Hostile Share Acquisitions and Corporate Governance: A Framework for Evaluating Antitakeover Activities

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HOSTILE SHARE ACQUISITIONS AND CORPORATE GOVERNANCE: A FRAMEWORK FOR EVALUATING ANTITAKEOVER ACTIVITIES†

John H. Matheson*
Jon R. Norberg**

In recent years, there has been a significant increase in the number of hostile share acquisitions of American businesses. The authors examine the validity of the various defensive measures employed by target companies to defeat or deter a hostile takeover bid. They argue that antitakeover activity should not be viewed as a separate subset of legal analysis, rather, it should be analyzed according to four traditional principles of corporate governance: (1) the discretion afforded corporate management by the business judgment rule; (2) the prohibition against discriminating between members of the same class of shareholders; (3) the prohibition against shifting control from the shareholders to the board of directors for actions reserved by statute to the shareholders; and (4) the prohibition against shifting control from a majority to a minority of shareholders for decisions reserved by statute to the majority.

Moreover, the authors assert that even if a court uses these principles of corporate governance as the basis for its decision, the court's analysis is still incomplete if it focuses only on the target board's initial decision to resist a hostile share acquisition. Rather, a court must undertake a two-step analysis, whereby it looks first at the target board's initial decision to resist the hostile takeover, and second, to the means employed by the target board to effectuate that decision.

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I. INTRODUCTION

Over the past decade a wave of hostile share acquisitions has swept over American business, leaving almost no industry untouched. Whether implemented by tender offer, market purchases or private arrangements, the prize sought is corporate control. Innovative forms of financing and changes in the banking climate make it now possible for acquiring entities to raise billions of dollars in a matter of weeks. Only the mightiest and best-managed corporate giants have the ability to ride the wave without fear for their own independence.

Corporate management, concerned for their corporation's continued independence, their shareholders' investment interests, and their own positions has been equally innovative in developing new ways to fend off unwanted overtures. The defensive actions taken by target management, in the face of a current threat to corporate control, have a colorful assortment of names—such as the Pac-man counter offer, the sandbag, the poison pill, crown jewel warrants, golden parachutes, the scorched earth defense and greenmail payments. A corporation may also adopt prophylactic antitakeover measures, often consisting of amendments to the corporate charter. These amendments are sometimes called "shark repellents" because they are designed to ward off corporate predators prior to a hostile acquisition of shares or a tender offer.

As hostile share acquisitions have increased and numerous corporations have either responded to a takeover attempt or sought to deter consideration of such an attempt, would-be suitors and other shareholders have challenged these antitakeover measures. The analyses of most courts look primarily to the initial decision to resist a change in control. Quite expectedly, the courts have been loathe to condemn wholesale all antitakeover activity. Moreover, corporate management can normally justify its decision to resist any individual overture. The result has been, with minimal exception, court approval of both the decision to resist and the means employed to effect
that decision. Indeed, two recent decisions by the Delaware Supreme Court, *Moran v. Household International, Inc.* and *Unocal Corporation v. Mesa Petroleum Co.*, highlight the near-complete abdication of judicial review that results from this approach.

It is the position of this Article that the fixation of the courts on the decision *vel non* to resist a hostile share acquisition provides only a partial analysis. Rather, in considering the propriety of antitakeover activity, an equally crucial focal point should be the means employed by incumbent management to effect that decision. These measures may impinge basic shareholder rights or alter the statutory distribution of power within the corporate structure, thereby requiring closer scrutiny than they have generally received.

More fundamentally, this Article disagrees with the popular consideration of "antitakeover activity" as a separate topic for legal analysis. Antitakeover activities are more appropriately considered as part of the ongoing activities of the modern American corporate enterprise. From this perspective, traditional and fundamental principles of corporate governance (for example, the fiduciary duties of corporate management and the allocation of powers within the corporate structure) may be applied to antitakeover activities, just as they are applied to other corporate activity. Applying these fundamental corporate principles can provide a framework of analysis to alert corporate management to the legal risks inherent in antitakeover activity and can also provide the courts with identifiable standards of review, commensurate with the threat of that activity to traditional notions of corporate democracy.

Part II of this Article discusses the market for corporate control and management’s response to these developments. Part III surveys generally the cases and the commentary in this area, and concludes that no current proposal or analysis adequately addresses the scope and extreme effect of the means employed by management to deter hostile suitors. In essence, the pace of management activity has outstripped the proposed tools of legal analysis. Thus, an alternative basis for reviewing all antitakeover measures is presented in part IV, with emphasis on the substantive effect of such measures. This Article proposes that such measures be viewed similarly to other corporate activity and likewise be judged by several fundamental principles

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1. *See infra* notes 101-26 and accompanying text.
2. 500 A.2d 1346 (Del. 1985).
of corporate governance. The analysis developed in part IV is then applied to several recent cases of notoriety, concluding that in many circumstances the decisions have been ill-advised. Properly applied, the method of analysis proposed here, coupled with traditional principles of corporate governance, is sufficient to correct abuses by corporate management in the takeover context.

II. ACTIVITY IN THE MARKET FOR CORPORATE CONTROL

Since 1975, there have been more than fifty billion-dollar mergers or acquisitions, with over one-half of these occurring since the beginning of 1984.4 In 1984 alone, there were nearly 3,000 mergers or acquisitions, the highest total in more than a decade.5 The approximate dollar value of these transactions rose from 61.9 billion dollars in

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4. Sloan, Why is no one safe?, FORBES, Mar. 11, 1985, at 134-35. See also Top 25 Transactions, appearing in quarterly issues of MERGERS & ACQUISITIONS. The economic factors behind the drastic increase in activity in the market for corporate control are many and complex but a few recent contributions are particularly notable. First, the cash flow ramifications brought about by the 1981 Economic Recovery Tax Act have been important. Pub. L. No. 97-34, 95 Stat. 172 (1981) (codified in scattered sections of 26 U.S.C.). Under the Act, companies were allowed to accelerate depreciation of assets. Since depreciation is a noncash expense, corporate cash flow increased relative to corporate earnings. To the extent that many of the financial markets overly emphasize earnings in valuing stock, it is believed that the increased cash flow provided greater collateral for the credit needed to carry out an acquisition—relative to the price of the corporate stock—than had previously existed. In addition to the greater liquidity brought about through rapid depreciation, corporate borrowing capacity was also supplemented by the drastic increase in earnings occurring as a result of the economic expansion which began in 1982. This produced a significant change because of the low levels of corporate borrowing and investment during the preceding recession.

Moreover, lending to those seeking to execute an acquisition is particularly attractive to banks because of the high interest rates and fees that can be charged on the very large loans typically involved. These enticing lending opportunities have come about at a time when bank profits are under increasing pressure due to deregulation and nonbank competition. It has thus become increasingly easy for acquisition loans to be obtained.

Another part of the financing of takeovers that is of recent origin is the issuance of low-grade high-yield debt instruments, now fashionably referred to as "junk bonds." These securities may be issued for the specific purpose of carrying out an acquisition. Sometimes they are issued by a corporation that will have no assets prior to acquisition of the target. Though there is considerable controversy over the use of junk bonds to finance acquisitions, the net effect of this financing tool has clearly been the production of an enormous source of funds for those attempting corporate acquisitions. See Junk Bonds Don't Merit A Black-Hat Image, Wall St. J., Apr. 29, 1985, at 18, col. 3 (Midwest ed.).

A final factor, though of probably lesser importance, is the reduction in antitrust challenges to business combinations under the Reagan Administration's Justice Department. The oil industry, in particular, has undergone a significant increase in market concentration without challenge. Of particular note are: Standard Oil of California's combination with Gulf (a $13.2 billion transaction joining the fourth and fifth largest companies in the industry), Texaco's acquisition of Getty Oil, Mobil's acquisition of Superior Oil, and Royal Dutch/Shell's acquisition of Shell Oil.

1983 to 124 billion dollars in 1984, an increase of 139 percent. The number of tender offers has also increased dramatically—1984's total of 142 nearly doubled the 1983 total of 77. In number of tender offers, the 1984 total approached the record levels set in the late 1970's, and in dollar amounts, the 1984 total of forty-two billion dollars exceeded all but the 1981 dollar measure.

The change in control among billion-dollar corporations has alerted incumbent management in other large companies. As a result, more than 200 of Standard & Poor's 500 largest corporations now have some form of antitakeover provisions. For example, golden parachute arrangements are the most prevalent measure—having been adopted by 180 companies. In addition, classified boards of directors were adopted by 154 companies, while 85 companies included fair price provisions. Also, over 300 of Standard & Poor's 500 had authority to issue preferred stock, the characteristics of which could be determined by the board of directors. The power to determine the characteristics of this stock gives rise to the possible creation of "poison pill preferred" stock.

6. Id.
8. Id.
9. This article addresses hostile share acquisitions as a set of transactions which may include attempts by insurgents to gain control, to trigger a premium priced repurchase of their shares or merely an investment by outside parties which is deemed threatening by management. The usual result is that the target ends up selling itself to a more friendly purchaser which is referred to in the jargon of the business as a "white knight." Historically, hostile tender offers for control had a better than even chance for success, but since 1982 the percentage of failed hostile tender offers has increased above 50%, and in 1984 reached 69.7%. Id. at 68.
11. Golden parachute agreements provide benefits to corporate executives should a change in corporate control occur. The benefits usually take the form of stock options or salary continuances for a specified number of years. In many cases the potential benefits have a value of millions of dollars. See infra note 45.
12. Classified boards allow a corporation to stagger the terms of its directors, thus making it more difficult and time consuming for an insurgent to gain control of the board.
13. Fair price provisions generally require that all shareholders of a corporation subject to a tender offer be paid the same price for their shares. These provisions seek to deter two-tiered tender offers in which the offeror offers one price for enough shares to gain control, and then offers a lesser price to the remaining shareholders once control has been obtained.
14. Poison pill preferred stock usually involves the creation of rights in the holder of the secur-
Defenders of the defensive activities of target corporations argue that the threat of hostile takeovers creates a diversion of resources from long-term projects that might not show a profit for several years to short-term projects that may increase temporarily the corporation's earnings and stock price. Corporate management often claims that it is only protecting the shareholders' long-term interests by increasing directors' negotiating power vis-a-vis potential suitors.

