon Divergence: Evolution of Judicial Review of Merger Litigation*, 12 VA. L. & BUS. REV. 531, 540 (2018).

[26] *See Revlon*, 506 A.2d at 182.

C. Implicating *Revlon* Duties

Under Delaware law there are generally two circumstances which may implicate *Revlon* duties. The first is when a corporation initiates an active bidding process seeking to sell itself or cause a business reorganization involving a clear break-up of the company.[27] *Revlon* duties may also be triggered where, in response to a bidder's offer, a target abandons its long-term strategy and seeks an alternative transaction involving the company's break up.

The key features of a *Revlon* enhanced scrutiny test are (a) a judicial determination regarding the adequacy of the decision-making process employed by the directors, including the information on which the directors based their decision; and (b) a judicial examination of the reasonableness of the directors' action in light of the circumstances then existing.[28] The directors have the burden of proving that they were adequately informed and acted reasonably.[29]

Revlon and its progeny have developed *how* and *when* enhanced review is applied. At first blush, *Revlon*'s enhanced scrutiny seems to be nearly identical to the substantive and procedural considerations under an entire-fairness standard. In *Paramount Communications, Inc. v. Time Inc*, the Delaware Supreme Court revealed its policy against corporate break-ups.[30] In effect, the *Paramount* opinion "undermine[s] the significance of a mere *sale* or *transfer of corporate control* in triggering the *Revlon* duty."[31] Time Inc. had entered into a merger agreement with Warner Communications, Inc. under which, "in an all stock reverse triangular merger, Warner would become a subsidiary of Time and Warner stockholders would end up owning approximately 62% of the outstanding common stock of Time."[32] The merger had to be approved by

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[27] *See, e.g.*, Mills Acquisition Co. v. Macmillan, Inc., 559 A.2d 1261 (Del. 1988).

[28] In re Baker Hughes Inc. Merger Litig., 2020 WL 6281427 at *7 (Del. Ch. Oct. 27, 2020); Paramount Communications Inc. v. QVC Network Inc., 637 A.2d 34, 45 (Del. 1994).

[29] *See* Paramount Communications Inc., 637 A.2d at 45.

[30] *See* Paramount Communications, Inc. v. Time Inc., 571 A.2d 1140 (Del. 1989).

[31] Portia Policastro, *When Delaware Corporate Managers Turn Auctioneers: Triggering the Revlon Duty After the Paramount Decision*, 16 DEL. J. CORP. L. 187, 190 (1991).

[32] J. Anthony Terell, *Revlon in Review*, 5 (Jan. 31, 2016) https://perma.cc/GZ75-VWKC.

Warner stockholders.[33] The issuance of stock by Time had to be approved by Time shareholders.[34] Paramount Communications, Inc. then made an unsolicited cash offer to purchase all outstanding shares of Time at a premium.[35] Paramount and Time stockholders brought an action seeking to enjoin the Time-Warner transaction.[36] They alleged that the original Time-Warner agreement triggered *Revlon* duties, and the Time board therefore had to maximize shareholder value in the immediate term.[37]

D. Reevaluating *Revlon*'s Limits

In *Lyondell Chemical Co. v Ryan*, the Delaware Supreme Court began its analysis by stating that *Revlon* "did not create any new fiduciary duties. . . [but] simply held that 'the board must perform its fiduciary duties in the service of a specific objective: maximizing the sale price of the enterprise.'"[38] The language in *Lyondell* supports the proposition that there should be limits on *Revlon*'s general prohibition on interference as it relates to the substance of a transaction, not the procedure. "Best price" needs to be assessed through a wider lens. Overall price is not equivalent to one's investment value. It is possible that corporate management did not receive the best short-term price knowing that shareholders' current investments are increasing. The substance of the transaction cannot be assessed at a single moment in time.

Revlon's general prohibition must also be assessed against the policy underlying *Revlon*: serving the best interests of the corporation and shareholders. Directors and officers should be allowed to interfere with an auction so long as their actions preserve the underlying policy concerns. Therefore, courts should not assess procedure and substance separately. Rather, courts should assess whether the process by which a board interfered with an auction led to a better substantive result. If interference benefits or was reasonably intended to benefit shareholders, then the procedural concerns raised in *Revlon* should be outweighed.

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[33] *Id.*

[34] *Id.*

[35] *Id.*

[36] *Id.*

[37] *Id.*

[38] Lyondell Chemical Co. v. Ryan, 970 A.2d 235, 239 (Del. 2009).

