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AOL Time Warner and the False God of Shareholder Primacy

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I. INTRODUCTION

The merger between America Online (AOL) and Time Warner is almost universally regarded as a disaster.[1] Announced at the beginning of 2000, the combination was heralded as ushering in a new age of Internet dominance. After all, AOL—a company only fifteen years old—was taking a majority stake in the merger with perhaps the preeminent entertainment and media company of the era. AOL had bought Time Warner! If further proof of the triumph of clicks over bricks had been necessary, the merger sealed the deal.

But only two months later, the tech market took its first major hit and never recovered. AOL, in particular, was a serious casualty. At the end of 2003, shareholders in AOL Time Warner had lost over $200 billion in equity value.[2] By then the chief architects of the deal—Time Warner's Gerald Levin and AOL's Stephen Case—had left

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1. *See, e.g.*, NINA MUNK, FOOLS RUSH IN: STEVE CASE, JERRY LEVIN, AND THE UNMAKING OF AOL TIME WARNER (2004); KARA SWISHER, THERE MUST BE A PONY IN HERE SOMEWHERE: THE AOL TIME WARNER DEBACLE AND THE QUEST FOR A DIGITAL FUTURE (2003).

2. MUNK, *supra* note 1, at 277.

the company, along with most of the former AOL executives who had initially run the combined company.[3] Fines paid to the SEC for accounting improprieties topped $300 million,[4] $3 billion will be paid to settle civil class action suits,[5] and in 2002 the company suffered a historic $99 billion write-down in goodwill. Even the name was changed—starting out as AOL Time Warner, the company's board later elected to drop the "AOL," as if to purge the stigma.[6] It is no wonder that the merger has been called "catastrophic,"[7] "the worst deal in history,"[8] and "the champion of all failed mergers."[9]

A deal this big and this bad is bound to have dramatic effects. However, little has been written about what the deal and its failures mean for corporate law. In my view, the cultures of the companies, both pre- and post-merger, present a great opportunity to discuss what "shareholder primacy" actually means in the context of corporate America. Although by no means universally held, the consensus among prominent corporate law scholars is that the corporation must be run to maximize shareholder value. This conclusion is so strongly held that two preeminent scholars have declared that there is no room for further debate on the subject.[10] However, the notion of shareholder primacy in practice is something that commentators have left largely unconsidered. What exactly does it mean to run a company for the sole benefit of the shareholders, and what effects would this focus have on the life of the company?

The AOL Time Warner merger offers a unique case study for the examination of this question. As journalistic accounts from books and articles about the merger demonstrate, the executives at AOL believed in the faith of shareholder primacy. They focused their efforts almost entirely on the stock price and believed they had a moral obligation to maximize shareholder value. Time Warner, on the other hand, had a culture that placed the institution above the shareholder, and journalistic ethics above any requirement to make short-term profits. The resulting culture clash between the two companies is instructive. AOL, in its efforts to boost share price, aggressively set and then met quarterly earnings targets throughout the late 1990s. Executives cared little about accounting proprieties or long-term client relationships; instead, the focus was solely on performing up to Wall Street's expectations. This worship of the shareholder and the share price led AOL to mislead investors and neglect its core businesses. While AOL went into the merger thinking its aggressive culture was going to transform the

3. ROBERT F. BRUNER, DEALS FROM HELL: M&A LESSONS THAT RISE ABOVE THE ASHES 275-78 (2005).

4. Carrie Johnson, *Time Warner, SEC Settle AOL Fraud Charges*, WASH. POST, Mar. 22, 2005, at E1, *available at* http://www.washingtonpost.com/wp-dyn/articles/A53801-2005Mar21.html.

5. Richard Siklos, *Time Warner Offers $3 Billion to End AOL Hangover*, N.Y. TIMES, Aug. 4, 2005, at C1.

6. BRUNER, *supra* note 3, at 287 (noting that the erasure of the AOL name, combined with all of the other fallout from the merger, "reveal[s] a remarkable wipeout of the vision of the deal's architects").

7. ALEC KLEIN, STEALING TIME: STEVE CASE, JERRY LEVIN, AND THE COLLAPSE OF AOL TIME WARNER 294 (2003).

8. SWISHER, *supra* note 1, at 9.

9. Gretchen Morgenson, *What Are Mergers Good For?*, N.Y. TIMES, June 5, 2005, (Magazine), at 56, 58. Even *The Onion* has chimed in. *See Ted Turner Sends Self Back in Time to Prevent AOL Time Warner Merger*, THE ONION, Mar. 12, 2003, at 1, 8, *available at* http://www.theonion.com/content/node/27938.

10. Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 GEO. L.J. 439 (2001).

underperforming Time Warner, ultimately AOL executives burned themselves out, leaving the merged company almost entirely in the hands of Time Warner management. That management remains ensconced, easily rebuffing recent shareholder efforts to assert a new direction for the company.

In Part I of the Article, I briefly discuss shareholder primacy as a belief system—its tenets, its utopian claims, its factions. Part II discusses the history of the two companies before, during, and after the infamous merger. And Part III attempts to draw some lessons about the practice of shareholder primacy in corporate life, and the potential perils of shareholder zealotry.

II. THE PRECEPTS OF SHAREHOLDER PRIMACY

Shareholder primacy is the core concept of U.S. corporate law. Although there are various approaches to the concept, shareholder primacy generally means that corporations exist to serve the interests of shareholders.[11] The basic structural component of shareholder primacy is the right of shareholders to elect the board of directors.[12] Because the board is the locus of final authority within the corporation, the right to choose the board gives shareholders ultimate authority. In addition, shareholders are granted rights to vote on essential corporate decisions, such as mergers and the sale of substantially all of the corporation's assets.[13] Shareholders are generally given the right to amend the corporation's charter,[14] and in some jurisdictions may retain the power to amend corporate by-laws.[15] In addition, federal regulations permit shareholders to propose resolutions,[16] and proposed regulations would give shareholders the ability to use the corporation's proxy mechanisms in nominating new members for the board.[17]

However, the concept of shareholder primacy extends well beyond these structural mechanisms. Shareholder primacy is a theory—a belief system, if you will—that maximizing shareholder wealth is in the best interests of society. Scholars have referred to the notion that corporations should seek primarily, if not solely, to maximize returns to their shareholders as the shareholder primacy norm[18] or the shareholder wealth maximization norm.[19] This norm is much more than a descriptive account of shareholders' rights; it is instead a normative judgment on the most socially efficient way of organizing the economy. Proponents of this norm argue that we will maximize our utility as a society only through a system of corporate law that recognizes and perpetuates shareholder primacy.

11. *See* D. Gordon Smith, *The Shareholder Primacy Norm*, 23 J. CORP. L. 277, 277 (1998) ("The structure of corporate law ensures that corporations generally operate in the interests of shareholders.").

12. *See, e.g.*, DEL. CODE ANN. tit. 8, § 212 (2004).

13. *See, e.g.*, *id.* § 251.

14. *See, e.g.*, *id.* § 242.

15. *See, e.g.*, *id.* § 109(b). *But see* OKLA. STAT. tit. 18, § 1013 (2004).

16. Proxy Rule 14a-8, 17 C.F.R. § 240.14a-8 (2004).

17. *See* Div. of Corp. Fin., Sec. & Exch. Comm'n, Staff Report: Review of the Proxy Process Regarding the Nomination and Election of Directors, [2003 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 86,938 (July 15, 2003).

18. Smith, *supra* note 11, at 278 & n.1.

19. Stephen M. Bainbridge, *In Defense of the Shareholder Wealth Maximization Norm: A Reply to Professor Green*, 50 WASH. & LEE L. REV. 1423, 1425 (1993).

Modern shareholder primacy can be traced back to the seminal work of Adolf Berle and Gardiner Means: *The Modern Corporation and Private Property*.[20] This oft-cited[21] work espouses the central tenet of the primacy movement: the separation of ownership and control in the modern corporation.[22] The corporation is owned by the shareholders but controlled by management. Resolving the effects of this separation provides the fundamental koan of modern corporate scholarship.[23]

In the 1970s and 1980s economists and corporate law scholars developed the "nexus of contracts" model for the corporation.[24] Instead of being the "owners" of the corporation, shareholders were one group of many whose contracts with one another jointly created the fictional corporate "entity."[25] However, shareholders were the sole "residual claimants:" their returns were not payable until the other contractual participants—creditors, employees, customers, suppliers—had been fully satisfied.[26] To maximize social wealth, the corporation's organizing principle needed to be the maximization of the residual returns payable to shareholders. In this way, all other claimants received their contractual entitlements, and the shareholders benefited from the maximization of the residual.

As a norm, shareholder primacy offers guidance to a range of activities. In law, the notion of shareholder primacy grounds our conception of the corporation itself. Perhaps the most familiar encapsulation is the following passage from *Dodge v. Ford Motor Co.*:

> A business corporation is organized and carried on primarily for the profit of the stockholders. The powers of the directors are to be employed for that end. The discretion of directors is to be exercised in the choice of means to attain that end, and does not extend to a change in the end itself, to the reduction of profits, or to the nondistribution of profits among stockholders in order to devote them to other purposes.[27]

According to this formulation, directors are not only elected by shareholders; they are

20. ADOLF A. BERLE & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY (1932).

21. A search for "'Modern Corporation and Private Property' and Berle" returned 924 results in the "Journals and Law Reviews" Database on Westlaw. *Cf.* Roberto Romano, *Metapolitics and Corporate Law Reform*, 36 STAN. L. REV. 923, 923 (1984) ("A survey of the literature suggests that the last major work of original scholarship was Adolf Berle and Gardiner Means' *The Modern Corporation and Private Property*.").

22. BERLE & MEANS, *supra* note 20, at 6.

23. *Cf.* David A. Westbrook, *Corporation Law After Enron: The Possibility of a Capitalist Reimagination*, 92 GEO. L.J. 61, 70 (2003) (referring to "Adolph Berle and Gardiner Means' discussion of the corporation as a drama enacted between shareholders and management").

24. FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 1-39 (1991); Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305, 310-11 (1976) (suggesting that nature of firm as nexus for contracting relationships moots discussions of precise corporate boundaries).

25. EASTERBROOK & FISCHEL, *supra* note 24, at 36.

26. *Id.* at 36-37. This perspective assumes that all other claimants have rigidly-set contractual entitlements, such that paying them more would be akin to a gift.