On the other side are promoters of increased activity in the market for corporate control—shareholders eager to accept the premium prices paid for their shares in tender offers, corporations and investors seeking to acquire underutilized or complimentary assets or lines of business. Typically, shareholders are entitled:

(i) to redeem these shares for cash or debt securities if an outside entity acquires a specified percentage of the corporation's stock, at, for example, a redemption price equal to the highest price per share paid for the target's shares during a specified period, and/or
(ii) to convert the shares into common or convertible preferred stock of any controlling entity into which the target is merged, at, for example, half price.

The redemption privilege attached to the stock discourages the making of partial tender offers by giving its holders the power to deplete the target company's assets substantially; the conversion privilege discourages two-tiered tender offers by allowing shareholders to decline to tender their shares yet still receive the tender offer price in cash or its equivalent if the tender offer succeeds.


of business and the Securities and Exchange Commission. SEC Chairman John Shad has stated that most shareholders, without the aid of a hostile suitor, will be unable to prevent board and management entrenchment, given the corporate control of proxy machinery and the substantial costs of a proxy fight.\(^1\) Hostile share acquisitions thus are seen as benefiting shareholders in one of two ways—either increased prices if they sell their stock or improved management if they hold on to it.

A number of members of Congress have rushed to initiate legislation on takeovers.\(^1\) Very little is likely to come of such congressional

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\(^{1}\) See Economists Urge SEC To Resist Pleas for Curbs On Hostile Takeovers, 17 SEC. REG. & L. REP. (BNA) 329 (Feb. 22, 1985). See also Rorer Group Retains Measure Against Takeovers, Wall St. J., May 29, 1985, at 25, col. 3 ("Rorer Group, Inc. said its board voted unanimously to retain a 'poison pill' anti-takeover measure even though a majority of voted shares had been cast in favor of rescinding the measure in an earlier proxy contest. The vote of shares wasn't binding.").

\(^{19}\) Several bills have recently been introduced in both the House and Senate, seeking, by various means, to curb takeover activity. On November 22, 1985, Senator Howard Metzenbaum introduced a bill (S. 1882) which would direct the SEC to promulgate regulations prohibiting poison pills. Bill Seeks to Outlaw "Poison Pills", Fed. Sec. L. Rep. (CCH) No. 1154, Part One, at 5 (Dec. 4, 1985). Proposed legislation (H.R. 1003) introduced by Oklahoma's congressional delegation (no doubt in response to constituents' fears surrounding the takeover attempts on Phillips Petroleum) would eliminate the interest expense deduction on borrowings used to finance hostile takeovers. See Proposal Would Stop Use of Tax Breaks to Finance Takeovers, 17 SEC. REG. & L. REP. (BNA) 257 (Feb. 8, 1985). The bill would also restrict two-tier takeover attempts and place a 50% excise tax on greenmail payments. Separately, Oklahoma Representative Mickey Edwards proposed a moratorium on hostile takeovers of domestic petroleum corporations and investigation of the wave of petroleum industry acquisitions by government regulatory authorities (H.R. 998). House Bill Would Impose Moratorium On Oil Company Takeovers, 17 SEC. REG. & L. REP. (BNA) 258 (Feb. 8, 1985). The proposed legislation would prohibit hostile tender offers during the moratorium—only offers approved by a corporation's independent directors would be allowed to proceed.

A bill introduced by Senator John Chafee (R-R.I.) would also seek to achieve similar ends via modification of the Tax Code. Chafee Introduces Tax Bill To Discourage Hostile Takeovers, 17 SEC. REG. & L. REP. (BNA) 408 (Mar. 8, 1985). The bill proposes three changes to the tax laws: (1) expenses associated with the production of greenmail income would no longer be deductible; (2) the interest deduction would be denied on funds borrowed to carry out hostile acquisitions; and (3) hostile acquisitions would be taxed generally under I.R.C. § 338 (West Supp. 1985) as asset rather than stock purchases and the tax-free liquidation provisions of I.R.C. § 337 (West 1978 & Supp. 1985) would be made unavailable to the acquiring corporation.

Legislation proposed by New Jersey Democratic Representative Peter W. Rodino, Jr. (H.R. 1074) takes a different approach, advocating an increase in the waiting period for cash tender offers to 30 days from its present 15. Rodino Bill Would Change Waiting Period For Mergers, Cash Tender Offers, 17 SEC. REG. & L. REP. (BNA) 299 (Feb. 15, 1985). The bill would also give enforcement agencies the power to increase the period beyond 30 days and eliminate the discretionary power the Justice Department and Federal Trade Commission now have to waive the waiting period.

Another bill attacking hostile acquisitions (S. 706) was introduced recently by Senator William Proxmire (D-Wis.). Proxmire Introduces Measure To Slow Down Hostile Takeovers, 17 SEC. REG. & L. REP. (BNA) 476 (Mar. 22, 1985). The bill would generally require approval by a target corporation's independent directors before any hostile tender offeror could obtain more than 15% of the
activity, however, because the Reagan Administration has established that it harbors no animosity towards the recent outbreak of "takeover fever." In The Annual Report of the Council of Economic Advisers (Chapter 6), released February 2, 1985, the Council concluded that the only abusive behavior in the current acquisition market was the adoption of antitakeover measures.\(^\text{20}\) It urged no federal regulation of either offensive or defensive tactics, however, preferring to allow the courts to fashion individual remedies. The Council argued against blanket prohibitions because of the difficulty in determining whether a particular measure is abusive. The interdependence between a particular provision and the context within which it was adopted was believed to make determination on anything other than a case-by-case basis impractical.

### III. The Absence of a Coherent Framework for Reviewing Antitakeover Activity by Target Corporations

The flurry of takeover activity in the past few years has put substantial pressure on all members of the legal community to develop a framework for analyzing the defensive actions taken by target corporations. Left with incomplete guidance from commentators and the SEC, the courts have approached the propriety of target antitakeover activity from a limited perspective. Without any convincing framework for separating traditional business decisions from those decisions made in response to a hostile share acquisition, the courts understandably have leaned heavily toward application of the business judgment rule and minimal scrutiny of such activity.\(^\text{21}\)

20. *White House Economists Say No Need For Additional Takeover Regulations*, 17 SEC. REG. & L. REP. (BNA) 247 (Feb. 8, 1985). The Council found a net benefit resulting from takeovers and stated that "the economic evidence suggests that existing regulations impose restraints that may deter potentially beneficial transactions." *Id.* Arguing that takeovers substantially increase the wealth of shareholders in target companies, but that delays force premiums paid above necessary levels, the Council also criticized the Williams Act for detaining takeover attempts thus increasing the cost of such attempts and enabling target companies to develop defenses which are often effective.

21. *See infra* notes 101-26 and accompanying text.
A. Scholarly Analysis of the Antitakeover Dilemma

The scholarly debate over the propriety of target antitakeover activity has concentrated heavily on the relative merits of the tender offer, both as a means of corporate control and as an element in enhancing economic wealth. The strength of this debate has been its exploration of hostile share acquisitions from a public policy perspective, defined in terms of allocative efficiency. Its weakness is its failure to move beyond this theoretical analysis and integrate its conclusions with the daily operation of the firm and with the relationship between management and shareholders within the modern public corporation.

1. Target Responses to Specific Hostile Share Acquisitions

The exchange between Frank Easterbrook and Daniel Fischel, on the one side, and Martin Lipton, on the other, typifies the scholarly debate relating to actions taken by the target company in connection with an attempted hostile share acquisition. In 1979, Lipton took a very firm pro-management position on the validity of a target board's responses to an unsolicited takeover bid. Lipton focused on the role of the board of directors in the traditional legal model of the corporation and particularly on the role of the board in making policy decisions which affect shareholders' welfare. Viewed in this manner, Lipton argued that a takeover bid is just another major business decision. Therefore, the business judgment rule should apply to a decision by the target board to reject a takeover bid, in the same manner that it applies to any major business decision. Moreover, according to Lipton, "[o]nce the directors have properly determined that a takeover should be rejected they may take any reasonable action to accomplish this purpose."

Two years later Easterbrook and Fischel took the exact opposite
position, based on an economic analysis of tender offers and target defensive maneuvers. Responding to a tender offer or other hostile overture is, in their view, a prerogative of the shareholders and "does not involve management of the corporation's affairs in any meaningful sense and thus can be made by shareholders even though they are not involved in those affairs to any significant degree." Thus, any responsive action by the target board only increases the offeror's cost and decreases the number of offers. Because fewer potential purchasers will be monitoring the efficiency of current management, the price of the target's shares will decline, to the detriment of target company shareholders. Easterbrook and Fischel conclude that a


27. Easterbrook & Fischel, supra note 26, at 1198.

28. While most of the empirical evidence indicates that the preclusion of offers is harmful to target shareholders, see supra note 17, there is evidence that some opposition by management may benefit target shareholders in the form of greater premiums so long as the offer is not totally defeated. See Jensen & Ruback, supra note 17, at 38 ("Currently available evidence suggests that managerial opposition to a takeover does not reduce shareholder wealth unless the resistance eliminates potential takeover bids."); see also Linn & McConnell, An Empirical Investigation of the Impact of 'Antitakeover' Amendments on Common Stock Prices, 11 J. FIN. ECON. 361 (1983) (finding some evidence of positive returns to shareholders when antitakeover amendments are adopted).

29. Easterbrook & Fischel, supra note 26, at 1165-82. Easterbrook and Fischel's argument is built on the presumption of the efficiency of securities markets, thereby mandating public trading. Their focus is on agency costs as "an inevitable consequence of this relationship" where "the corporation is publicly held [and] the managers are unlikely to own a significant proportion of the firm's securities." Id. at 1195. Accord Friedenberg, Jaws III: The Impropriety Of Shark-Repellent Amendments As A Takeover Defense, 7 DEL. J. CORP. L. 32 (1982):

This paper focuses on shifts in control in publicly held corporations whose shares are widely traded. In essence, the argument made in this Part is that the stock market provides a good indication of the "worth" of a firm and that bidders who offer a premium above that price must contemplate that a transfer of control will enhance that value. They can achieve this transfer because shareholders as investors lack a strong attachment to management. In closely held corporations the situation is different. Apart from the fact that there is no organized market which will objectively value the firm, shareholders may have a strong interest in management (indeed, some will be management). Thus, it is less clear that shifts in control produce a net benefit, since the interests of shareholders who sell may not outweigh the interests of shareholders who retain their stock and discover that the quality of their investment has changed. Courts have been relatively liberal in allowing share transfer restrictions (such as the right of first refusal) in order to preserve shareholder expectations in closely held corporations. See generally Manne, Our Two Corporation Systems: Law and Economics, 53 VA. L. REV. 259, 278-80 (1967). Although that approach is facially at odds with the free transferability argument presented in this article, it is not inconsistent with the analysis upon which the argument is based.