The type of method of payment should dictate the limits on enhanced scrutiny. It is "time to wipe away the mistake arising from applying *Revlon* to cover situations beyond its original foundation of choosing between two all-cash bids and thereby return Delaware takeover jurisprudence to the simpler wisdom of the unadorned Unocal test."[39] If the board's reaction to a hostile tender offer is found to constitute only a defensive response and not an abandonment of the corporation's continued existence, *Revlon* duties are not triggered, but *Unocal* duties attach.[40]

In a sale of control transaction, it is counterintuitive for management to exert the time and resources to get shareholders the best deal. Corporate directors do not have an incentive to do so if the acquisition preempts their positions. The long-term effect of the blanket *Relvon* rule also disincentivizes those who must bear the search cost of finding target companies. Consider the perspective of acquirer-company A who spends time seeking out target companies. Acquirer-company A finds a target and offers its shareholders a premium, thereby attracting companies B–E. An auction commences and company A is consistently out-bid by "tag-along" companies B, C, D, or E. Company A will eventually stop spending its resources searching for targets in which it sees the potential for growth. Subsequently, fewer auctions will take place and shareholders will be worse off in the long-run. Directors and officers must therefore interfere with auctions to ensure that shareholders can continue to benefit from acquisitions.

In order to alleviate the "tag-along" problem, corporate directors should conduct an advanced form of greenmail. Greenmail "refers to the practice of buying out a takeover bidder's stock at a premium that is not available to other shareholders in order to prevent the takeover."[41] In the case of wanting to incentivize and work with company A, corporate directors should promise company A that if another company out-bids company A, it will buy back their stock at more than 50% of the current price This allows the auction to continue and does not deter the "company A's" of the market from continuing to find target companies to acquire.

[39] Franklin A. Gevurtz, *Removing Revlon*, 70 WASH. & LEE L. REV. 1485, 1488 (2013).

[40] *See, e.g.*, Ivanhoe Partners v. Newmont Mining Corp., 535 A.2d 1334, 1345 (Del. 1987).

[41] James D. Cox & Randall S. Thomas, *Delaware's Retreat: Exploring Developing Fissures And Tectonic Shifts In Delaware Corporate Law*, 42 DEL. J. CORP. L. 323-89 (2018).

III. CONCLUSION

In conclusion, the question of whether there should be limits to *Revlon*'s general prohibition against directors and officers interfering with an active auction is a complex and multifaceted issue. This article has explored the arguments for and against imposing limitations on *Revlon*'s general prohibition, while considering factors such as market evidence, the time value of money, and cost savings.

The analysis has shown that the *Revlon* doctrine shifted the primary fiduciary duty of directors and officers from preserving a company's independence to maximizing shareholder value during an auction or sale process. However, as the corporate landscape evolves, it is necessary to reevaluate established standards and adapt them to the complexities of modern business transactions.

One key consideration is the assessment of auction outcomes beyond mere financial metrics, taking into account potential benefits and drawbacks. This requires a comprehensive examination of factors such as market evidence, the time value of money, and cost savings associated with concluding the auction promptly. By incorporating these factors, a more nuanced perspective can be gained, which takes into consideration the unique circumstances of each transaction.

In reevaluating *Revlon's* limits, it becomes clear that the general prohibition should be assessed against the underlying policy concern of serving the best interests of the corporation and shareholders. Rather than assessing procedure and substance separately, courts should consider whether interference with an auction by directors and officers ultimately leads to a better substantive result that benefits shareholders.

Furthermore, the type of payment method involved in a transaction should dictate the limits on enhanced scrutiny. Differentiating between all-cash bids and other forms of payment can help align the scrutiny level with the specific circumstances, ensuring that management's actions are properly evaluated.

Finally, the article proposes the use of an advanced form of greenmail to alleviate the "tag-along" problem and incentivize companies seeking to acquire targets. This approach allows auctions to continue while providing assurance to the initial bidder that their investment will be protected.

In conclusion, a thorough analysis of the limits of *Revlon's* general prohibition is necessary to gain valuable insights into how corporate governance practices can best serve the interests of shareholders in the evolving landscape of corporate transactions. By considering the complexities of each transaction, incorporating various factors, and

reevaluating the application of *Revlon*'s doctrine, a more balanced and nuanced approach can be achieved, ensuring that shareholder value maximization remains a primary objective while taking into account the unique circumstances of each case.