27. Dodge v. Ford Motor Co., 170 N.W. 668, 684 (Mich. 1919). Despite this oft-quoted expression of the shareholder primacy norm, Gordon Smith has a persuasive reading of the *Dodge* case as an example of minority shareholder oppression. Smith, *supra* note 11, at 315-20.

also duty-bound to use their discretion only to select the best way of maximizing shareholder profits.

Proponents of shareholder primacy thus believe that the law should orient itself to enforce and reinforce the primacy norm. For example, the norm underlies much of the scholarly analysis on mergers and acquisitions, particularly hostile takeovers. Since the early 1980s commentators have debated the legality and wisdom of various techniques used by boards to fend off or defeat hostile takeover attempts.[28] Devices such as poison pills, lock-ups, and staggered boards have been sharply criticized for their power to diminish shareholder value.[29] Shareholder proponents view the market for corporate control as a useful constraint on managerial opportunism. More importantly, the control market serves as a way of maximizing shareholder value.[30] Since hostile takeovers are generally proposed through a tender offer to shareholders, the offer must be attractive to shareholders to have any chance of success. Defensive techniques are generally a method of thwarting the shareholders' desire (either actual or predicted) to take part in the offer. These techniques thereby threaten to diminish shareholders' returns in the interest of managerial self-protection.[31]

The clearest victory for shareholder primacy in the law of mergers and acquisitions is *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc*.[32] In *Revlon*, the court held that directors have a duty to maximize shareholder returns when conducting an auction for the sale of control of the corporation.[33] Once the sale of the company was ensured, "[t]he duty of the board had thus changed from the preservation of Revlon as a corporate entity to the maximization of the company's value at a sale for the stockholders' benefit."[34] In other words, the duty of the directors was "getting the best price for the stockholders at a sale of the company."[35]

Shareholder primacy has had less success in other areas of takeover law. The *Paramount v. Time, Inc.*[36] case is a noted counter-example; in that case, the Delaware Supreme Court held that Time could legally structure a combination with Warner Brothers to avoid a shareholder vote. Such evasive actions were necessary as Paramount had offered Time shareholders $200 a share, well above the roughly $110 a share at which the shares had been trading. The court stated that "absent a limited set of circumstances as defined under *Revlon*, a board of directors, while always required to act

28. *See, e.g.*, Frank H. Easterbrook & Daniel R. Fischel, *The Proper Role of a Target's Management in Responding to a Tender Offer*, 94 HARV. L. REV. 1161 (1981); Larry E. Ribstein, *Takeover Defenses and the Corporate Contract*, 78 GEO. L.J. 71 (1989); Robert B. Thompson & D. Gordon Smith, *Toward a New Theory of the Shareholder Role: "Sacred Space" in Corporate Takeovers*, 80 TEX. L. REV. 261 (2001).

29. *See, e.g.*, Lucian Ayre Bebchuk, John C. Coates IV & Guhan Subramanian, *The Powerful Antitakeover Force of Staggered Boards: Theory, Evidence, and Policy*, 54 STAN. L. REV. 887 (2002); Julian Velasco, *The Enduring Illegitimacy of the Poison Pill*, 27 J. CORP. L. 381 (2002).

30. *See* EASTERBROOK & FISCHEL, *supra* note 24, at 113 ("Self-interest thus assures us that changes of corporate control, like other voluntary exchanges, move assets to higher valued uses.").

31. Corporate constituency statutes allow the board to consider non-shareholder constituencies such as employees, creditors, customers, suppliers, and even communities in making decisions in the course of a proposed merger or acquisition. *See, e.g.*, N.Y. BUS. CORP. § 717(b) (2005).

32. 506 A.2d 173 (Del. 1986).

33. *Id.* at 185.

34. *Id.* at 182.

35. *Id.*

36. 571 A.2d 1140 (Del. 1989).

in an informed manner, is not under any *per se* duty to maximize shareholder value in the short term, even in the context of a takeover."[37] The court also recognized that the board may take into account a variety of factors in defending against a hostile takeover, including "the impact on 'constituencies' other than shareholders."[38] More generally, over thirty states have passed corporate constituency statutes that expressly allow directors to consider non-shareholder interests, particularly in the takeover context.[39]

Despite mixed evidence about the law's relationship to shareholder primacy, the legal academy has undoubtedly embraced this norm.[40] The bulk of corporate scholars agree that shareholder wealth maximization is the most socially efficient organizing principle for corporate law. In fact, many of the contemporaneous debates over corporate policy take the norm as the starting point, and then wrestle over the best way of achieving it. Recent scholarly acceptance of defensive mechanisms, such as the poison pill, for example, has come not from an embrace of managerialism, but rather from the notion that poison pills may actually help boards achieve maximum value for their shareholders.[41] Similarly, longtime shareholder primacist Stephen Bainbridge has recently adopted a model of director primacy, in which he describes the board of directors as "a *sui generis* body—a sort of Platonic guardian—serving as the nexus for the various contracts comprising the corporation."[42] However, he still believes shareholder wealth maximization should be the goal of the firm; director primacy is simply the best method of attaining it.[43]

As the dispute over the best means to effectuate the norm demonstrates, shareholder primacy is the dominant normative theory of the corporation. As Kraakman and Hansmann put it in their "end-of-days" article: "There is no longer any serious competitor to the view that corporate law should principally strive to increase long-term shareholder value."[44] While acknowledging the argument that this dominance may prove "ephemeral,"[45] they argue that the logic of the model's efficiency, along with the performance of shareholder-based economies, will dictate the model's continued success.[46] The increasing size of the shareholder class in the United States, Europe, and Japan will bring additional converts to the cause.[47] Ultimately, Kraakman and Hansmann conclude: "The triumph of the shareholder-oriented model of the corporation over its principal competitors is now assured, even if it was problematic as recently as twenty-

37. *Id.* at 1150.

38. *Id.* at 1153 (quoting Unocal Corp. v. Mesa Petrol. Co., 493 A.2d 946, 955 (Del. 1985)).

39. Einer Elhauge, *Sacrificing Corporate Profits in the Public Interest*, 80 N.Y.U. L. REV. 733, 737 (2005).

40. Stephen M. Bainbridge, *Director Primacy in Corporate Takeovers: Preliminary Reflections*, 55 STAN. L. REV. 791, 798 n.35 (2002) ("Today, most corporate law scholars embrace some variant of shareholder primacy.").

41. *See, e.g.*, Jennifer Arlen & Eric Talley, *Unregulable Defenses and the Perils of Shareholder Choice*, 152 U. PA. L. REV. 577 (2003); Marcel Kahan & Edward B. Rock, *How I Learned to Stop Worrying and Love the Pill: Adaptive Responses to Takeover Law*, 69 U. CHI. L. REV. 871 (2002).

42. Stephen M. Bainbridge, *Director Primacy: The Means and Ends of Corporate Governance*, 97 NW. U. L. REV. 547, 550-51 (2003).

43. *Id.* at 550; Bainbridge, *supra* note 40, at 794-95.

44. Hansmann & Kraakman, *supra* note 10, at 439.

45. *Id.* at 450.

46. *Id.* at 449-51.

47. *Id.* at 451-53.

five years ago."[48]

However, one issue has remained problematic to shareholder primacists, even in the face of such dominance in the marketplace of ideas. Ultimately, shareholder primacy is about the governing principles behind the corporation. However, there is very mixed evidence about whether those who actually run corporations believe in shareholder primacy. In assessing this question, Gordon Smith determined that "the influence of the shareholder primacy norm on ordinary business decisions is an empirical question not susceptible to a ready answer."[49] Nevertheless, Smith noted that at least one study of director behavior found "widespread ambivalence" about shareholder primacy.[50] According to the study, most directors balanced many constituencies when making corporate decisions.[51] In a similar vein, Lynn Stout has noted the prevalence of a variety of powerful tools against hostile takeover efforts and tender offers.[52] These tools are antithetical to shareholders' rights advocates, and yet they are found in most corporations. Recent studies demonstrate the continued popularity of poison pills and classified boards, even though these devices arguably lessen shareholder value.[53] If corporations and their directors were truly oriented toward shareholder primacy, goes the argument, then such devices would be far less common. Overall, there is significant evidence that firms are oriented toward managerial or stakeholder prerogatives in making corporate decisions.

One area in which shareholder primacy has influenced corporate behavior is executive compensation. In an influential article in the *Harvard Business Review*, Michael Jensen and Kevin Murphy argued that executive compensation should be directly linked to the value of the firm's shares.[54] Instead of worrying that CEO pay was too high, the authors contended that firms must make sure that their CEO's incentives were aligned with those of the shareholders. Instruments such as stock options were well-suited to give executives an incentive to pay attention to stock price. Stock options, in fact, amounted to a win-win for shareholders: executives would only profit from them when the shareholders had profited as well. Jensen and Murphy's hypothesis was influential in the legal academy and remains so.[55] But their ideas also changed the shape

48. *Id.* at 468.

49. Smith, *supra* note 11, at 290.

50. *Id.* (citing JAY W. LORSCH & ELIZABETH MACIVER, PAWNS OR POTENTATES: THE REALITY OF AMERICA'S CORPORATE BOARDS 38 (1989)).

51. *Id.* at 290-91.

52. Lynn A. Stout, *Bad and Not-So-Bad Arguments for Shareholder Primacy*, 75 S. CAL. L. REV. 1189, 1206 (2002).

53. *See, e.g.*, Bebchuk, Coates & Subramanian, *supra* note 29, at 895 ("Today, among a sample of 2,421 large public U.S. companies, 59% have staggered boards."); Robert Daines & Michael Klausner, *Do IPO Charters Maximize Firm Value? Antitakeover Provisions in IPOs*, 17 J.L. ECON. & ORG. 83, 85 (2001) (finding that roughly two-thirds of sampled IPO charters had antitakeover provisions).

54. Michael C. Jensen & Kevin J. Murphy, *CEO Incentive—It's Not How Much You Pay, But How*, 68 HARV. BUS. REV. 138 (1990).