Id. at 67 n.190.
rule of "managerial passivity" should be imposed and that any attempt by the target's managers to frustrate a tender offer should be prohibited.  

Several elements of this exchange are notable, particularly as these positions typify both the level and the focus of the scholarly approach to target board activity. First, both positions approach the issue of defensive maneuvers as a monolith. Depending on the protagonist, nearly all such measures are either proscribed or approved. One side emphasizes the accepted role of the board in making corporate policy, even with respect to significant fundamental corporate changes; while the other side focuses on the traditional right of shareholders to dispose of their shares without interference by the corporation or the board.

As a practical matter, however, such a dichotomy ignores the symbiotic nature of corporate governance and the economic welfare of shareholders in the modern corporation. In the public corporation, the board of directors makes policy decisions on a regular basis which fundamentally affect the desirability and value of the shares in the corporation, thereby determining the ability of shareholders to dispose favorably of these shares. These board actions, often involving business opportunities which may or may not result in enhancement of the corporation's value, traditionally have been reviewed in a framework where there is a presumption of propriety. To attempt to use the tender offer to redefine the relations within the corporation for all purposes is unrealistic. Neither the courts nor any regulatory authority will be willing to adopt the "managerial passivity" thesis wholesale.

Moreover, even when accepting the validity of hostile tender offers as a valuable means of changing or monitoring corporate control, Easterbrook and Fischel's condemnation of defensive measures is tied to the timing of their implementation. "[I]f actions that materially hindered either the offer or the acquisition were taken immediately after management first had reason to know of an impending offer,

30. Easterbrook & Fischel, supra note 26, at 1175-82. Gilson and Bebchuk differ from Easterbrook and Fischel in that the former authors would limit management action to that which facilitates an auction for the target, whereas Easterbrook and Fischel would prohibit all defensive measures.

31. For an excellent and comprehensive survey of the various economic positions on the antitakeover debate, see Coffee, supra note 22, at 1161-73.

then courts could presume that the actions were undertaken with a view to defeating the offer.”

In contrast, “courts could simply presume, subject to rebuttal by a litigant who established the contrary, that any plans set in motion before target managers had reason to believe that there would be a takeover attempt were not taken with a view to resisting the tender offer.” This focus on timing is strongly shared by many who do not agree wholesale with the passivity argument.

The timing distinction is not persuasive, however. The crux of the argument in favor of managerial passivity is that any action that raises the offeror’s cost in attempting to commence or conclude a hostile share acquisition decreases the number of such acquisitions and therefore is harmful. Easterbrook and Fischel argue that a decrease in hostile offers insulates the corporation and incumbent managers from the impact of the market in monitoring these managers and minimizing agency costs. The prohibitions embodied in the managerial passivity rule are keyed, however, not only to these defensive actions, but also to their timing.

Antitakeover actions, though, are not limited to responsive measures adopted in the face of a current tender offer or other takeover effort. Fairly routine charter provisions, such as staggered board terms, may also raise the offeror’s cost, yet these provisions may have been in place since the inception of the company. Since these provisions likewise increase the costs faced by an acquiring company in the takeover market, logically they should also be proscribed. Indeed,

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33. Easterbrook & Fischel, supra note 26, at 1203.

34. Id. In a later article, arguing over the validity of management measures designed to facilitate an auction, Easterbrook and Fischel still focus on the commencement of the tender offer process as the crucial point in time. See Easterbrook & Fischel, Auctions and Sunk Costs in Tender Offers, 35 STAN. L. REV. 1 (1982). The approach taken in another article by them would prohibit all defensive measures, even of a prophylactic nature. See Easterbrook & Fischel, Corporate Control Transactions, 91 YALE L.J. 698 (1982). The problems with the approach proposed in that article are discussed in Coffee, supra note 22, at 1216-21. For a view that all arguable antitakeover actions are invalid, see Johnson, Anti-Takeover Actions and Defenses: Business Judgment or Breach of Duty?, 28 VILL. L. REV. 51 (1982-83).

35. See, e.g., Coffee, supra note 22, at 1261-63; Gilson, Seeking Competitive Bids Versus Pure Passivity In Tender Offer Defenses, 35 STAN. L. REV. 51, 51-52, 64-66 (1982); Oesterle, Target Managers as Negotiating Agents For Target Shareholders In Tender Offers: A Reply to the Passivity Thesis, 71 CORNELL L. REV. 53, 83-84 (1985). See also the recommendations to the SEC of the Advisory Committee on Tender Offers, discussed infra notes 73-89. For an argument that keys the validity of some charter amendments to the timing of their effect, see Friedenberg, supra note 29.

36. Easterbrook & Fischel, supra note 26, at 1165-82. For a cogent argument challenging this conclusion, see Oesterle, supra note 35, at 73-81.
even relatively insignificant board actions (for example, creating employee stock options or declaring a dividend) could increase the costs or decrease the desirability of a company as a potential target.

More fundamentally, the theoretical beauty of any rule of clear prohibition is its presentation of a bright-line demarcation that is not dependent on an inexact inquiry into managerial motives. Once it is recognized, however, that the force of the managerial passivity thesis is not limited to responsive measures of currently embattled management, this beauty disappears. Indeed, if the thesis is persuasive, there is nothing magical about post-tender offer maneuvers that would substantively separate them from pre-tender activities, except the apparent desire to use timing as a surrogate for an inquiry into managerial motivations.

Courts and corporate regulators will not cripple corporate boards by imposing a rule of managerial passivity with respect to all actions that increase the costs to a possible acquirer. Nor will courts be willing to prohibit all post-tender activity based on a built-in presumption of jaundiced justifications. In the absence of this prohibition, the validity of individual board actions or charter amendments, if challenged, must be tested by some other mode of analysis. It is here that the managerial passivity thesis provides no guidance.  

37. Any focus on post-tender actions alone is flawed as a practical matter as well. Especially in an era where hostile share acquisitions and corporate takeovers have become both routine and good business, only the most myopic of managers would make even relatively routine business decisions without consideration of the effect those decisions have on the company's desirability as a takeover target. Any theory which uses the timing of the action as the trigger for application severely underestimates managerial intelligence and power. The prophylactic activity discussed in part I is a testament to such managerial ingenuity and ability.

Moreover, any analysis which focuses on responsive measures fails to take into account the often drastic differences in ultimate effect of such measures when compared to today's panoply of prophylactic maneuvers. Many actions taken in response to a tender offer may be episodic and of little structural effect. Greenmail is a good example. It is a one-time premium payment to a large shareholder, certainly causing a depletion in corporate assets. But its lasting effect is minimal. No structural change in the corporation occurs and no reallocation of corporate decision-making power results.

The current penchant for charter amendments as a deterrent to takeover consideration provides a sharp contrast. Initially, unlike many defensive maneuvers which deter only the individual hostile suitor currently seeking control, such amendments, if effective, deter all potential suitors. Moreover, some of these provisions, such as supermajority requirements where the vote necessary to approve any significant shift in corporate control allows a present majority to prevent a future majority from taking effective action, result in a shift in control among shareholders. Where the supermajority is set so high that action cannot be taken without the vote of shares held or controlled by incumbent management, all control over fundamental changes effectively shifts from the shareholders to incumbent management.

A focus on the timing of action taken thus tends to ignore the variations in the effect of that
While an economic analysis provides insight into the effect of antitakeover maneuvers, it is necessarily inconclusive. In a recent comprehensive article on the economics of the market for corporate control, John Coffee surveyed the debate over the economics of the tender offer and concluded that "if one asks 'who wins and who loses from takeovers,' these different explanations give every possible answer." Even if it is accepted that hostile share acquisitions and accompanying auction markets have a positive effect on allocative efficiency, it does not necessarily follow that defensive actions or prophylactic measures should be invalidated. Such a conclusion, even from an economic perspective, does not indicate whether incremental gains from preventing such tactics exceed incremental costs.

The above analysis is not meant to imply, however, that Lipton is right in his analysis. On the contrary, he also errs by being overly simplistic to the extent that he judges all defensive or prophylactic measures, particularly board activities, as presumptively valid under the business judgment rule. Lipton contends that:

Once the directors have properly determined that a takeover should be rejected they may take any reasonable action to accomplish this purpose, including litigation, complaints to governmental authorities, the acquisition of a company to create an antitrust or regulatory problem for the raider, the issuance of shares to a big brother, or the premium purchase of shares of the target from the raider.

Indeed, Lipton does not even limit this carte blanche to episodic responses to a particular, arguably unfair, tender offer. Rather, in his view, a "company may attempt to discourage takeovers through such tactics as shark-repellent charter amendments and lobbies for take-

38. Coffee, supra note 22, at 1173. But see supra note 17, which relates to the financial benefits to target corporation shareholders.

39. See DeAngelo & Rice, Antitakeover Charter Amendments and Stockholder Wealth, 11 J. FIN. ECON. 329 (1983) (finding slight negative returns to shareholders when antitakeover amendments are adopted); Linn & McConnell, supra note 28, at 361 (finding some evidence of positive returns to shareholders when antitakeover amendments are adopted). See also supra note 28, which indicates that some opposition of takeover offers may be beneficial to target shareholders.

40. Coffee, supra note 22, at 1198-99. Coffee ably catalogues the diseconomies of the tender offer. Id. at 1221-50.

41. Lipton, supra note 15, at 123-24 (citations omitted).
over laws that have the same effect."^42

The near-abdication of judicial review implicit in applying the business judgment rule ignores the corporate governance and power allocation effects of such action by presuming its validity. A focus on the traditional *power* of the board to oversee management of the corporation subsumes the second level issue of whether the *means* employed by the board infringe on the allocation of decision-making power within the corporation, so as to violate accepted norms of corporate governance. For example, while the board may normally act to declare the rights and preferences for stock, and to declare dividends on that stock, when a redeemable poison pill stock is created (thus making any substantial share acquisition prohibitively expensive) this effectively forces the potential suitor to negotiate with the target board over the redemption of the poison pill. The result is the reallocation of control, from the shareholders to the board, over all proposed large share acquisitions.

