The Revlon Doctrine – The Fiduciary Duties of Directors when Targets of Corporate Takeovers and Mergers

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Traditionally, decisions of a corporation’s board of directors are insulated from judicial review and governed by the business judgment rule. The business judgment rule is a presumption that, in making a business decision, the directors of a corporation acted on an informed basis, in good faith and in honest belief that the action taken was in the best interest of the company. However, under Delaware law, if a “sale of a company” or “sale of control” is in question, courts will deviate from the business judgment rule and apply what has come to be known as the “Revlon doctrine.”

Where the Revlon doctrine applies, judicial review of a board’s decision changes in two important ways. First, a court will require that the board’s fiduciary duties, rather than focusing on the long-term interests of the corporation, are focused on serving the short-term interests of the stockholders in achieving a transaction that will maximize the immediate value of their shares. Second, if the board’s performance of these duties is challenged, the court, rather than defer to the board’s business judgment, will review the decision with “enhanced scrutiny.” Enhanced scrutiny requires independent, disinterested directors to prove: (1) that their decision-making process was performed with adequate care; and (2) that their decision was reasonable under the circumstances.

I. The Revlon Doctrine

In Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506, A.2d 173 (Del. 1986), the Delaware Supreme Court reviewed a decision by Revlon’s board of directors to sell the company to Forstmann-Little & Co. The sale was intended to block Pantry Pride, Inc.’s attempt to acquire Revlon by means of a hostile takeover. Pantry Pride countered the Forstmann-Little deal with a new proposal increasing the price of its all-cash, all-shares offer. After further attempts by the Revlon board to stymie Pantry Pride’s take over, Pantry Pride filed an action in Delaware’s Court of Chancery to enjoin the sale to Forstmann-Little and the defense measures taken by the Revlon board, alleging that the Revlon board breached its fiduciary duties to its stockholders.

The Delaware Chancery Court found in Pantry Pride’s favor and enjoined the defense measures taken by Revlon’s board. The Court held that when the board decided to “sell the company,” its duty “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.” Ultimately, because the defensive measures undertaken by Revlon’s board prevented Revlon’s stockholders from accepting Pantry Pride’s superior offer, the Revlon board’s actions were inconsistent with the board’s duty to maximize the immediate value of their shares.

A. When Revlon Duties Are Triggered

In Paramount Communications, Inc. v. QVC Network, Inc., 637 A.2d 828 (Del. 1993), the Delaware Supreme Court clarified some of the circumstances that trigger Revlon. As such, Revlon duties will apply to any transaction in which corporate control passes to a third party, including a sale or merger for cash or debt securities, or a merger for securities (even a strategic merger) that transfers control to a private company or to a public company with majority shareholder. Revlon duties also will apply when a company determines to sell itself for
cash through an active bidding process, or a transaction of business reorganization will cause a clear break-up of the company.

Conversely, the Delaware Court of Chancery has held that Revlon duties should not apply to (i) the process of evaluating whether to accept an acquisition proposal; (ii) a situation in which a company with a strategic plan rejects an unsolicited offer; or (iii) a transaction that does not result in a transfer of control, such as a merger of equals or a common stock merger with a widely held public company.

**B. Enhanced Scrutiny**

When the Revlon doctrine applies, the Paramount court explains that a court’s enhanced judicial scrutiny will include: (i) 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 (ii) a judicial examination of the reasonableness of the directors’ action in light of the then-existing circumstances. The corporation’s board will bear the burden of proof to show that they followed a reasonable decision-making process. Through a fact-intensive review of the circumstances that led to the sale of the company, the court will look at the reasonableness of each decision made by the board throughout the sales process. At each decision point, the court will inquire whether the board’s actions were within the range of decisions that would have been reasonable in the circumstance.

**II. Conclusion**

There is no single blueprint that a board must follow to fulfill its duties. However, following Revlon and its progeny, the Delaware Court of Chancery has held that when it evaluates a sale of a corporation or a sale of control, it will apply enhanced judicial scrutiny, rather than the business judgment rule, and a board’s fiduciary duty will shift from a duty to preserve the corporate entity to a duty to maximize value for the shareholders.

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