55. *See, e.g.*, Roberta Romano, *The Sarbanes Oxley Act and the Making of Quack Corporate Governance*, 114 YALE L.J. 1521, 1539 (2005) ("Because executive loans in many cases appear to serve their purpose of increasing managerial stock ownership, thereby aligning managers' and shareholders' interests, the blanket prohibition of executive loans in [the Sarbanes-Oxley Act] is self-evidently a public policy error."). Even Lucien Bebchuk & Jesse Fried, critics of current executive compensation policies, agree that compensation should be tied to the corporation's stock performance. LUCIAN BEBCHUK & JESSE FRIED, PAY WITHOUT PERFORMANCE: THE UNFULFILLED PROMISE OF EXECUTIVE COMPENSATION 19-20 (2004).

of executive compensation. Between 1980 and 1994, the percentage of CEOs holding stock options in their firm increased from 30% to almost 70%.[56] In 1996, CEOs at 111 of the nation's 200 largest companies had received stock option packages valued at over $10 million.[57] Stock options were truly the pay revolution of the late twentieth century.[58]

As will be discussed below, stock options were an important part of the culture at AOL—a culture that seems to have been shaped by the precepts of the shareholder primacy norm. The AOL-Time Warner merger thus presents a unique opportunity. As developed further below, the companies involved in the merger reflected two schools of corporate thought: AOL embodied the shareholder primacy model, and Time Warner followed a more traditional managerialist path. The fate of these companies before, during, and after the merger provides some evidence about the effects of these models when applied to actual corporate governance.

III. THE AOL-TIME WARNER MERGER: A TALE OF TWO ORTHODOXIES

If one were looking to compare the differences between the traditional "managerialist" or "stakeholder" theory of the corporation and the "shareholder primacy" norm, perhaps no two companies could provide better examples of each approach than Time Warner and America Online. Time Warner and its predecessor, Time Inc., were companies that had consistently hearkened back to the importance of company traditions of journalistic integrity and excellence. In fact, this mission had clearly risen above any commitment Time might have had to its shareholders. In contrast, America Online immersed itself in the boom of the go-go 1990s, and eventually organized its business largely to facilitate an ever-increasing stock price. The merger of these companies thus provided a clash of cultures—a clash that was won initially by AOL, but now sees Time Warner reigning triumphant. Before discussing the merger, however, I begin by talking more in depth about the different companies and their cultures before the merger.

A. Time Warner and the Protection of Corporate Culture

Born to American missionaries in China, Henry Robinson Luce founded Time Incorporated with a sense of mission and moral certainty.[59] Its premier product, *Time* Magazine, became immensely popular for its relatively shorter articles with a crisp, distinctive style. Soon thereafter, the company introduced *Fortune*, *Life*, and *Sports Illustrated* to the American scene.[60] Although financially successful, Luce saw the company's primary mission as its journalistic enterprise. Rather than taking the title of "chairman" or "president," Luce referred to himself as "editor in chief" of the company.[61] The locus of power within the company was the editorial staff; Time

56. Brian J. Hall & Jeffrey B. Liebman, *Are CEOs Really Paid Like Bureaucrats?*, 113 Q.J. ECON. 653, 663 (1998).

57. *See* Rachel Emma Silverman, *Your Career Matters: The Jungle*, WALL ST. J., Nov. 9, 1999, at B18.

58. ROGER LOWENSTEIN, ORIGINS OF THE CRASH: THE GREAT BUBBLE AND ITS UNDOING 15 (2004) (noting that Jensen and Murphy's "call to arms . . . reverberated in the counsels of compensation consultants").

59. MUNK, *supra* note 1, at 3.

60. *Id.* at 5.

61. *Id.* at 9.

employees on the business side were sometimes referred to as "galley slaves."[62] In fact, moneymaking was seen as somewhat undignified.[63] Although Luce recognized the importance of returning value to his shareholders, he did not see that as the overriding mission of the corporation. "Time Incorporated is now, and is expected to continue to be, principally a journalistic enterprise," Luce said, "and, as such, an enterprise operated in the public interest as well as in the interest of its stockholders."[64]

Even after Luce's passing, Time, Inc. continued to have a strong corporate culture devoted to its journalistic traditions. Luce's handpicked successor, Andrew Heiskell, admitted that he didn't know what a balance sheet was when he started his job.[65] Later leaders of Time made greater efforts to accommodate Wall Street; Nick Nicholas, who took over in 1986, made a greater return on equity his highest priority.[66] However, Time's culture and traditions stayed strong. In fact, former CEO Gerald Levin has noted that Time possesses an "immunological system" that rejects influences from outsiders.[67]

It was the power of that culture that drove perhaps the most famous takeover controversy of the late 1980s takeover boom. In 1987, Time and Warner Communications, home of the famous Warner Brothers Studio, began merger talks. Nicholas and his right hand man at the time, Gerald Levin, were convinced that Time needed a "transforming transaction" to bring it into the new world of media and entertainment convergence.[68] After talking with Stephen Ross, CEO and Chairman of Warner, the Time executives moved forward with plans for a merger. But many at Time, particularly board members, were worried about the clash of cultures involved. The board eventually agreed to the deal, but on the condition that Time's culture would remain intact.[69] The leadership of the combined company was structured so that, after a period of co-CEOs, Nicholas would take over the combined company and Ross would retire.[70] After two years of negotiations, the companies announced plans for a stock-for-stock merger.

Two weeks before the shareholders voted on the merger, Paramount Communications sprung a surprise $175 tender offer for Time, Inc. shares. The offer was soon upped to $200. The Time leadership was stunned. Their carefully planned merger was threatened with an outright buyout of the company. And even though the Time board members had concerns about the corporate culture at Warner, they had much greater concerns about Paramount.[71] Moreover, the Paramount buyout would have nothing to ensure the preservation of Time's corporate culture through its continued control of the company. Time executives saw that the survival of their company (as well as their jobs) was at stake.

To avoid a shareholder vote, which might very well defeat the merger, Time and

62. *Id.*
63. *Id.*
64. MUNK, *supra* note 1, at 3.
65. *Id.* at 26.
66. *Id.* at 30.
67. *Id.* at 31.
68. *Id.*
69. MUNK, *supra* note 1, at 36.
70. *Id.* at 36-37.
71. *Id.* at 37 (noting that Time executives viewed Paramount CEO Martin Davis as an "unprincipled parvenu" and a "son of a bitch").

Warner restructured their merger as a buyout of Warner by Time. Warner was a significantly larger company, and Time would have to take on a massive amount of debt to buy out the Warner shareholders at a generous price. But the buyout would allow the merger to go forward without a Time shareholders' vote.[72] The board and executive structure would remain the same as had been worked out in the merger. Although a drastically different method of combination from a financial perspective, the buyout was essentially a way of preserving the merger by avoiding Time shareholders.

Paramount, as well as some Time shareholders, sued to block the buyout. Such a buyout was, in their eyes, a blatant effort to contravene shareholder preferences to preserve executives' positions and powers. However, in decisions that surprised and dismayed many corporate commentators, both the Delaware Court of Chancery and the Delaware Supreme Court refused to enjoin the buyout. Essential to these decisions was the notion that Time, Inc. had a special "culture" that the board was seeking to protect. In his discussion of Time's long range strategic planning, Chancellor Allen noted that the company had manifested "a desire to maintain an independent Time Incorporated that reflected a continuation of what management and the board regarded as distinctive and important 'Time culture.'" [73] Allen found that: "This culture appears in part to be pride in the history of the firm—notably *Time* Magazine and its role in American life—and in part a managerial philosophy and distinctive structure that is intended to protect journalistic integrity from pressures from the business side of the enterprise."[74] In fact, Allen stated that: "The mission of the firm is not seen by those involved with it as wholly economic, nor the continued existence of its distinctive identity as a matter of indifference."[75] Despite this, Allen found that "there is insufficient basis to suppose at this juncture that such concerns have caused the directors to sacrifice or ignore their duty to seek to maximize in the long run financial returns to the corporation and its stockholders."[76] Finding the combination to be a reasonable response to hostile tactics, Allen denied the motion to enjoin the buyout.

The Delaware Supreme Court affirmed. It echoed Allen's findings, stating that: "The record attests to the zealousness of Time's executives, fully supported by their directors, in seeing to the preservation of Time's 'culture,' i.e., its perceived editorial integrity in journalism."[77] In upholding Time's efforts to avoid a shareholder vote, the court noted: "Directors are not obliged to abandon a deliberately conceived corporate plan for a short-term shareholder profit unless there is clearly no basis to sustain the corporate strategy."[78]

The Delaware Supreme Court thus pitched the *Paramount v. Time* decision as a victory for long-term corporate interests over short-term shareholder profiteering. But

72. The structure of the buyout was as follows: "Time would make an immediate all-cash offer for 51% of Warner's outstanding stock at $70 per share. The remaining 49% would be purchased at some later date for a mixture of cash and securities worth $70 per share." Paramount Commc'ns, Inc. v. Time, Inc., 571 A.2d 1140, 1148 (Del. 1989).

73. Paramount Commc'ns Inc. v. Time, Inc., Civil Action Nos. 10866, 10670, and 10935, 1989 WL 79880, at *4 (Del. Ch. July 14, 1989).

74. *Id.*

75. *Id.* at *7.

76. *Id.*

77. *Paramount*, 571 A.2d at 1152.

78. *Id.* at 1154.

many viewed the decision as a triumph of managerialism over shareholders' rights. The overwhelming response from commentators was criticism of the decision.[79] Shareholders' advocate Robert A.G. Monks described the case as "the greatest incursion in United States business history into the rights of shareholders."[80] In contrast, Gerald Levin recently described the decision like this: "What a beautiful thing."[81]

After the merger, Time executives consolidated their power over the combined company, although Levin, not Nicholas, emerged as the new CEO.[82] Levin continued to pursue a growth strategy, expanding cable operations and acquiring Turner Broadcasting in 1995.[83] However, Time Warner's internal efforts to break into electronic commerce and the Internet resulted in failure.[84] By the end of the decade, Levin was looking for another "transforming transaction" to bring the company into the digital age.