In sum, as typified by the Easterbrook and Fischel versus Lipton debate, the scholarly positions on the validity of responsive measures by a target board provide little guidance for deciding particular cases. Because the circumstances and nature of hostile share acquisitions vary greatly, courts would be unlikely to totally handcuff incumbent management. Conversely, it is not justifiable to grant unbridled discretion to the board, since the means employed may tend to cripple the corporation more than the perceived effect of a hostile takeover.^44

2. *Adoption of Prophylactic Measures*

Compared with the commentary on responsive measures to a current or impending takeover threat, less has been written about corporate actions which may deter possible suitors from ever attempting to take over another corporation. Scholarly commentary often gives little play to the plethora of prophylactic actions implemented by the board of directors, either pursuant to statutory authority or a broad enabling provision in the corporate charter.^45 Instead, the existing

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^42. *Id.* at 113.


^45. The notable exception has been commentary on "golden parachutes.” *See, e.g.*, Riger, *On Golden Parachutes, Ripcords or Ripoffs? Some Comments on Special Termination Agreements*, 3 PACE L. REV. 15 (1982); *Note, Corporate Golden Parachutes: An Executive Bailout From Fiduciary Duty?,* 9 NOVA L.J. 447 (1985); *Note, Golden Parachute Agreements: Cushioning Executive Bailouts*
articles focus primarily on the shareholder's adoption of charter pro-
visions which either (1) make an acquisition more expensive, (2) inter-
pose requirements that cause a delay, or (3) create veto provisions in
favor of some group within the corporate structure.\textsuperscript{46}

\textbf{a. Preventive Actions by the Board}

Board decisions, in the ordinary course of business, have always
had the cloak of presumptive validity provided by the business judg-
ment rule. Where these decisions appear to be made in good faith,
after due deliberation, the board's members are not liable for breach-
ing their fiduciary duty to the shareholders, even if the decision later
turns out to be detrimental to the corporation.\textsuperscript{47} Only where the di-
rectors can be found to have been grossly negligent will liability
attach.\textsuperscript{48}

The popularity of board-approved highly lucrative severance
agreements with top management, commonly referred to as "golden
parachutes," highlights the difficulty faced by the commentators in
analyzing pre-tender offer antitakeover activities. Most commenta-
tors have been critical of these agreements but have not provided a
persuasive basis for invalidation.\textsuperscript{49} The most common argument
against such provisions is that they waste corporate assets. However,
claims of corporate waste are extremely difficult to prove, especially in
the compensation context, since part of the board's traditional func-
tion is to determine appropriate levels of executive compensation.
Thus, like other decisions which involve primarily a monetary expend-
iture or financial commitment, the protection afforded by the busi-
ness judgment rule is difficult to avoid.

The current popularity of "blank check" preferred stock or stock


\textsuperscript{49} See, e.g., authorities cited at \textit{supra} note 45.
warrants, which allows the board to issue such stock at its discretion and to endow the stock with any designations, preferences and rights selected by the board, raises the same problems. The authority of the board to make this issuance is sanctioned by statute. The focus thus turns to the board’s exercise of this power. Like other board decisions affecting the general operation of the corporation and its capital base, commentators have concluded that the use of such authority to deter a hostile suitor is well within traditional board discretion.

b. Charter Amendments

Particularly perplexing for the commentators has been the proper way to analyze amendments to the articles of incorporation which chill takeover efforts. At least two problems arise in this context. First, what standard should be applied to board implementation or recommendation of such changes, and second, what effect should shareholder approval have on the validity of these organizational alterations?

With respect to board-proposed charter amendments, the commentators once again are split. Easterbrook and Fischel, for example, while not specifically addressing pre-tender offer tactics, do incidentally opine that the “business judgment rule should not apply, however, to unambiguous preventive defensive tactics such as shark repellent charter and bylaw amendments. This type of resistance . . . should be prohibited per se.”

The problem with such a conclusion is that it would prohibit the board from making decisions (for example, recommending a change in the articles or bylaws) that are normally part of the board’s proper functions. It is not enough to respond that only “shark repellent” provisions, but not other charter amendments, should be prohibited, because such a distinction raises a problem of identification. For ex-

50. See supra note 14.
51. See, e.g., DEL. CODE ANN. tit. 8, § 151(g) (1983).
54. Easterbrook & Fischel, supra note 26, at 1203 n.2. See also supra note 18.
55. See, e.g., Gilson, supra note 46; Friedenberg, supra note 29. See also Coffee, supra note 22, at 1192 (“highly restrictive limits should be placed” on shark repellents).
ample, a charter amendment which creates staggered terms for the board of directors may have some deterrent effect. Does a board breach its fiduciary duty by proposing such an amendment?

Without adopting a strict rule which would hold that a board breached its fiduciary duty by proposing changes which have any deterrent effect, standards must be developed for distinguishing valid from invalid changes. Here, however, as in analyzing unilateral board action, the guidelines for the inquiry pose the problem. Any attempt to ferret out and weigh motivations in the context of business decisions must fail, since persuasive parsing of complex judgmental decisions is rarely possible.56

Commentators urging the total invalidation of these charter amendments also must contend with shareholder sanction. Unlike unilateral board action, these charter changes often require and receive majority shareholder approval. Assuming full disclosure of the relevant provision, its effects and the purposes for its recommendation, such approval by the shareholders would appear conclusive. It thus seems that the board not only is insulated by this shareholder action, but also that shareholder approval prevents an attack on the substance of the provision.

Authors respond to the issue of shareholder approval either by ignoring this impediment to their theory,57 by depreciating (but not

56. One author attempts to obviate a direct inquiry into motive by looking at the purpose of the amendment. See Friedenberg, supra note 29. "Purpose," however, is defined not in terms of justification, but in relation to the circumstances in which the charter provisions would operate. "A per se prohibition is clearly appropriate when the amendments serve no function outside the tender offer context." Id. at 92.

Such a theory takes the managerial passivity thesis one step further. Not only does a target's board have no legitimate function in the face of a tender offer other than the provision of information to the shareholders, but the recommendation by the corporate board of any charter provision which operates solely in the tender offer context is a breach of fiduciary duty. According to this approach, efficient operation of the market for corporate control requires invalidation of any such recommendation, no matter what the justification.

A focus on "purpose", so defined, would thus result in invalidation of charter provisions, such as supermajority voting requirements and fair price provisions. Such a rule poses great difficulties. For example, invalidation of charter provisions requiring supermajority voting approval for mergers or other business combinations ignores the fact that many states impose such a requirement by statute. Beyond the facial incongruity of prohibiting such amendments in states where there is no statutory provision but accepting its mandatory application in jurisdictions which impose the requirement by statute, such provisions have well-recognized positive purposes in protecting minority shareholders. A rule imposing a complete ban on such provisions appears too extreme, if not fundamentally misguided.

57. See, e.g., Johnson, supra note 34, at 71-74.
denying) the efficacy of such approval or by boldly arguing that "the significance of tender offers is too important to be bargained away by shareholders." Except for the possibility of federal or state legislation which would prohibit the adoption of certain provisions, these theories fail to provide a sufficiently specific rationale for wholesale invalidation of these acts of shareholder democracy. It is ironic that the genesis of the theories that would invalidate all antitakeover activity stems from a concern for shareholder rights and welfare, yet, as applied, such theories must urge rejection of otherwise statutorily approved acts of shareholder democracy. The courts, attempting to apply traditional concepts of corporate governance, require finer tools of legal analysis.

B. The Role of the Securities and Exchange Commission

Despite the level of takeover activity over the past decade, and the numerous bills designed to address particular aspects of the issue which have been introduced in Congress in the past few years, the Securities and Exchange Commission stands as something of a lone ranger with a single six-shooter against the onslaught of varied and imaginative defensive weapons developed by potential target corporations. Its primary statutory tool, the Williams Act, was enacted eighteen years ago, primarily to regulate the tender offeror. Consequent on investing in a business, investors implicitly signal their approval of current management. Unless the market price of the stock plummets dramatically due to perceived mismanagement, most shareholders, representing a variety of diverse investment goals, will not be interested in changing the status quo. Other investors, or even outsiders, may believe that the currency market price of the stock, while acceptable to some, is far below the market price that could be achieved either by liquidating assets or altering strategy. To these investors the question is not whether management is achieving an acceptable market price per share of stock but whether management is maximizing the market price per share.

Such investors could attempt to effect change through a proxy battle or a merger, but these options give wide discretion to current management. Beginning in the early 1960s, these investors focused on the tender offer as the best alternative means to bring about corporate change. The tender offer was seen as less expensive, as not requiring approval by management or a vote of the shareholders, and, because shareholders tendered their shares voluntarily, as running less risk that the fairness of the tender offer price would be challenged.

Most important, the tender offer remained secret until it was implemented. The offeror did not have to disclose the offer to management prior to making the offer and did not even have to disclose its identity once the offer became public. Nor did the offeror have to disclose any plans for the target company if control was acquired. Thus, even without a front-end loaded two-tiered tender offer,
quently, the SEC has been hampered in its attempt to regulate the defensive activities of a target corporation.

1. The Limitations of SEC Authority Under Tender Offer Legislation

After much consideration of the value of tender offers to the economy, Congress passed the Williams Act in 1968 and designated

there was reason for shareholder concern for the corporation's long-term viability, adding impetus to the reasons to tender. Not surprisingly, tender offers became very popular and successful.

63. At first, the problems posed by cash tender offers were presented in Congress couched in inflammatory terms:

In recent years we have seen proud old companies reduced to corporate shells after white-collar pirates have seized control with funds from sources which are unknown in many cases, then sold or traded away the best assets, later to split up most of the loot among themselves.

... A group of corporate raiders, collusively joined together, can buy up enough shares of a corporation's stock virtually to guarantee victory in a proxy fight without management or shareholders having any knowledge of these acquisitions. The purchases can be made in so-called street names or, even more furtively, by Swiss banks for an undisclosed account number.

111 CONG. REC. 28,257-58 (1965) (Statement of Sen. Williams). Senator Kuchel, embellishing these remarks of Senator Williams, spoke of "financially raped" corporations. Full Disclosure Of Corporate Equity Ownership And In Corporate Takeover Bids: Hearings on S. 510 Before the Subcomm. on Securities of the Senate Comm. on Banking and Currency, 90th Cong., 1st Sess. 46 (1967) (statement of Sen. Kuchel) [hereinafter cited as Hearings on S. 510]. Later, free from impassioned and inflammatory remarks, the debate began to center upon the merits of tender offers. The tenor of the debate changed dramatically as exemplified by the following exchange between Senator Williams and Mr. Painter:

Sen. Williams: "Raider" is a bad word. We don't use that word in this bill. This is a corporate takeover bill . . . .

Mr. Painter: There must be some policy reason why you are seeking regulation here. And since the word "raiders," or "pirate," or whatever you wish to call it, had been used previously in these hearings—and I think even had been used on the floor of the Senate when you introduced the bill.