B. America Online: From Internet Evangelism to Profit Maximization

America Online began its life as a humble startup hawking an application for the Atari 2600 video game system.[85] The company, then known as Control Video Corporation, had been founded by "serial entrepreneur" Bill Von Meister in the early 1980s.[86] After the Atari application flamed out, the company switched to online services and reincorporated as Quantum Computer Services.[87] The original online service, known as Q-Link, soon developed a devoted following and eventually was renamed America Online.[88] By the mid-1980s, the company was being run by James Kimsey as CEO and Stephen Case as his second in command. Case was responsible for perhaps the most important deal in the company's early history: an exclusive deal to manage an online service for Apple Computer.[89] By the late 1980s, Case had established himself as the de facto head of the company. In 1991, he became CEO.[90]

As leader and CEO, Case was known for his grand, almost messianic vision. Case had an "unshakable" belief in the future of the company and its services.[91] For him, the purpose of the company was the promotion of this new method of interactivity—a new mode of human contact. He cultivated this sense of mission amongst his employees. As one AOL executive put it: "To the people at AOL, AOL is not just a company, it's a

79. *Cf.* Edward B. Rock, *Saints and Sinners: How Does Delaware Corporate Law Work?*, 44 UCLA L. REV. 1009, 1075 (1997) ("The Delaware Supreme Court's decision in *Time-Warner w*as widely viewed as the complete undermining of *Revlon* and as an endorsement of the 'just-say-no' defense.").

80. ROBERT A.G. MONKS & NELL MINOW, CORPORATE GOVERNANCE 350 (2d ed. 2001).

81. MUNK, *supra* note 1, at 40.

82. *Id.* at 43-44.

83. *Id.* at 54.

84. KLEIN, *supra* note 7, at 69-78; SWISHER, *supra* note 1, at 90-94.

85. SWISHER, *supra* note 1, at 25.

86. *Id.* at 24-25.

87. *Id.* at 28-29.

88. *Id.* at 31-32.

89. MUNK, *supra* note 1, at 77.

90. *Id.* at 78. Case was forced to step down briefly prior to the company's IPO in 1992, due to concerns about his youth and inexperience. *Id.*; SWISHER, *supra* note 1, at 33-34. However, he was reinstated later in 1992.

91. MUNK, *supra* note 1, at 71.

religion. If AOL is your religion, Steve is your spiritual leader."[92] Particularly in the early years, Case rejected opportunities to cash out to pursue his long-term vision. One critical moment was a $50 million buy-out offer from CompuServe, then the market leader in online services. Then-CEO Kimsey was interested in the offer, but Case adamantly insisted on rejecting it.[93] For him, the company's mission was more important than selling out at a high price.[94]

Admittedly, there was an underside to the highfalutin' rhetoric. Commentators believe that AOL's early growth was due, in large part, to members engaged in emailing, chatting, and even exchanging e-files all about sex. Unlike other online providers, AOL was happy to let its users indulge in these activities, and, as a result, it soon surpassed its rivals.[95] In addition, the company used questionable accounting practices for new subscribers and marketing revenue to improve its short-term financials. These practices would lead to a $385 million write-off in 1996, and accusations that the company was "morally bankrupt."[96]

During the 1990s, the Internet changed from a fad to the future. And America Online changed from a dalliance for the few into the primary vehicle for America to get online. Along the way, the company suffered inevitable growing pains from its incredible expansion. After surviving the initial effort by Microsoft to enter the market, AOL surged in popularity when it chose to go to a flat-fee system.[97] However, the company was ill-equipped for the jump in usage, leading to blackouts and widespread busy signals.[98] Although Case had been a superb visionary, there was increasing consensus that AOL needed a new CEO who could handle these very different circumstances.[99] The focus on membership had come at a cost to the bottom line, and Wall Street prognosticators were itching to finally see the company make a profit.[100] To appease these concerns, in October 1996, AOL hired Robert Pittman to manage the daily operations of the company.[101]

Known to some as Bob "Pitchman," Pittman was well-known for co-founding MTV and managing the Six Flags amusement parks for Time Warner.[102] Although he had been enormously successful in these ventures, Pittman had acquired a reputation as

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92. *Id.* One former executive described his AOL experience like this: "There are very few times in your business life that you truly believe with a capital B. When it happens, it's like your first love—you never forget it. You never forget the time you really, really frickin' believed." *Id.* at 80.

93. *Id.* at 77; SWISHER, *supra* note 1, at 32-33.

94. Kimsey later reported that he would have taken the offer if CompuServe had offered $60 million. SWISHER, *supra* note 1, at 33.

95. Or, as *Wall Street Journal* reporter Kara Swisher opined, AOL outdistanced rivals like Prodigy "precisely because on AOL someone could type the word *f*[***]." *Id.* at 41.

96. *Id.* at 56-57 (quoting short seller David Rocker). Former CEO Kimsey described the accounting issue as "the big turd" that "sat in the middle of the company and smelled up the place." *Id.* at 57. Short-seller Rocker claimed that for AOL, "every revenue is ordinary, and every expense is extraordinary." *Id.*

97. MUNK, *supra* note 1, at 84.

98. *Id.*

99. *Id.* at 83-84.

100. SWISHER, *supra* note 1, at 49-50.

101. MUNK, *supra* note 1, at 84; SWISHER, *supra* note 1, at 52. Pittman was hired as president of AOL Networks. *Id.*

102. SWISHER, *supra* note 1, at 53-54.

being "more interested in short-term fixes than in long-term solutions."[103] Upon taking the job, Pittman brought a new sensibility to AOL: a focus on earnings estimates and greater profitability.[104] He implemented aggressive financial goals and immediately slashed costs. In a move known as the "November '96 Massacre," AOL under Pittman announced its first large-scale layoffs.[105] Perhaps most importantly, Pittman opened up advertising as a profit stream for the company.

Prior to Pittman, AOL had focused on subscription fees rather than advertising as its profit base.[106] In fact, AOL employees generally thought of advertising as "anathema" to the community feel they were trying to create.[107] This discomfort with advertising extended all the way up to the top. Myer Berlow, AOL's advertising chief, had been hired in 1995 but initially hit resistance when he tried to execute his plans. For example, after Berlow had secured one of his first major deals, Case requested that the purchased ad be put where members wouldn't see it.[108] Another time, after requesting that a customer's ad be placed on the site, Berlow was told by a technology manager that advertising was "a bad idea, generally."[109] However, under Pittman all that changed. In fact, Pittman's AOL would be "all about making money through its ad deals."[110] The harbinger of change was a $100 million deal with a start-up long-distance company named Tel-Save Holdings.[111] For its $100 million, Tel-Save became the exclusive advertiser on AOL for long-distance service.[112] Although a shockingly high amount to pay, the deal boosted Tel-Save stock to new heights, giving the company a $2 billion market capitalization.[113] And in the process, AOL became a star as well.

Over the next four years, AOL would establish itself as the premier Internet advertising placement. New Internet start-ups were willing to pay almost any price to ensure that they got AOL "eyeballs" directed to their sites, and AOL's team made sure that they did, in fact, pay almost any price. The advertising group, headed by Berlow, took an extremely aggressive approach. Dubbing himself the "Darth Vader of AOL," Berlow and his two-hundred odd salespeople were responsible for attracting potential clients.[114] Once they had been baited with offers of exclusivity and placement, clients would hammer out the final deal with AOL's Business Affairs department, known as "BA." If Berlow had a harsh reputation within AOL, BA was notorious outside of it. Headed by David Colburn, a swashbuckling executive who wore cowboy boots, the BA team sought to squeeze every last penny out of potential advertisers.[115] At the time, AOL had the market power to do so. For the start-ups, an AOL placement created the

103. *Id.* at 54.
104. MUNK, *supra* note 1, at 84; SWISHER, *supra* note 1, at 54.
105. MUNK, *supra* note 1, at 85.
106. *Id.* at 97.
107. SWISHER, *supra* note 1, at 61.
108. MUNK, *supra* note 1, at 100.
109. *Id.* at 99.
110. SWISHER, *supra* note 1, at 61.
111. MUNK, *supra* note 1, at 101; SWISHER, *supra* note 1, at 62.
112. MUNK, *supra* note 1, at 102.
113. *Id.* at 103.
114. *Id.* at 109; SWISHER, *supra* note 1, at 61.
115. One AOL employee referred to BA as having a "shit-kicking, hulking, bravado culture." MUNK, *supra* note 1, at 114.

credibility necessary to launch a successful IPO.[116] So AOL could afford to indulge BA's "scorched-earth" negotiating tactics.[117] Such tactics included changing deal terms at the last minute, promising one thing and then retracting it down the road, and openly negotiating with competitors to keep everyone off balance.[118] BA executives, particularly Colburn, even had a reputation for enjoying this process; they were known for taking pleasure in causing their clients pain.[119]

Such aggressive deal-making boosted AOL's profits, and thereby its stock price. Pittman and the other AOL executives were extremely successful in maximizing AOL's stock price by consistently beating Wall Street's targets for revenues and earnings. And to AOL employees, maximizing stock price was not some ephemeral goal. Prior to Pittman's tenure, working at AOL had not been that financially rewarding. Steve Case's annual salary had only been $200,000 for years.[120] Like many Internet and technology companies at the time, however, AOL offered its employees generous stock option packages.[121] As the stock began its astronomical rise from the mid- to late-1990s, AOL employees noticed. Employees had the stock price displayed in the bottom left hand corner of their computer screens, as well as on the liquid crystal displays found on computer printers.[122] In fact, one commentator said that "[b]y 1998, AOL's stock price had become the group's mission, a sacred trust."[123] AOL executives made a ton of money; by 1999, four of the *Forbes* 400 list of richest Americans were AOL'ers.[124] And AOL executives took advantage of the stock's growth by regularly selling off significant chunks of their holdings.[125] However, prosperity was spread throughout the company; by one count, more than two thousand of the company's employees were millionaires.[126] Not surprisingly, such potential for wealth was attention-getting. One observer noted: "To the penny, every AOL employee knew exactly what the stock was trading at."[127]

If there was a downside to this prosperity, it was perhaps a sense that the company had lost track of its core values. Pittman had done a remarkable job of turning the company into a profitable, market-dominating presence; as Merrill Lynch analyst

116. *Id.* at 113; SWISHER, *supra* note 1, at 116.

117. SWISHER, *supra* note 1, at 117.

118. *Id.* at 116.