Sen. Williams: Walt a minute. Say that again?

Mr. Painter: I seemed, in reading your remarks, Senator, to catch some flavor of the type of language that I have been using in your remarks on the floor when you introduced the bill.

Sen. Williams: You are absolutely right. But that was during the 89th Congress and I have changed my language.

Id. at 123. The first issue was whether tender offers served a legitimate purpose. Proponents argued that tender offers helped to rid the American economy of its worst enemy—inefficient management. Id. at 62 (testimony of Prof. Samuel Hayes III) (study finds that target companies were sluggish, unprofitable, and excessively liquid). With the increasing size of corporations, ownership was becoming less concentrated. Widely scattered shareholders could not mount a serious challenge to
the SEC as the regulatory agency responsible for promulgating and implementing regulations. The legislative history of the Act reflects the concern of the bill's author that the SEC should remain neutral in the tender offer forum. The purported purpose of the bill was to protect investors by requiring the offeror to make "full and fair disclosure" because it was only with such disclosure that investors could make an informed investment decision.

On the other side, Congress was concerned with offerors who liquidated a target company after a successful tender offer. The supporters of tender offers conceded that corporate raiders were a problem. In the end, however, Congress decided that while corporate raiders may be a problem, the problem posed by entrenched management was much greater. For the good of the economy, tender offers would not be abolished.

After deciding that most tender offers were beneficial, Congress next addressed the issue of whether to regulate tender offers, i.e., whether any side in the dispute should be accorded more or less protection. Even without regulation, management was not powerless. Management could use corporate assets and shareholders. Management could count on the support of those who symbiotically were linked to management: bankers, suppliers, customers, and institutional investors.

Management could drive up the market price of the corporation's stock by repurchasing the stock or by increasing the dividend. Once the gap between the market price and tender offer price narrows, the incentive for arbitragers to enter the market decreases. Moreover, the incentive for shareholders to tender their shares also decreases. Of course, the offeror could raise the tender offer price, thereby providing an incentive for both arbitragers and shareholders, but the offeror may not be able to raise the price because of a lack of financing or because a higher price would render the tender offer unprofitable.

Management could also amend the corporate charter, highly publicize the offer hoping to scare customers, suppliers, and employees of the offeror, issue new shares, execute long term employment contracts with the corporation, change the situs of the corporation to take advantage of a more restrictive state takeover statute, merge the corporation with another corporation or bring an action for injunctive relief.

The shareholders of the target company were perceived to be at an extreme disadvantage due to the secrecy and speed of the typical tender offer. While state corporation laws generally required both disclosure and a vote of approval by shareholders for other methods of changing corporate control, shareholders presented with a tender offer often did not have the information they needed to make an informed decision. Compounding this problem, shareholders regularly were required to tender within just a few days of the announcement of the offer, shares were accepted on a first-tendered basis, and the shares could not be withdrawn until the offer was completed or abandoned.

The Williams Act attempted to mitigate the information problem by requiring that a person who would beneficially own more than five percent of a class of securities after completing a tender offer must file a Schedule 14D-1 with the SEC on the date of commencement of the offer and must
While the SEC is given general regulatory authority under the Williams Act, its authority to deal with target company antitakeover activity is constrained by both the terms and the focus of the Act, as well as by related legislation. By its language, the Williams Act only governs tender offers. While third-party tenders are the primary method of obtaining corporate control, tender offers by corporations for their own shares are a possible, but relatively infrequent, takeover defense.

The unevenness in regulation under the Act also appears from its focus on protecting the target shareholders. The purpose of the Act was to regulate the activities of bidding and target companies only to the extent necessary to insure an informed and unhurried decision by these shareholders. There is no attempt to regulate the internal affairs of either corporation. The tender offer itself is thus the public act being regulated, while the maneuvering by target management is of little apparent concern. The result is that, in a tender offer, the actions of the bidder are circumscribed by federal law while the activities of the target are mostly left to state regulation.

Although the SEC, under the guise of protecting target shareholders generally, might be able to adopt a specific regulation dealing

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68. 15 U.S.C. §§ 78m(d)(1), (d)(4), (d)(5), (d)(8), (c) (1982).
70. Bidders also have moved to avoid the restraints of the Williams Act by making share acquisitions by private or open market purchase instead of by tender offer. See, e.g., Hanson Trust PLC v. SCM Corp., 774 F.2d 47 (2d Cir. 1985).
with a particular abuse by the target corporation,\textsuperscript{71} such a method suffers by being reactive. Today the SEC might prohibit discriminatory self-tenders,\textsuperscript{72} but tomorrow incumbent management will devise a new method to forestall a takeover attempt. What is needed, therefore, is a theory of substantive regulation of defensive devices which provides a framework for analysis and prescription.

In partial recognition of the limitations of its authority under current federal law, the SEC, in 1983, established an Advisory Committee on Tender Offers. The Committee was to review the effectiveness of current laws and recommend legislative and regulatory changes which would govern the actions of both target and bidding corporations.\textsuperscript{73} The Committee was composed of eighteen prominent acquisition experts,\textsuperscript{74} and its final report contained fifty recommendations.\textsuperscript{75}

Eleven of the Committee's fifty recommendations concerned "Regulation of Opposition to Acquisitions of Control,"\textsuperscript{76} and they contained several interesting elements. First, the Committee embraced the view that "the business judgment rule should be the principal governor of decisions made by corporate management including decisions that alter the likelihood of a takeover."\textsuperscript{77} This reaffirms the dichotomy of federal regulation for the bidder and state regulation for

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\item \textsuperscript{71} For example, SEC Rule 14e-2, 17 C.F.R. § 240.14e-2 (1985), requires target management to tell shareholders of its position on the tender and to disclose the reasons for that decision.
\item \textsuperscript{72} See SEC Staff Seeks Rule to Spell Out Ban Against Exclusionary Tender Offers, Wall St. J., June 24, 1985, at 2, col. 3.
\item \textsuperscript{74} The members were Dean LeBaron, President of Batterymarch Financial Management, who was selected as Chair of the Committee; Jeffrey B. Bartell, Esq., of Quarles & Brady; Michael D. Dingman, President of the Signal Companies, Inc.; Frank H. Easterbrook, of the University of Chicago Law School; Joseph H. Flom, Esq., of Skadden, Arps, Slate, Meagher & Flom; the Honorable Arthur J. Goldberg; Robert F. Greenhill, Managing Director of Morgan Stanley & Co., Inc.; Ray J. Groves, Chair and Chief Executive of Ernst & Whinney; Alan R. Gruber, Chair and Chief Executive Officer of Orion Capital Corporation; Edward L. Hennessey, Jr., Chair of the Board of Allied Corporation; Gregg A. Jarrell, Senior Economist of Lexecon, Inc.; Robert P. Jensen, Chair and Chief Executive Officer of E.F. Hutton LBO, Inc.; Martin Lipton, Esq., of Wachtell, Lipton, Rosen & Katz; Robert E. Rubin, of Goldman, Sachs & Co.; Irwin Schneiderman of Cahill, Gordon & Reindel; John W. Spurdle, Jr., Senior Vice President of Morgan Guaranty Trust Company of New York; Jeff C. Tarr, Managing Partner of Junction Partners; and Bruce Wasserstein, Managing Director of the First Boston Corporation. SEC ADVISORY COMMITTEE ON TENDER OFFERS, REPORT OF RECOMMENDATIONS (July 8, 1983), reprinted in FED. SEC. L. REP. (CCH) No. 1028 (extra ed.) (July 15, 1983) [hereinafter cited as ADVISORY COMMITTEE REPORT].
\item \textsuperscript{75} Id.
\item \textsuperscript{76} Id., Recommendations 33-43.
\item \textsuperscript{77} Id., Recommendation 33, at 34.
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the target. Second, the Committee, with some dissent, generally agreed that antitakeover measures were "inappropriate when adopted after the announcement of a takeover," once again putting a premium on prophylactic measures. Third, the Committee focused on supermajority vote requirements for change of control transactions. In the Committee's view, a supermajority provision could only be adopted if the vote for adoption at least matched the vote required under the provisions of the supermajority provision itself. In essence, a current majority could not adopt a supermajority provision that does not have the support of a current supermajority.

The Advisory Committee's Report, as it relates to target antitakeover activity, suffers from several fundamental flaws. Most important, there is no guiding principle or principles identified by the Committee in reaching its conclusions. Further, no attempt is made to address the critical question of the role of the target board of directors and its interrelation with both the role of the shareholders in corporate governance and the related right of shareholders, as individuals, to dispose of their stock. Finally, the Committee's re-

78. Some members thought that some antitakeover measures were justified by the coercive nature of partial or two-tier tender offers. Id. at 37.
79. Id.
80. Specifically, the Committee suggested that change of control compensation (e.g. golden parachutes) be prohibited after a tender offer commences but not before. Id., Recommendation 28, at 40-41. It is not clear from the report whether other post-tender actions should be analyzed under the business judgment rule, a stricter standard, prima facie prohibited, or some other method of review employed by the courts. The Committee would put prophylactic charge of control compensation to an advisory (non-binding) shareholder vote. Similarly, to provide a check when incumbent management negotiates special agreements aimed at courting a friendly bidder (white knight), the Committee suggested that any issuance of more than 15% of a target company's stock during a tender offer must be approved by the shareholders. Id., Recommendation 41, at 44.
81. Id., Recommendation 35, at 36.
83. See also Gilson, supra note 46.
84. The Committee suggested that certain matters be designated "advisory vote matters" requiring review at annual shareholder meetings. Matters covered include supermajority provisions, disenfranchisement, standstill agreements, and change of control compensation. These matters would be separately designated in the proxy statement in a "Change of Control" section but the shareholder vote would be non-binding on the board and would not affect existing agreements. Thus, we have the minimal review of the business judgment rule for some actions, others are totally prohibited, and a third group are subject to an apparently futile exercise of pretend corporate democracy by way of a shareholder straw vote. Why certain actions or provisions fall into one category as opposed to another may be guessed at, but nothing is clear beyond the conclusions presented.
85. When do the actions of the board involve sufficient aspects of self-dealing to require a stricter standard of review? When do these actions sufficiently impose on shareholder rights or discriminate among shareholders so as to be invalid as a violation of statutory and common law
The weakness of this point-in-time focus and lack of overriding principles is highlighted by two antitakeover measures, not unheard of at the time of the Committee report, but which have become more significant since the Committee made its recommendations. First, the board of directors may issue “poison pill preferred” stock to ward off potential raiders. The Committee report does not address such use of share preferences specifically, nor does it provide a prescriptive framework for analyzing the validity of this device or the board’s use of it. Rather, the Committee reaffirms its general allegiance to the business judgment rule.

Second, consider the adoption by the shareholders of a fair-price amendment designed to insure equality of treatment in response to a two-tier tender offer. The Committee does not address such a provision directly and only gives vague guidance as to its position on the validity of such an amendment. “Congress and the Commission should adopt appropriate legislation and/or regulations to prohibit the use of charter or by-law provisions that erect high barriers to change of control.” Whether the fair-price provision fits within this suggested prohibition is left to speculation. In any event, significant Congressional action in the foreseeable future in support of these proposals is unlikely.

2. SEC Antifraud Regulation

The federal securities laws provide the SEC with another alternative whereby they can use existing statutory provisions to regulate antitakeover activity. Initially, federal law was thought to apply to a target board’s actions in response to a tender offer, either under the share-transactions fraud prohibition of Section 10(b) and Rule 10b-5 or pursuant to Section 14(e) of the Williams Act. Thus, it was

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86. That is, it appears that the Committee simply chose some favorite antitakeover measures and voted up or down on them. Maybe the Committee viewed its role as merely surveying the then current variety of defensive measures and pronouncing judgment on them. But we are left with no means by which to assess the validity of future mechanisms designed to thwart takeover activity.

87. ADVISORY COMMITTEE REPORT, supra note 75, Recommendation 33, at 34.

88. Id., Recommendation 35, at 35.


thought that the federal and/or state securities laws could be used to regulate target board activity which seemed unfair or manipulative, even if the conduct did not amount to outright misrepresentation or deception.\textsuperscript{93}

This theory was dashed by the Supreme Court in \textit{Schreiber v. Burlington Northern, Inc.}\textsuperscript{94} The issue presented to the Court in \textit{Schreiber} was whether the actions of El Paso's board (the target company), which caused the rescission of an initial tender offer by Burlington in favor of the less-favorable friendly proposal, violated the antifraud provisions of the Williams Act. This action, the plaintiff alleged, was manipulative within the meaning of the statutory prohibition of "fraudulent, deceptive or manipulative acts or practices."\textsuperscript{95}

The Supreme Court, however, rejected this claim. According to the Court, "manipulative acts" require some element of misrepresentation or nondisclosure.\textsuperscript{96} Without misrepresentation or nondisclosure, there is no violation of the antifraud provisions of the Williams Act. It thus appears clear that the typical array of antitakeover activity by target corporations, if accompanied by adequate disclosure, will not give rise to a federal antifraud cause of action.

3. \textit{SEC Regulation of Proxy Solicitations}

Although the SEC has been limited in its ability to substantively regulate the defensive tactics of target companies, it does have the authority to regulate the solicitation of proxies from shareholders by either the target or an outsider. The SEC rules on solicitation have

\textsuperscript{92} 15 U.S.C. § 78n(e) (1982).
\textsuperscript{93} See, e.g., Applied Digital Data Sys., Inc. v. Milgo Elec. Corp., 425 F. Supp. 1163 (S.D.N.Y. 1977); Royal Indus., Inc. v. Monogram Indus., Inc., [1976-77 Transfer Binder] \textbf{FED. SEC. L. REP. (CCH)} § 95,863 (C.D. Cal. Nov. 29, 1976). Santa Fe Indus. v. Green, 430 U.S. 462 (1977), provided the first limitation on the application of federal antifraud provisions to target activity. In \textit{Santa Fe}, the Supreme Court held that a merger could not be challenged under these provisions on the basis of claimed unfairness. Rather, some element of manipulation or deception must serve as a prerequisite to applicability of these federal statutes.

Despite the limiting effect of \textit{Santa Fe}, in \textit{Mobil Corp. v. Marathon Oil Co.}, 669 F.2d 366 (6th Cir. 1981), the Sixth Circuit found room for federal regulation of target board actions. In \textit{Mobil}, Marathon attempted to defeat Mobil's tender by contracting to sell out to United States Steel Corporation as a "white knight," the tender by U.S. Steel being contingent upon Marathon's agreement to sell ten million treasury shares to it and to sell Marathon's "crown jewel" oil field to it if Marathon was acquired by a third party. The Sixth Circuit held that the two options granted to U.S. Steel constituted "manipulative acts" within the meaning of the Williams Act because both options had the effect of "circumventing the natural forces of market demand." \textit{Id.} at 376.

\textsuperscript{94} 105 S. Ct. 2458 (1985).
\textsuperscript{95} \textit{Id.} at 2460-61; 15 U.S.C. § 78n(e) (1982).
focused on the scope and depth of required disclosures and have direct applicability to the adoption by target corporations of charter amendments.

The primary issue in proxy disclosure cases is the extent of disclosure necessary to satisfy the SEC's antifraud proscription. In 1978, the SEC Advisory Committee on Corporate Disclosure specifically recommended that the SEC's Division of Corporate Finance screen management antitakeover proposals carefully to insure adequate disclosure to stockholders. Consequently, the Division of Corporate Finance published guidelines requiring extensive disclosure when a proxy statement containing an antitakeover amendment is filed with the Commission. But disclosure is not prohibition or re-

97. The general statutory provision is § 14(a) of the Securities and Exchange Act, 15 U.S.C. § 78n(a) (1982), and is implemented by SEC rule 14a-9, 17 C.F.R. § 240.14a-9 (1985), prohibiting false or misleading proxy statements.


99. The Advisory Committee's Digest of its report summarizes the discussion of antitakeover provisions as follows:

The Advisory Committee believes that the disclosures in proxy statements about management proposals, particularly those where management may have a conflict of interest, such as option and other similar type plans, anti-takeover proposals, and plans for going private, are not always adequate. The Commission should closely review proxy materials on management proposals and assure that there is adequate discussion of their disadvantages.


The Commission should direct the SEC staff to review intensively proxy materials which contain certain management proposals, with a view to requiring more uniform and adequate disclosure of the advantages and disadvantages of proposals which may substantially affect the interests of shareholders, including disclosure of estimated costs of any option or similar type plan and the possible impact such plan may have on the behavior of management.

Id. ¶ 81,357, at 88,674.

100. See Disclosure in Proxy and Information Statements; Anti-Takeover or Similar Proposals—Securities Exchange Act Release No. 15230, reprinted in [1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 81,748 (Oct. 13, 1978) [hereinafter cited as SEC Release]. The Division of Corporate Finance indicated that the instructions in the release were "merely for the guidance of the staff and [were] subject to revision without formal notice." Id. at 80,984. Like all suggestions from a dominant regulatory authority such as the SEC, these "guidelines" have been accepted as a gloss on the requirements of the statute and regulations. The Release states:

The Advisory Committee on Corporate Disclosure in its report urged the Commission staff to review closely proxy materials containing anti-takeover proposals in order to ensure that there is adequate discussion of their disadvantages as well as advantages. In February of 1978, the Commission responded with an indication that the suggestion would be imple-
striction. These guidelines therefore presume the substantive validity, under state law, of all such charter amendments or other antitakeover measures that have been approved by the shareholders.

C. Judicial Review of Antitakeover Actions

The commentators have debated whether the target board could make any response at all, and the SEC, having only the provisions of federal law to build upon, is severely limited in proposing a framework for analysis of these activities. Thus, in assessing the validity of antitakeover activities, the judiciary has not been in an enviable position. Both the focus of the scholarly debate and the limitations of federal law have put tremendous pressure on state corporate law principles and their piecemeal application by the courts.

The pressure was compounded by the nature of the American corporate governance system. Within this codified system the board of directors is accepted as the policy-making organ of the corporation. The directors' presumed expertise and familiarity with the corporation's business affairs best enables them to make business deci-

101. See, e.g., MODEL BUSINESS CORP. ACT ANN. § 8.01 (3d ed. 1985) ("All corporate powers shall be exercised by or under the authority of, and the business and affairs of the corporation managed under the direction of, its board of directors, subject to any limitation set forth in the articles of incorporation.")
sions that maximize the shareholders’ welfare. From this starting point, a judicially created rule has developed which states that the majority of directors should have the right to determine the business policy of the corporation, free from judicial second-guessing, so long as they acted in good faith and without conflict of interest or breach of trust. Thus, it is not surprising that the courts charged with reviewing antitakeover activities began their inquiry from this perspective.

102. See United Copper Sec. Co. v. Amalgamated Copper Co., 244 U.S. 261, 263-64 (1917) (“Courts interfere seldom to control such discretion intravires the corporation . . . .”); Miller v. American Tel. & Tel. Co., 507 F.2d 759, 762 (3d Cir. 1974) (“[The sound business judgment rule . . . expresses the unanimous decision of American courts to eschew intervention in corporate decision-making . . . .”); Zapata Corp. v. Maldonado, 430 A.2d 779, 782 (Del. 1981) (“[The ‘business judgment’ rule evolved to give recognition and deference to directors’ business expertise when exercising their managerial power . . . .”); Selheimer v. Manganese Corp., 423 Pa. 563, 224 A.2d 634, 644 (1966) (“[C]ourts are reluctant to interfere in the internal management of a corporation, since that is a matter for the discretion and judgment of the directors and shareholders . . . .”).

103. See, e.g., Regenstein v. J. Regenstein Co., 213 Ga. 157, 97 S.E.2d 693, 695 (1957) (“No principle of law is more firmly fixed in our jurisprudence than the one which declares that the courts will not interfere in matters involving merely the judgment of the majority in exercising control over corporate affairs.”); Neidert v. Neidert, 637 S.W.2d 296, 301 (Mo. Ct. App. 1982) (“[W]here the matter under consideration is one that calls for the business judgment of a board of directors or of the majority shareholders and if this judgment is exercised fairly and honestly courts will not interfere.”).

104. An early federal appellate court decision highlights the strength of this premise. Johnson v. Trueblood, 629 F.2d 287 (3d Cir. 1980), cert. denied, 450 U.S. 999 (1981), involved a battle for control of a closely-held corporation where a challenge was made to the proposed sale of new shares to someone loyal to the majority owners. The minority shareholders alleged that the corporate directors were acting under a desire to remain in control and were therefore not acting in the corporation’s best interests as it relates to all the shareholders. A bench trial resulted in a victory for the defendants.