119. MUNK, *supra* note 1, at 111-12. Perhaps the best known example of BA tactics was the negotiation between AOL and Netscape. In 1996, AOL was searching to license an Internet browser, and it had negotiated extensively with Netscape over such a license. On March 11, AOL and Netscape announced a deal for AOL to license Netscape's Navigator browser, a move that was seen as crucial to Netscape's future. However, the very next day, AOL announced that Microsoft's Internet Explorer would be the primary browser for its software; Netscape users would have to download the Navigator browser. Netscape had believed that its deal would be exclusive but had never secured exclusivity in the final deal. As a result, Netscape became a "wounded duck" that was later bought out by AOL. *Id.* at 108-09.

120. MUNK, *supra* note 1, at 115.

121. *Id*.

122. *Id.*

123. *Id; see also* KLEIN, *supra* note 7, at 168 ("It got to the point where employees practically worshipped at the altar of AOL's stock.").

124. MUNK, *supra* note 1, at 117.

125. SWISHER, *supra* note 1, at 119.

126. MUNK, *supra* note 1, at 116.

127. *Id.* at 202.

Henry Blodget declared, "AOL is *the* Internet blue chip."[128] However, in adapting itself to the expectations of the market, AOL had grown to place importance on short-term profitability and stock price. To some, AOL had started out with a profound mission—to change the world through an incredible new medium—and had ended up handing over their company to car salesmen.[129] But given the plaudits from Wall Street, as well as the immense wealth they had generated, no one at AOL seemed too concerned.

C. The Merger

Actually, some AOL folks were concerned. They harbored suspicions that the incredible valuation might not last forever. In fact, several members of the AOL leadership urged fast action to leverage their impressive stock valuation into an important merger or buyout.[130] Beginning in 1999, Case and other AOL executives brainstormed about potential combinations. Although the company discussed potential mergers with other Internet companies, such as eBay, or telecom companies, such as AT&T, the team settled on potential mergers with media conglomerates.[131] Time Warner was at the top of AOL's list. So beginning in late 1999, Case began courting Time Warner CEO Gerald Levin at international events in Paris and Shanghai. Case and Levin talked ideas, and Case impressed Levin with his big-picture thinking about the global market and the role of business in society.[132] Prior to this courtship, Levin himself had been intent on bringing Time Warner into the Internet age—if not by internal advancement, then by combination or acquisition. And Levin found Case to be "unusually idealistic," and the culture at AOL to be "more humanistic" than he had thought.[133] Perhaps AOL was the company for Levin's "transformative transaction"—transforming not only the company but even the global landscape. The good feelings continued over a private dinner between Case and Levin at the Rihga Royal Hotel. Business, the pair agreed, was not just about making money; "it was about integrity, and values, and the greater good, and making a difference."[134] By the end of the dinner, the merger was on its way.

The two thorniest issues to resolve, not surprisingly, were the share-exchange ratio and managerial control. Levin was adamant regarding control. Case conceded the top position upfront; Levin would be CEO and Case would be Chairman of the Board.[135] Otherwise, it would be a "merger of equals": each company would get eight members on the board, and Pittman would share the COO position with Time Warner's Richard Parsons.[136] But from Case's perspective, it could not be a merger of equals for the shareholders. Considering the companies' market capitalizations, AOL dwarfed Time Warner. Looking at share prices as of the end of 1999, AOL would have been worth about sixty-five percent of a combined company to Time Warner's thirty-five percent.[137]

128. *Id.* at 119.
129. *Id.* at 110.
130. SWISHER, *supra* note 1, at 124-25.
131. *Id.* at 129-30.
132. *Id.* at 133.
133. *Id.* at 134.
134. MUNK, *supra* note 1, at 142.
135. *Id.* at 139-40.
136. *Id.* at 144; SWISHER, *supra* note 1, at 141.
137. MUNK, *supra* note 1, at 145.

True, on other indices Time Warner was much bigger than AOL: 70,000 employees versus 15,000; $27 billion in revenues versus $5 billion.[138] But AOL's market valuation was almost twice as large as Time Warner's. For the next two months, the two companies haggled over the exchange ratio, until Levin ultimately agreed to a fifty-five percent split to AOL and a fourty-five percent split to Time Warner.[139]

The public reaction to the merger announcement on January 10, 2000, would prove the unreliability of conventional wisdom. First, the deal was celebrated as evidence that the Internet was coming of age. Rather than an end-of-an-era capstone, the merger was seen to herald in a new era of synergy and convergence. Second, it looked like Time Warner shareholders had gotten the better of the deal. After all, they had gotten a 55/45 split on a 65/35 valuation. In fact, an AOL board member had raised this issue during the board meeting approving the merger.[140] In contrast, Ted Turner, a Time Warner board member and its largest shareholder, announced that he had voted for the merger "with as much or more excitement and enthusiasm as I did when I first made love some forty-two years ago."[141] Third, it looked as if AOL was buying Time Warner. By taking fifty-five percent of the new stock, AOL shareholders held ownership of a majority of the company.

Levin's approach to the merger was telling. At first, he had been adamant that Time Warner shareholders get at least half of the new company. In time, however, he relented. The merger, after all, was a combination of two companies into a completely new company, and he was the new CEO. With him at the top and half of the board controlled by Time Warner directors, Levin reassured himself that the merger was a merger of equals. "I realized that it didn't matter what the [share ratio] numbers were because we were equals," said Levin later.[142] A similar mindset can be seen in Levin's decision not to seek a "collar"—a contractual stipulation that the merger's terms would be recalculated if either stock dropped below a certain price before the merger's consummation. Levin thought that a collar would signal uncertainty or doubt in the merger and the joint vision that led to it.[143] Ultimately, the lack of a collar would lead Time Warner shareholders to suffer enormous losses in the year between the merger's announcement and its closure. It seems that to Levin, the only requirement of the deal was that he—and an approximation of his board—retain control over the new venture.

Levin's intention was to infuse AOL's Internet savvy and stock market success into a somewhat moribund Time Warner. And he thought he would be the one to oversee it. The only significant spat between him and Case was over Case's role; Levin tried to force Case into a "non-executive" chairmanship despite Case's claims that they had agreed to the contrary.[144] But Case was willing to leave the day-to-day control to Levin, and Levin responded by putting AOL managers in charge of much of the company. Pittman was handed operating control over the growth areas of the new company: AOL,

138. *Id.* at 144.
139. *Id.* at 150-56.
140. SWISHER, *supra* note 1, at 145. Interestingly, the AOL board member was Franklin Raines.
141. MUNK, *supra* note 1, at 179.
142. *Id.* at 153.
143. SWISHER, *supra* note 1, at 142.
144. MUNK, *supra* note 1, at 167-69.

Time, Inc., Time Warner Cable, HBO, TBS and the WB network.[145] Parsons, on the other hand, was in charge of the Warner Brothers and New Line Studios, Warner Music, the trade publishing house, and human resources.[146] The allocation clearly indicated that Pittman was Levin's heir apparent. Throughout the rest of the executive ranks, AOL executives got the nod over their Time Warner counterparts.[147] AOL CFO Mike Kelly became CFO of the new company.[148] AOL advertising executives like Berlow and Colburn were given free rein to institute AOL's aggressive policies across the company. In fact, Colburn's team had T-shirts printed up saying, "Putz, we are."[149] The T-shirt quoted Colburn's response to a comment from a horrified Time Warner executive: "You're making it sound as if you're buying us."[150]

With their ascendance to power, the AOL team brought a new focus on delivering shareholder value. Many at AOL thought their Time Warner counterparts had been lazy, boring, complacent, and unfocused.[151] AOL, on the other hand, was known for meeting and beating its performance goals, even when such goals were extremely aggressive. AOL executives knew that to be rewarded by Wall Street, they had to consistently beat Wall Street's consensus estimates.[152] Pittman was legendary for his ability to set and deliver "outlandish" revenue and earnings targets.[153] Time Warner, on the other hand, had a reputation for not playing the game with much enthusiasm. Levin and the AOL folks thought they could implant the target-focused culture to the Time Warner divisions and immediately bring the stock up in price.

As part of this infusion, Levin also agreed to get rid of the Time Warner employee cash bonus plan in exchange for AOL's employee stock option plan. Under the old plan, Time Warner employees were rewarded for meeting or beating internal goals and incentives. However, at AOL, employees were rewarded with stock to better align their interests with the shareholders.[154] At first, the change intrigued Time Warner employees, who had heard about the riches earned at AOL. However, as the stock began to drop, so did employees' feelings about the new plan, and their views on the merger soured as well. As one commentator noted, "all of corporate morale was tied much too closely with AOL Time Warner's stock price."[155]

That stock price would eventually take a tumble. After the merger was announced in

145. *Id.* at 191-92; SWISHER, *supra* note 1, at 164.
146. MUNK, *supra* note 1, at 192.
147. *Id.* at 191.
148. SWISHER, *supra* note 1, at 165.
149. *Id.* at 150.
150. *Id.* at 149.
151. MUNK, *supra* note 1, at 200.
152. *Id.* at 201.
153. *Id.* at 202. One AOL executive related this anecdote:

> Bob Pittman told David Colburn, Myer Berlow, and the others, "Go out and bring back what I tell you to." It's like the flying monkeys coming out of the f[***]ing castle in *The Wizard of Oz*. You know, they'd send the flying monkeys out every quarter and they brought back Dorothy, and without that you don't have AOL and a market cap of $200 billion plus.

Id.

154. SWISHER, *supra* note 1, at 178-79.
155. *Id.* at 180.

January 2000, the Internet stock boom ended with a bang in March. A rash of Internet companies saw their stock prices fall and their investor funding dry up. Since many of these companies were AOL advertising clients, their downfalls would presumably hurt AOL as well. Throughout 2000, however, AOL executives, including Pittman and Case, reported that their advertising revenues continued to climb. In response to the industry shake-up, they argued the downturn drove a "flight to quality" from which AOL benefited.[156] Despite these assertions, AOL stock still took a hit: by November 2000, AOL's stock price had fallen off fifty percent from its January high.[157] As it turned out, the worst was yet to come.

D. After the Merger: The AOL Crash and Time Warner Ascendance

After the merger was finalized in January 2001, the AOL executives now in charge of the new company pressed employees to carry out their reforms. The executives were often frustrated by the intransigence they encountered from Time Warner employees, who were set on continuing in the old ways. In the former Time Warner, the company was organized around its divisions, with division performance being the crucial indicia of success.[158] As a result, the divisions often fiercely competed with one another, even if it meant that the company overall lost some of the benefits of synergy. The AOL folks, on the other hand, believed in the value of synergy and looked at the firm's overall share price as the ultimate goal. In addition, Time Warner employees believed in the importance of long-term values and relationships. Getting the best deal might become secondary if it meant cutting off ties with a valued customer or supplier. AOL, on the other hand, had always focused on getting the most money possible at any given point in time.

One example of this culture clash was a dispute over the company's relationship with American Airlines. American had long been one of Time's biggest advertisers, and Time Warner employees had always flown American (at discounted rates) when traveling.[159] In 2001, however, American resisted renewing its advertising contract with AOL. So the new leadership proposed dumping its long-standing ties to American in favor of a new cross-divisional deal with United. Old Time Warner executives railed against the deal, calling it a short-sighted move that would alienate a trusted client. But the deal with United went through—and was trumpeted by the company as an example of convergence.[160]

The positive press for Pittman and his team continued through 2001, but the share price continued to fall.[161] Internally, the company was getting signals that its aggressive revenue targets would fall far short.[162] However, the company ultimately decided not to revise those targets. Whatever chance it had of meeting them ended with the September 11th terrorist attacks. The attacks sent the economy into a downturn, and with it went

156. MUNK, *supra* note 1, at 204-05.

157. *Id.* at 208. Had the merger been negotiated in November, Time Warner shareholders would have held 65% of the combined equity value, and AOL shareholders 35%. *Id.* at 208-09.

158. KLEIN, *supra* note 7, at 249.

159. MUNK, *supra* note 1, at 233.

160. *Id.* at 234.

161. *Id.* at 234, 237.

162. *Id.* at 235.

AOL Time Warner's advertising revenue. In late September, the company admitted that it would miss its 2001 goals by a wide mark.[163]

CEO Gerald Levin was also changed after the attacks. Instead of going along with the Pittman program, Levin began to resist it. He told his employees that the news divisions should spend whatever they needed to cover the crisis.[164] The company had a "fundamental moral responsibility," he wrote in an email, to the goals of journalistic independence and democratic dialogue.[165] When others within the company pressed him on the earnings failures, he dismissed such business matters as unimportant in light of the changed world. As he reported later, Levin began to perceive Case as an "automation" who was unable to connect with national events.[166] Case, for his part, was frustrated with Levin's sudden lack of concern for the company's shareholders.[167] He began an internal campaign to force Levin out.[168]

Levin soon departed; in December 2001, he announced his resignation.[169] But he was succeeded by Parsons, rather than Pittman, in a sign that AOL's dominance was beginning to come to an end.[170] In a January 2002 statement, Parsons told Wall Street that the company would not try to "over-promise" and would focus on building "long-term value."[171] The announcement was paired with another disappointing earnings report. The bad news continued throughout 2002. The company reported a massive $99 billion write-off in goodwill and disclosed a staggeringly bad agreement with Bertelsmann AG that required AOL to buy back AOL Europe (a joint venture between AOL and Bertelsmann) at a grossly inflated price.[172] In April, Pittman was reassigned to AOL to restore the success of that unit. But his tenure was short-lived. On July 18 Pittman left the company.

That same day, the *Washington Post* began a series of articles by reporter Alec Klein about misleading and potentially illegal advertising and accounting practices within AOL from 2000 to 2001.[173] In essence, the articles alleged that AOL had doctored its advertising revenue by pre-booking revenue, overvaluing advertising contracts, and treating contractual "barter" as ad revenue. The most prominent example was a deal between AOL and PurchasePro.com, a Las Vegas software maker. Through a complex contract, AOL was able to declare $30 million in advertising revenue by granting certain

163. *Id.* at 247.

164. MUNK, *supra* note 1, at 244, 248.

165. *Id.* at 244.

166. *Id.* at 247.

167. *Id.* at 249-50.

168. KLEIN, *supra* note 7, at 269-74.

169. MUNK, *supra* note 1, at 253. A February 2003 *New York Times* article reported that after leaving Time Warner, Levin moved to Marina del Rey to live with Laurie Perlman, a clinical psychotherapist he met in June 2002. Leslie Cauley, *After a Tense Exit, Levin Tells His Side*, N.Y. TIMES, Feb. 2, 2003, at C6. He has filed for divorce from his wife of 32 years. Levin told the reporter: "I want to be known as a social activist in education and mental health and, eventually, a writer." *Id.*

170. Levin convinced the board that Parsons should succeed him as CEO. KLEIN, *supra* note 7, at 278.

171. MUNK, *supra* note 1, at 259.

172. *Id.* at 260-61.

173. Alec Klein, *Unconventional Transactions Boosted Sales; Amid Big Merger, Company Resisted Dot-Com Collapse*, WASH. POST, July 18, 2002, at A1; Alec Klein, *Unorthodox Partnership Produced Financial Gains; Deals Allowed AOL, PurchasePro.com to Boost Revenue*, WASH. POST, July 19, 2002, at A17; Alec Klein, *Creative Transactions Earned Team Rewards*, WASH. POST, July 19, 2002, at A1.

PurchasePro stock warrants to AOL.[174] But as the PurchasePro CEO later claimed, the warrants really had nothing to do with advertising revenue; they had been in fact created simply to give AOL the appearance of immediate revenue.[175] The articles catalogued a number of other misleading and potentially illegal accounting practices that had helped to boost AOL's earnings at a critical time.

One week after the first article came out, Parsons announced that the SEC was investigating the company's accounting practices. The stock price cratered to $8.70, a drop of 85% in just over a year.[176] Colburn was fired, his locks were changed, and his files hauled away to be investigated.[177] The merger was now officially a disaster. As AOL executives resigned or were ushered out, Time Warner executives stepped in to assume control.[178] Under fire from the board, employees, and major investors, Case resigned in January 2003.[179] In October 2003, the company was renamed "Time Warner," and its stock symbol changed from "AOL" back to "TWX."[180]

IV. LESSONS: THE PERILS OF PRIMACY AND THE CONSTANCY OF CULTURE

A. The Perils of Primacy

The logic of shareholder primacy is persuasive. Shareholders, it is argued, are the most vulnerable of the corporate stakeholders. Being residual claimants, they are entitled to payment only after everyone else's claims have been satisfied. It therefore makes sense to try to maximize their net wealth at the end of the day. After all, by design, satisfying shareholders is only possible if all of the other constituencies have been satisfied, at least to the extent of their contractual claims. Maximizing shareholder wealth means, again by design, that societal wealth has been maximized as well.

Moreover, it also makes sense to encourage employees to think like shareholders. The separation of ownership and control means that shareholders must sit passively by while others use their money to run the corporation. The principal-agent problems are obvious: if shareholders cannot monitor or discipline the executives running the show, then there will be opportunities for the executives to siphon off money in a variety of contexts. If executives think like shareholders, on the other hand, their interests will be

174. KLEIN, *supra* note 7, at 206.

175. PurchasePro's CEO has since been indicted for securities fraud; he has pled not guilty to the charges. John G. Edwards, *Ex-PurchasePro Boss Pleads Guilty, Faces Trial*, LAS VEGAS REV. J., Jan. 25, 2006, *available at* http://www.reviewjournal.com/lvrj_home/2005/Jan-26-Wed-2005/business/25736072.html.

176. MUNK, *supra* note 1, at 272.

177. *Id.*

178. *Id.* at 273 ("By the late summer of 2002, almost every senior AOL executive had been fired, forced out, or marginalized.").

179. SWISHER, *supra* note 1, at 260. Case now heads Revolution, a private holding company with majority stakes in several health care companies. Nina Munk, *Steve Case's New Act: You've Got Revolution!*, N.Y. TIMES, June 19, 2005, at 5. Case appears to be back in the mode of his early days at AOL. *See id.* ("It struck me that Revolution might be a good name, because it does sort of summarize what we're trying to bring to bear, which is not an incremental, tweaking kind of thing, but really to take some risks and swing for the fences and to have a transformative impact on society . . . .").

180. Dan Ackman, *AOL Nixes AOL, Keeps X*, FORBES.COM, Sept. 19, 2003, http://www.forbes.com/2003/09/19/cx_da_0919topnews.html.

"aligned" with ownership, and the company will act more efficiently.[181]

The AOL of the late 1990s took these lessons to heart. It made shareholder value its corporate mission, and it deputized its employees through generous stock options. The strategy worked, at least on Wall Street. AOL grew from roughly $2 a share in 1997 to more than $95.81 a share just before the merger.[182] It is truly remarkable that AOL—a company only fifteen years old—could be the majority partner in a merger with massive media conglomerate Time Warner. It only could do so because of its success in driving up its own stock price.

AOL's employee stock option program was also extremely effective in motivating employees toward that goal. The fabulous wealth of executives and the small fortunes of lower-level employees encouraged everyone to hop on the stock option bandwagon. As one AOL employee later put it, "The whole culture at AOL was share price, share price, share price. Why else were we in business?"[183] This mindset seemed to have its desired effects, as employees did everything they could to meet the market-oriented revenue and earnings targets set by AOL leadership.[184]

If the AOL mindset represented the "yin" of shareholder primacy, Time Warner represented the "yang." Time Warner focused on the importance of the institution. Even within the company, employees fought hard not for the overall corporate entity, but for their particular divisions. Long-term relationships were prized above the best deal that might have been available at any given time. And Time Warner leadership was not particularly solicitous of shareholder concerns. After all, Time had forced the Warner merger down its shareholders' throats, in the face of an extremely attractive tender offer from Paramount. Even at its founding, Henry Luce had declared that shareholders, while important, were no more important than the public interest in the operation of a journalistic enterprise.[185] Perhaps as a reflection of this indifference, Time Warner's share price languished throughout most of the 1990s, despite the company's obvious strengths in the growth areas of cable, media, and entertainment.

Time Warner CEO Gerald Levin was looking for some of AOL's stock price mojo when he agreed to the merger between the two companies. He had hoped to inject some of AOL's creative DNA into his seemingly behind-the-times institution. But what he actually got is instructive, and it points up some of the dangers in a corporate philosophy of shareholder primacy.

First, AOL had been ruthlessly effective in keeping its share price rising higher and higher. How did it do this? Of course, AOL did have a dominant product in a hot industry. But perhaps more importantly, AOL—under the leadership of Robert Pittman—was all about making its earnings numbers. AOL did what it took to meet and beat analysts' quarterly and yearly earning projections. "Are you going to make your numbers?" was the question asked of AOL division heads. And AOL did make its numbers—and surpass them.