As a case for setting a standard of strict scrutiny or even prohibition of director actions in the context of a battle for corporate control, Trueblood was an unlikely candidate. First, although the case admittedly involved an aspect a loss of corporate control, this issue arose in the context of a close corporation. Unlike control battles involving publicly-held corporations, these partnerships in corporate clothes have participants who wear multiple hats. The defendants were both majority shareholders and directors. Even the most ardent antitakeover commentators modify their proposals in the context of the close corporation.

Second, the alleged antitakeover activity—issuance of authorized but unissued corporate shares—is a recognized function of the corporate board, often sanctioned by statute. Unlike some of the more recent and ambitious antitakeover devices serving clearly to discriminate between shareholders or shift total control over potential takeovers to the corporate board, this measure was both episodic and clearly within board authority under both statute and charter. See also Franz Mfg. Co. v. EAC Indus. Inc., [current] F. Sec. L. Rep. (CCH) ¶ 92,405 (Del. Dec. 5, 1985) (purchase of authorized but unissued shares by target board-created employee stock ownership plan plan after insurgents had gained majority control held ineffective when opposed by new majority).

Finally, the issue before the court was not the general propriety of antitakeover behavior. The issuance of shares was undeniably made in order to increase the corporation’s capital in a time of financial exigency. Rather, the plaintiffs complained that the shares should have been issued to
Panter v. Marshall Field & Co.\textsuperscript{105} exemplifies the solidification of the business judgment rule in cases involving management responses to perceived takeover threats. In Panter, Marshall Field was approached, as it had been in the past, concerning its interest in a merger. Marshall Field is publicly traded and its management previously had pursued a course which avoided combination with other entities. When Carter Hawley Hale (CHH) made a tender offer, Marshall Field once again determined to remain independent. To carry out its objective, Field first made acquisitions that were designed to cause antitrust problems for CHH and then sued to enjoin the tender offer because it would result in violations of the antitrust laws.

The court’s focus in Panter was on the initial decision of the board to fight the offer. The means used, purchase of additional retail outlets and the initiation of legal proceedings, were actions that generally are recognized as being safely within the discretion of a company’s board of directors.\textsuperscript{106} The plaintiff, however, attacked the use of these otherwise accepted powers in the context of a control struggle. The Seventh Circuit predictably held that the “desire to build value within the company, and the belief that such value might be diminished by a given offer is a rational business purpose.”\textsuperscript{107}

A significant shift in antitakeover activities, however, has occurred between Panter and the most recent cases. The means adopted by a board of directors to retain its control of a target corporation have become increasingly discriminatory in effect, causing disparities in treatment of otherwise comparably situated shareholders. In addi-

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\textsuperscript{105} 646 F.2d 271 (7th Cir.), cert. denied, 454 U.S. 1092 (1981).
\textsuperscript{106} Id. at 297-98.
\textsuperscript{107} Id. at 296.
tion, the means employed by target management to prevent or resist takeover consideration have focused more on limiting shareholder discretion, whereby a board attempts to create a regime of corporate barriers and board prerogatives so that incumbent management has plenary power to approve all changes in corporate ownership and control.

While target management has enhanced the sophistication and discrimination of its antitakeover tools, the courts have continued to focus primarily on the propriety of the board’s decision to resist a particular hostile suitor. In essence, the board’s decision to retain the corporation’s independence, because it deems an offer “inadequate”, has been used by the courts to justify giving the board a free hand to effect this decision by whatever means the board believes necessary. As a result of collapsing these two issues into one, fundamental corporate governance principles have been compromised.

Nowhere is the pernicious effect of the current trend of antitakeover devices more evident than in two very recent cases decided by the Delaware Supreme Court. In *Unocal Corporation v. Mesa Petroleum Co.*, the court addressed the defensive maneuvers taken by Unocal in response to a tender offer by Mesa. Mesa sought fifty-one percent of Unocal’s shares and was willing to pay fifty-four dollars per share. Unocal responded by making its own tender at seventy-two dollars per share. By its terms, however, this self-tender excluded Mesa and all of its affiliates from participation.

Initially, the Delaware Chancery Court had granted a temporary restraining order against Unocal’s self-tender offer. As Mesa presented the case, the propriety of Unocal’s decision to fight Mesa was properly separated from the validity of the means employed to wage the battle. “Mesa does not dispute the bona fides of Unocal’s decision to oppose its tender offer. However, Mesa contends that the business judgment rule has no application in deciding the validity of the defensive technique chosen by Unocal.” Rather, Mesa contended, and the chancery court found, that discrimination among shareholders must be justified by a showing that the exclusion was fair to all concerned. As determined by the chancery court, such discrim-

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111. Id.
ination could not be upheld solely because it involved a battle for control. "In other words, legally or equitably impermissible conduct cannot be justified by the fact that it was motivated by a proper purpose."\textsuperscript{112} The end sought by Unocal did not necessarily justify the means it used to achieve that end.

The Delaware Supreme Court approached the issue differently, however. The court applied only one standard to evaluate the very separate issues of the decision to fight and the means adopted. The supreme court viewed the standard of review of the means employed as subsumed in the propriety of resistance. Once the propriety of the decision to resist is established, any means "reasonably related to the threats posed"\textsuperscript{113} is justified, even if it discriminates among shareholders:

In conclusion, there was directorial power to oppose the Mesa tender offer, and to undertake a selective stock exchange made in good faith and upon a reasonable investigation pursuant to a clear duty to protect the corporate enterprise. Further, the selective stock repurchase plan chosen by Unocal is reasonable in relation to the threat that the board rationally and reasonably believed was posed by Mesa's inadequate and coercive two-tier tender offer. Under those circumstances, the board's action is entitled to be measured by the standards of the business judgment rule. Thus, unless it is shown by a preponderance of the evidence that the directors' decisions were primarily based on perpetuating themselves in office, or some other breach of fiduciary duty such as fraud, overreaching, lack of good faith, or being uninformed, a Court will not substitute its judgment for that of the board.\textsuperscript{114}

The second Delaware case, \textit{Moran v. Household International, Inc.},\textsuperscript{115} involved a defensive device known as a Preferred Share Purchase Rights Plan,\textsuperscript{116} or "poison pill." Under the terms of the Plan, Household shareholders were entitled to one "Right" for every common share held, upon either (1) the announcement of a tender offer for thirty percent or more of Household's shares, or (2) the acquisition of twenty percent or more of Household's shares by any single entity or group.\textsuperscript{117} The "Rights" were redeemable by Household's board of directors for fifty cents per right if a thirty percent tender offer was announced, but they became nonredeemable if anyone ac-

\textsuperscript{112} Id. at 7.
\textsuperscript{113} Unocal Corporation v. Mesa Petroleum Co., 493 A.2d 946, 956 (Del. 1985).
\textsuperscript{114} Id. at 958.
\textsuperscript{115} 500 A.2d 1346 (Del. 1985).
\textsuperscript{116} Id. at 1348.
\textsuperscript{117} Id.
quired twenty percent or more of Household’s shares.\textsuperscript{118} Most importantly, if a merger or consolidation occurred, the holder could exercise the “Right” and purchase two hundred dollars of the common stock of the tender offeror or other acquiring entity for one hundred dollars.\textsuperscript{119}

\textit{Moran} is unusual in several respects. First, the Rights Plan was prophylactic in nature, since it was not adopted during a battle for corporate control. Second, in an unprecedented move, the SEC filed an \textit{amicus curiae} brief which supported the challenge to the Plan.\textsuperscript{120} Finally, unlike the selective self-tender offer at issue in \textit{Unocal}, in \textit{Moran} the Delaware Supreme Court was presented with a defensive mechanism which, although adopted by the board of directors, had fundamental effects on the structure of the corporation and the separation of functions between the shareholders and the board.

Rejecting arguments to the contrary, the Delaware Supreme Court upheld the Rights Plan in \textit{Moran}. Preliminarily, the court turned aside the claim that the Household board of directors did not have statutory authority to adopt the Plan.\textsuperscript{121} The court then focused on the substantive effect of the Plan. As phrased by the SEC, “the Rights Plan will deter not only two-tier offers, but virtually all hostile tender offers.”\textsuperscript{122} In sum, it was argued that this poison pill made any unapproved merger or consolidation prohibitively expensive, thus changing Household’s fundamental structure by deterring any substantial hostile share acquisition not approved by the company’s board. The Delaware Supreme Court refuted the claim that no hostile tender offers would be attempted after the adoption of this Plan by pointing to Sir James Goldsmith’s takeover of Crown Zellerbach Corporation, since Crown Zellerbach had had a poison pill provision similar to the one at issue in \textit{Moran}.\textsuperscript{123}

\textsuperscript{118} \textit{Id.} at 1349.
\textsuperscript{119} \textit{Id.}
\textsuperscript{120} \textit{Id.} at 1348.
\textsuperscript{121} Statutory authority for creation of the Plan came from sections 151(g) and 157 of the Delaware General Corporation Law. \textit{Del. Code Ann. tit. 8, §§ 151(g), 157} (1983). The court had some trouble with the fact that the “Rights” were not operative to purchase Household’s shares, but rather to purchase the shares of some as yet unidentified hostile suitor. The court analogized the “Rights” to “anti-destruction” or “anti-dilution” provisions which sometimes accompany corporate securities, finding the Household “Rights” to be sufficiently like these latter devices to be valid against a hostile suitor. \textit{Moran}, 500 A.2d at 1352.
\textsuperscript{122} \textit{Id.}, 500 A.2d at 1354.
\textsuperscript{123} \textit{Id.} For a more detailed discussion of the Goldsmith battle with Crown Zellerbach, including a showing that the Delaware Supreme Court’s reliance on that scenario for its conclusion in \textit{Moran} was misplaced, see \textit{infra} notes 167-84 and accompanying text.
The court also rejected the claim that the Plan gave substantial new power to Household's board to deter hostile share acquisitions. With respect to the "governance structure" of the company, the court noted that the board did not have absolute discretion in determining whether to redeem the "Rights," but it focused primarily on the question of the Plan's effect on the "value structure" of the company—which the court found to be minimally affected. Quoting language from its *Unocal* decision, the court then approved the Plan because the board's adoption of the Plan was protected by the business judgment rule.

As evidenced by *Unocal* and *Moran*, court review of antitakeover measures has resulted in minimal scrutiny of these actions, whether employed in the context of a current control battle or adopted as a preventive device. Once a corporate board expresses concern about allegedly coercive takeover techniques, there is little to limit the board's ability to adopt almost any defensive mechanism. Consequently, the board may discriminate among shareholders, or deter third parties from purchasing shareholders' interests at a premium, because the board's actions are shielded by the protective cloak of the business judgment rule.