181. Jensen & Murphy, *supra* note 54. This "call to arms" would later "reverberate[] in the counsels of compensation consultants." LOWENSTEIN, *supra* note 58, at 15.

182. MUNK, *supra* note 1, at 115, 151; *see also* SWISHER, *supra* note 1, at 267 (noting that $1000 invested in AOL stock in 1992 would have been worth $58,000 in 2003, even after the 2001 crash).

183. MUNK, *supra* note 1, at 222-23.

184. *See* KLEIN, *supra* note 7, at 168 ("Employees came to call themselves 'options whores.'").

185. MUNK, *supra* note 1, at 3.

Generally, a corporation should look to meet its earnings estimates. Like any goal, earnings estimates can drive employees to work harder to meet a tangible measure of achievement. AOL employees worked very hard—one executive compared life at AOL to driving a motorcycle with your hair on fire.[186] But the estimates also encourage employees and executives to cheat, if necessary, to meet them, and it is also clear that AOL executives and employees cheated. When hard work was not enough, AOL relied on techniques such as backdating contracts, moving revenue forward, moving expenses back, and re-jiggering its advertising deals on the fly. As with many companies in the 1990s, the leadership either encouraged or turned a blind eye to such tactics.[187]

These schemes were not like the traditional principal-agent conflict in which the agent is stealing from the principal. After all, the stockholders at that time were the primary beneficiaries of these accounting maneuvers. The trick here was that executives and employees, through their stock and stock options, had the same incentives as the public stockholders. The purpose of AOL's malfeasance was to keep the stock price going up, perhaps in large part so that employee options would become more valuable. But if the schemes had never been discovered, AOL stockholders would have been quite happy about them, at least from a purely self-interested perspective. Everyone at the company would have won.

But this kind of "shareholder wealth maximization" is probably not what shareholder primacists have in mind. Certainly, it cannot be societally efficient for companies to achieve financial success through accounting chicanery. Primacists might argue that, although such illegality may work in the short term, it will generally be a losing strategy in the long term. Eventually, reported earnings will diverge so significantly from reality that a cheating company will be forced to acknowledge the disparity, and this confession will end up doing far more damage to the company than short-term benefits from illegality. Shareholder primacy is not about today's stock price, they would say; it is about maximizing returns to shareholders over time. As Kraakman and Hansmann contend, "corporate law should principally strive to increase *long-term* shareholder value."[188] Even if the AOL executives appeared to be shareholder primacists, they were at best heretics—believers who had strayed from the path by following a twisted version of the true faith.

Such a view ignores the realities of not only the market, but of shareholder primacy as well. The relentless short-term focus of the markets, particularly in the late 1990s, encouraged a limited horizon with respect to share value.[189] AOL executives were

186. MUNK, *supra* note 1, at 117.

187. LOWENSTEIN, *supra* note 58, at 62 (noting that "number games were becoming a pervasive part of the culture [of the 1990s boom]").

188. Hansmann & Kraakman, *supra* note 10, at 439 (emphasis added).

189. As Bill Bratton has argued:

> For equity investors in recent years, the practice of shareholder value maximization has not meant patient investment. Instead, it has meant obsession with short-term performance numbers. For managers, the shareholder value norm accordingly has come to mean more than astute investment and disinvestment. It also means aggressive management of reported figures responsive to the investment community's demands for immediate value.

William W. Bratton, *Enron and the Dark Side of Shareholder Value*, 76 TUL. L. REV. 1275, 1284 (2002).

keenly aware that missing one quarterly earnings estimate might have changed the dynamic of their share price. To focus on maximizing shareholder value, managers had to focus—and still must focus—on meeting Wall Street expectations.[190] The market controls the price of the stock, and shareholder-primacy managers must therefore cater to the desires of the market.

Of course, the market price should reflect the actual value of the company. Proponents of the efficient capital market hypothesis posit that the market takes short-term and long-term value into account in determining a company's stock price at any particular moment in time.[191] Managing for the short-term should be a losing market strategy; the market should discount such near-sightedness and reward longer-thinking firms with higher stock prices. In the 1990s technology boom, however, companies were rewarded for meeting their short-term goals. As the AOL experience so amply demonstrates, it is good for your stock—for years at a time—to be focused on meeting Wall Street's short-term expectations.

Moreover, it is difficult to give much content to a shareholder wealth maximization norm that truly focuses on the long term. After all, even folks like Gerald Levin insist that their decisions will ultimately end up maximizing shareholder wealth in the long term. If the long term is long term enough, then the notion of a long-term shareholder wealth maximization norm becomes fairly meaningless. As others have argued, a short-term focus may be an endemic part of shareholder primacy.[192]

As a complement to the short-term focus of the market as a whole, stock options also encourage employees to act like short-term investors.[193] Most employee stock options have a certain vesting period during which the options are not exercisable. However, once an employee has been at the company a few years, these options will begin to vest, perhaps with a different set of options vesting each year thereafter.[194] To diversify their holdings, financially prudent employees will immediately cash out on their

190. *See, e.g.*, LOWENSTEIN, *supra* note 58, at 29 ("Executives became acutely sensitive to what would make their stocks rise, not over the long term but by the hour."); Bratton, *supra* note 189, at 1284.

191. *See, e.g.*, Margaret M. Blair & Lynn A. Stout, *Director Accountability and the Mediating Role of the Corporate Board*, 79 WASH. U. L.Q. 403, 407 n.6 (2001) (noting that an interpretation of the hypothesis holds that the markets are "'fundamental value efficient,' meaning that absent contradictory private information, today's stock price represents the best possible estimate of the long-term, as well as the short-term, value of the shareholders' stock").

192. *See* LAWRENCE E. MITCHELL, CORPORATE IRRESPONSIBILITY: AMERICA'S NEWEST EXPORT 4-5 (2001) (arguing that shareholder wealth maximization "keeps managers' and stockholders' focus on the short term"); Margaret M. Blair, *Directors' Duties in a Post-Enron World: Why Language Matters*, 38 WAKE FOREST L. REV. 885, 890-95 (2003) (contending that "the mantra of share value maximization has no distinctive meaning and policy implications if it is not interpreted to mean maximization of short-term value").

193. Michael Lewis, *The Artist in the Gray Flannel Pajamas*, N.Y. TIMES, Mar. 5, 2000, (Magazine), at 45, 46-47.

> Many corporate employees behave less like old-fashioned workers than they do like investors. Rather than think, I need to stay here and do my best because I have an investment in this company, they think, I am going to keep a close eye on this ship, in case it starts to sink and my options become worthless.

Id.

194. Klein reports that AOL employees were typically given a major grant of stock options upon hiring that took four years to vest. KLEIN, *supra* note 7, at 168.

options and reinvest. Thus, employees are encouraged to think like short-term shareholders; they want the stock price to stay high up until their options vest.[195] AOL employees and executives apparently followed this pattern. Stephen Case cashed out on extremely large holdings during his tenure as CEO.[196] In 2001, while he was still COO, Pittman sold almost all of his AOL Time Warner stock.[197] In contrast, Henry Luce never sold his shares of Time, Inc. and died holding fifteen percent of the company's stock.[198]

At AOL as well as many other dot-com companies, the cycle was clear: executives push to meet short-term targets; investors push up the price of the stock; and executives (and other employees) cash out on the options.[199] The cycle continues until the company can no longer meet its targets, but cheating can prolong the process. Perhaps that is why there was so much cheating at the end of the 1990s boom. Like desperate gamblers, executives relied on accounting tricks to keep their hot streaks alive, in the hopes that they could make up for their losses in future quarters. But the losses just kept mounting until the tricks were no longer enough.[200]

It may seem unfair to blame this cycle on shareholder primacy. But the cycle is a natural product of both the ends of a primacy philosophy (shareholder wealth maximization) as well as the means to achieving those ends (stock options and a focus on making the numbers).[201] Indeed, perhaps AOL did succeed in maximizing shareholder wealth. After all, its stock jumped astronomically from 1990 to 2000, based not only on the Internet boom but also on the methods instituted by Pittman to manage advertising revenue. Then, before the crash, AOL latched on to Time Warner and agreed to a merger without a stock-price collar. Although AOL Time Warner plummeted in value after the merger, surely AOL shareholders would have borne much more of the brunt of this fall absent the merger. Despite the post-merger losses, Tele-Communications, Inc. CEO and AOL shareholder John Malone still said, "Steve [Case] was fabulous for his shareholders. They should build a statue to this guy."[202]

B. The Constancy of Culture

In comparison, Time Warner shareholders cannot be too happy about the financial impact of the merger. For those who were originally Time shareholders, they watched as the company dodged a generous Paramount tender offer to conduct a generous buyout of Warner shareholders. The AOL merger must have seemed at first like a blessed turnaround; when announced, Time Warner shareholders were getting a more generous slice of the post-merger company than their equity warranted. But the market

195. *Cf. id.* (noting that a popular term among employees was "FYIV," which stood for, "F[***] you, I'm vested.").

196. MUNK, *supra* note 1, at 276 ("[I]n the decade since AOL had gone public, Case had exercised and sold about $700 million worth of AOL stock options.").

197. *Id.* at 229.

198. *Id.* at 230. Luce's wife once asked him if it was a mistake to have all of their financial eggs, so to speak, in one basket. "It's all right," he answered, "as long as it's my basket." *Id.*

199. *See* LOWENSTEIN, *supra* note 58, at 226 (arguing that the stock option, with its inevitable short-term focus, "is at the root of all that went wrong" and "is the period's original sin").

200. *See id.* at 77 ("The odd fact about cooking the books is that the day of reckoning always comes.").

201. *Id.* at 217-19.

202. SWISHER, *supra* note 1, at 242.

soon changed that, and the deal went through with the valuation roughly flipped. Without a collar to protect their share values, shareholders again had to watch helplessly as Levin marched forward with a now financially disadvantageous merger.[203] By 2003, the AOL disaster had sucked $200 billion away from the valuation of the companies at the time of the merger.[204] It is no wonder Time Warner shareholders felt robbed.

From the perspective of Time Warner the institution, however, the outlook is not so bleak. Time, Inc. has managed to merge with three separate companies—Warner Communications, Turner Broadcasting, and AOL—and swallow them into the Time "culture." Each of those companies had its own imperious CEO, its own distinctive corporate culture, and a valuation that surpassed the original Time, Inc. Yet Time managed to stay in control. At the current company, Richard Parsons is the CEO; once rumored to be an interim caretaker, he is now ensconced for the foreseeable future.[205] Time Warner executives Don Logan and Jeff Bewkes have ascended to the most important managerial positions within the company.[206] Steve Ross, Steve Case, and Robert Pittman are gone; Ted Turner has been marginalized.

Perhaps the most instructive lesson came at the expense of Carl Icahn. Icahn, a significant shareholder in Time Warner, agitated for managerial changes to improve the company's languishing share price.[207] Key to Icahn's goals was a break-up of the company. In a report commissioned by Icahn, investment and consulting company Lazard argued that the company should be split into four pieces.[208] The report was unveiled at a press conference with much hoopla, and Icahn announced he would wage a proxy fight against the board if they failed to act on his plan.[209] The report, however, was a flop.[210] Icahn ultimately reached a compromise with Time Warner on a stock buyback plan, but the Wall Street consensus is that he lost. Lazard CEO Bruce Wasserstein has also seen his reputation tarnished.[211] For his part, Parsons dismissed the notion that Icahn's plan would improve the company: "[I]f we broke up the company, would Warner Bros. make better movies? Would the magazines be better?"[212] And he cited once more to Time Warner's higher purpose: "[I]f the goal is only financial, what about the notion of journalistic integrity?"[213]

To the extent that "culture" means continuing control by the company's

203. As one commentator opined at the time, "Time Warner must feel like a girl who agreed to marry a guy for his money, found out he wasn't nearly as rich as she thought, and then noticed he's ugly, too." Dan Ackman, *Top of the News: AOL Time Warner's Tragic Marriage*, FORBES.COM, Jan. 12, 2001, http://www.forbes.com/2001/01/12/0112topaol.html.

204. *See* Ackman, *supra* note 180 ("Since the merger, the company has lost over $200 billion in market value . . . .").

205. *See* David Carr, *Dick Parsons Knows What You Think*, N.Y. TIMES, June 13, 2005, at C1, C7 (noting that Parsons "may have engineered one of the biggest turnarounds in recent history . . . .").

206. David Carr, *No Use Crying Over Spilled Billions*, N.Y. TIMES, June 20, 2005, at Business 1, 4.

207. Ken Auletta, *The Raid*, NEW YORKER, Mar. 20, 2006, at 132.

208. *Id.* at 142.

209. *Id.*

210. *Id.* at 142-43.

211. Andrew Ross Sorkin, *The Adviser Who Became the Activist*, N.Y. TIMES, Feb. 26, 2006, at B1 (noting that Lazard's involvement in Icahn's "failed fight . . . may have exposed him as Wall Street's Emperor With No Clout.").

212. Auletta, *supra* note 207, at 134.

213. *Id.*

executives, Time has imposed its culture over this burgeoning corporate entity. Ideally, of course, culture means more than control. Culture is an ethos, an approach, a methodology, a way of doing business. Time has consistently represented that it places primary importance on a culture of "journalistic integrity." I am in no position to assay whether the current stable of Time Warner media properties lives up to the standards of Henry Luce. But to the extent that Time Warner employees brought a different ethos to the merger than the AOL employees, it is the Time Warner ethos that appears to have triumphed. After the merger, when AOL executives were placed in key positions of control throughout the company, they were exasperated by the culture of the Time Warner employees. These employees placed a premium on long-term relationships, rather than getting the best deal. They fought for their divisions, rather than thinking broadly about the company as a whole. They valued institutions like their corporate library and their employee perks. Former AOL Time Warner ad executive Myer Berlow summed up his feelings about Time Warner employees this way: "To them, it's all about status; it's not about money. Anyone who believes it's about money is really looked down upon."[214]

In contrast, by the time of the merger, AOL employees had lost their religious fervor about AOL, the product. Initially, many employees, including Case himself, had been loathe to foist advertising on AOL customers. In the late 1990s, however, the huge influx of advertising cash washed this attitude away. Instead of exalting the techies who developed the critical software and customer support, the company lionized the advertising and business affairs departments. Perhaps as a result, the company has lost the product dominance it once maintained. In her suggestions for revitalizing AOL, *Wall Street Journal* reporter Kara Swisher lists thirteen "easy steps" for revitalizing AOL.[215] Almost all of them concern AOL's loss of focus on the quality of its online service.[216]

Taking a step back, it seems easy to answer which company has been more successful. Time Warner continues to influence the world with its numerous media properties; it recently announced a joint purchase of Adelphia cable properties with Comcast Cable.[217] Although I make no claim about the beneficence of Time Warner's actual cultural impact, the company clearly exerts a powerful influence on our society. AOL, on the other hand, has been reduced to a division within Time Warner; its online service is still struggling for a role in an increasingly broadband world. Can we really say that AOL has given more to society if it has given a greater return on value to its shareholders? Is this metric the only way to measure corporate success? The AOL Time Warner merger seems to provide strong evidence to the contrary.

So, perhaps that is the ultimate lesson—the importance of having a corporate "culture" beyond simply maximizing shareholder value. Somewhere in the 1990s, AOL lost its missionary zeal for changing the world through its incredible technology. Instead,

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214. MUNK, *supra* note 1, at 240. Berlow concluded his thought by saying: "Well, what the f[***] else matters when you're in business?" *Id.*

215. SWISHER, *supra* note 1, at 278.

216. *See id.* at 278-94 (discussing problems such as "lack of passion," "lack of product innovation," "loss of community roots," "diminution of brand," and "AOL's place in the digital lifestyle"). Swisher ends her book with a note of hope, saying that one AOL executive, Ted Leonisis, was "still in love—and it was a profound love—with the digital future and the promise it might still bring." *Id.* at 294.

217. Annalisa Burgos, *Time Warner, Comcast Buying Adelphia in $17.6B Deal*, FORBES.COM, Apr. 21, 2005, http://www.forbes.com/markets/2005/04/21/cx_ab_0421video1.html.

executives and employees fell to worshipping the false god of share price. But a higher share price should be a byproduct of a successful company, not its end. Perhaps this notion is the greatest falsehood of shareholder primacy: that the company itself—its people, its culture, its purpose—does not matter. Time, Inc. has often stood for the contrary. And its longevity—perhaps, even, its success—asks us to rethink whether shareholder wealth maximization should really be the ultimate arbiter of corporate value.

V. CONCLUSION: A CAUTIONARY NOTE

Of course, the failure of one company does not a revolution make. It could quite plausibly be argued that the corporate improprieties at AOL and AOL Time Warner reflected at most a pathology endemic to a particular normative system. Perhaps shareholder-primacy companies are more prone to overstate earnings, have generous stock option packages, and focus excessively on the short term. But any approach to corporate governance will have pathologies that stem from the weaknesses of that approach. A company based on employee primacy, for example, might be prone to overpay its employees, or it may descend into a morass of internal bickering over basic decisions.[218]

Time Warner itself may be seen as representative of a management-primacy pathology. The company has consistently ignored the interests of its shareholders in making its most important decisions about its future. The decision to escape the Paramount tender offer by overpaying Warner shareholders remains an oft-criticized episode of corporate hubris. The later decision to merge with AOL and forgo the stock-price collar ultimately cost Time Warner shareholders billions of dollars. Nor was the merger popular with Time Warner employees. In fact, Time Warner management continues to be criticized for its handling of company matters.[219] Time Warner is no paragon of corporate virtue nor a model for corporate governance.

However, the perils of excess managerialism have been well documented and are what led to the "shareholder primacy" revolution of the 1970s and 1980s. My hope for this narrative is that the AOL Time Warner merger may now stand as one data point reflecting potential problems of excessive shareholder wealth maximization. The experience of AOL, along with other busts from the 1990s like Enron, WorldCom, Global Crossing, and Computer Associates, vividly demonstrates the danger of shareholder primacy as an organizing principle for corporations and corporate law.[220] If

218. *See* HENRY HANSMANN, THE OWNERSHIP OF ENTERPRISE 89-90 (1996) (arguing that "employees are far more likely than investors to differ among themselves concerning the firm's policies"). Daniel Greenwood has argued, however, that the shareholder primacy norm encourages, rather than merely permits, such pathologies. Daniel J.H. Greenwood, *Enronitis: Why Good Corporations Go Bad*, 2004 COLUM. BUS. L. REV. 773, 775 ("The single-valued profit maximization ethos of the share-centered corporation demands that managers teach themselves to exploit everyone around them. It is inevitable that some will learn this lesson so well that they will exploit even those for whose benefit they are supposed to be exploiting.").

219. *See, e.g.*, Richard Siklos & Andrew Ross Sorkin, *Icahn Plan For a Split Gets a Push*, N.Y. TIMES, Feb. 8, 2006, at C1 (discussing the Lazard report in favor of splitting up Time Warner against current management's wishes).

220. *See* LOWENSTEIN, *supra* note 58, at 218 (noting that the "credo of shareholder value" led to an obsessively short-termed focus, which in turn led to "[v]irtually every transgression" of the 1990s boom); Bratton, *supra* note 189, at 1283 ("Like GE under Jack Welch, Enron under Ken Lay and Jeff Skilling pursued

shareholder value is the central concern, then companies will jump through hoops to meet Wall Street expectations. The pressure of meeting such expectations may push executives into an excessively short-term focus and unethical or illegal accounting moves. Moreover, shareholder primacy has been touted as a way of curbing managerial discretion, making sure that executives do not take excessive rents from the true owners. But with the advent of stock options, executives could mouth the scripture of "shareholder value" while taking gargantuan slices of that value for themselves. A focus on what is best for the shareholders became a focus on what was best for the share price at the time the executives' options were vesting.

AOL's actions in pursuit of "shareholder primacy" may have worked to the advantage of investors who bailed before 2001, but long-term investors suffered badly from the company's quarterly-earnings focus, and the corporation itself was reduced from an Internet titan to a unit within a division of another company. Perhaps AOL's experience will serve as a cautionary note, not only to corporations but to corporate scholars as well. The religion of shareholder primacy may offer a persuasive theology and tantalizing rewards. But in the end, it is the worship of a false god.

maximum shareholder value.").