IV. AN ALTERNATIVE FRAMEWORK FOR ANALYZING ANTITAKEOVER ACTIVITY

The role of shareholders in the modern public corporation is not large. The shareholders "own" the corporation, but they do not run it. The board of directors makes policy and manages the business of the enterprise. The corporate management, officers and other employees carry out the directions of the board and effectively make policy on a continual basis.

The statutory powers allocated to the shareholders are limited. The holders elect and remove directors, make or amend the charter or the bylaws, and undertake organic changes in the corporate

125. *Id.*
126. *Id.* at 1356-57.
structure (such as a merger,\textsuperscript{130} the sale of substantially all of the assets of the business,\textsuperscript{131} or a dissolution\textsuperscript{132}). These powers give meaning to the basic right of the shareholders—to vote and control the structure of their enterprise. According to the corporate norm, the “owners,” if unhappy, can dispense with their representatives, or seek to change the scope or direction of the enterprise through a merger or sale. Thus, while the corporate managers conduct the ordinary business operations, the holders theoretically make the decisions which substantially change the structure of the enterprise.

Even when exercising these traditional functions, however, shareholder power is constrained in many states by the requirement that the board act first to propose the action.\textsuperscript{133} Where no statutory provision directly affects shareholder voting power by requiring board initiative, incumbent management has moved to limit the scope of shareholder action through bylaw changes which limit the ability of the “owners” to meet and vote.\textsuperscript{134} The impetus for these actions is, on the one hand, to recognize the norm of shareholder control over such fundamental issues while, on the other, providing precious little opportunity for the actual exercise of that control.

These statutory provisions and procedural alterations have insulated management from challenge substantially more than even the traditional corporate norm would dictate.\textsuperscript{135} Moreover, there appears to be little dispute over the purpose behind such insulation. These shareholder activities relate to fundamental changes in the corporate structure and in the allocation of power among the corporate organs. The ability of the shareholders to alter these aspects of the legal and economic constitution of the business threatens incumbent manage-


\textsuperscript{134} This can be done by limiting the timing and scope of special shareholder meetings and by restricting the topics for action at all meetings by imposing notice requirements or other obstacles. \textit{See generally} Hochman & Folger, \textit{supra} note 25.

\textsuperscript{135} \textit{See generally} M. Eisenberg, \textit{The Structure of the Corporation} 1-6 (1976).
ment. Thus, "structural decisions almost invariably give rise to management conflicts-of-interest."\textsuperscript{136} The response of corporate management is predictable—attempts to limit the ability of the shareholders to engage in these activities.

Two developments over the past several decades have hindered the ability of incumbent management to protect completely against ouster by the shareholders: the aggregation of stock in the hands of institutional investors and the rise of the tender offer. The consolidation of substantial holdings in the hands of professional investors provides the potential for an ongoing check on management discretion within the corporate body.\textsuperscript{137} In contrast, tender offers act as an external monitoring mechanism on incumbent management.\textsuperscript{138}

The recent increase in defensive measures is a response to the threat posed to incumbent management by these two developments. To the extent that management can impede the change in control which proxy contests and takeover bids portend, management security is enhanced. To the extent that the board of directors can preempt such threats, security is guaranteed.

It is the position of this Article that the key to analyzing management antitakeover activities is to examine the specific defensive measures employed by a target corporation in light of the traditional statutory and judicial principles of corporate organization and operation. The framework of analysis proposed by this Article flows from four discrete and fundamental principles of corporate governance. First, within the ambit of authorizing corporate expenditures and making other traditional business decisions, the actions of the board of directors of a corporation are insulated from review by the business judgment rule. Second, where corporate actions discriminate among members of the same class of shareholders, such discrimination, if not

\textsuperscript{136} Id. at 30. See generally Donaldson, Financial Goals: Management vs. Stockholders, 141 HARV. BUS. REV., May-June 1963, at 116, 121; Manne, Mergers and the Market For Corporate Control, 73 J. POL. ECON. 110 (1965).

\textsuperscript{137} "[W]e have now reached the tertiary stage of capitalism. Control of the American business passed from the founder-shareholders to the professional managers who held sway until the 1970's and now, at least in the sense of ability to control in the event of a tender offer or a proxy context, to the professional managers of pension funds, foundations and mutual funds." Lipton, supra note 15, at 114. See generally Berle, The Modern Corporation Revisited, 64 COLUM. L. REV. 1410 (1964); BERLE & MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY (1932). There is dispute over the efficacy of this check. See Coffee, supra note 22, at 1183-92 (summarizing the dispute in the case of charter amendments).

per se invalid, must be justified under a standard of intrinsic fairness. Third, actions which effect an institutionalized shift in control from the shareholders to the board, for decisions reserved by statute to the shareholders, are presumptively invalid. Fourth, actions which effect an institutionalized shift in control from the majority to the minority of the shareholders, for decisions reserved by statute to the majority, are presumptively invalid.

These principles have worked well as a guide to the validity of a variety of behavior in the traditional context of corporate operations. There is no reason to abandon these principles simply because the current context involves a possible change in corporate control. Rather, if applied properly, these principles provide a comprehensive and understandable framework for judicial or regulatory analysis, not only of measures that have previously found their way into the antitakeover arsenal, but also as a prescriptive guide to the legality of proposed actions. In the next four sections, this Article presents such a framework and applies these principles to the panoply of defensive measures in use today.

A. The Role of Management Business Discretion in Relation to Hostile Share Acquisitions

When a challenge is made to the activity of corporate managers, the business judgment rule accords a presumption of regularity to their decisions. Absent a showing of fraud, bad faith, self-dealing,

139. Next, the plaintiffs argue that the district court improperly charged the jury on their burden in overcoming the business judgment rule. That rule, which admittedly is part of the law of Delaware, provides that directors of a corporation are presumed to exercise their business judgment in the best interest of the corporation . . . .

It is frequently said that directors are fiduciaries. Although this statement is true in some senses, it is also obvious that if directors were held to the same standard as ordinary fiduciaries the corporation could not conduct business. For example, an ordinary fiduciary may not have the slightest conflict of interest in any transaction he undertakes on behalf of the trust. Yet by the very nature of corporate life a director has a certain amount of self-interest in everything he does. The very fact that the director wants to enhance corporate profits is in part attributable to his desire to keep shareholders satisfied so that they will not oust him.

The business judgment rule seeks to alleviate this problem by validating certain situations that otherwise would involve a conflict of interest for the ordinary fiduciary. The rule achieves this purpose by postulating that if actions are arguably taken for the benefit of the corporation, then the directors are presumed to have been exercising their sound business judgment rather than responding to any personal motivations.

Faced with the presumption raised by the rule, the question is what sort of showing the plaintiff must make to survive a motion for directed verdict. Because the rule presumes
or lack of adequate investigation, courts will refuse to second guess the advisability of the decisions made by the corporate managers.\textsuperscript{140} Whether justified as necessary to attract competent directors,\textsuperscript{141} to ensure dynamic corporate decisionmaking,\textsuperscript{142} or as a recognition of the inability of the courts to evaluate business decisions,\textsuperscript{143} the underlying principle is that managers will run businesses better if granted broad discretion.

The rationale for the business judgment rule also defines its lim-

\textsuperscript{that business judgment was exercised, the plaintiff must make a showing from which a factfinder might infer that impermissible motives predominated in the making of the decision in question.}


\textsuperscript{140} \textit{See}, e.g., Panter v. Marshall Field \& Co., 646 F.2d 271, 293 (7th Cir.), cert. denied, 454 U.S. 1092 (1981); Treadway Cos., Inc. v. Care Corp., 638 F.2d 357, 382 (2d Cir. 1980); Auerbach v. Bennett, 47 N.Y.2d 619, 393 N.E.2d 994, 1000, 419 N.Y.S.2d 920, 926-27 (1979); Cheff v. Mathes, 41 Del. Ch. 494, 199 A.2d 548, 555 (1964). The Second Circuit has observed that “an automobile driver who makes a mistake in judgment as to speed or distance injuring a pedestrian will likely be called upon to respond in damages,” but “a corporate officer who makes a mistake in judgment as to economic conditions, consumer tastes or production line efficiency will rarely, if ever, be found liable for damages suffered by the corporation.” Joy v. North, 692 F.2d 880, 885 (2d Cir. 1982), cert. denied, 460 U.S. 1051 (1983).

\textsuperscript{141} \textit{See}, e.g., Percy v. Millaudon, 8 Mart. (n.s.) 68, 78 (La. 1829). \textit{See also} Briggs v. Spaulding, 141 U.S. 132, 149 (1891).


\textsuperscript{143} It appears to us that the business judgment doctrine, at least in part, is grounded in the prudent recognition that courts are ill-equipped and infrequently called on to evaluate what are and must be essentially business judgments. The authority and responsibilities vested in corporate directors both by statute and decisional law proceed on the assumption that inescapably there can be no available objective standard by which the correctness of every corporate decision may be measured, by the courts or otherwise. Even if that were not the case, by definition the responsibility for business judgments must rest with the corporate directors; their individual capabilities and experience peculiarly qualify them for the discharge of that responsibility.

Crouse-Hinds Co. v. Internorth, Inc., 634 F.2d 690, 702 (2d Cir. 1980). \textit{Accord} Joy v. North, 692 F.2d at 886:

[After-the-fact litigation is a most imperfect device to evaluate corporate business decisions. The circumstances surrounding a corporate decision are not easily reconstructed in a courtroom years later, since business imperatives often call for quick decision, inevitably based on less than perfect information. The entrepreneur’s function is to encounter risks and to confront uncertainty, and a reasoned decision at the time made may seem a wild hunch viewed years later against a background of perfect knowledge.]

its. A corporation’s managers must be free to make business decisions that affect the profitability of the company and the value of its shares. They, directly or through their subordinates, commit to contracts, authorize new lines of production, determine salaries, obtain additional financing and generally determine business policy for the enterprise. They are hired to enhance shareholder equity by making these decisions and their actions may have the effect of decreasing that equity. Within the ambit of making business decisions which relate to the ultimate value of the corporation and the derivative value of its shares, corporate management enjoys the benefit of the business judgment rule.

This principle should not change merely because of a takeover threat. The business judgment rule properly applies in this context with respect to two decisions made by the board of directors. First, the initial decision to either accept or attempt to defeat a takeover effort, a decision which has been the subject of most of the debate about defensive maneuvers, is clearly one that affects shareholders equity and possibly the continued viability and profitability of the enterprise. Despite the perspective of the managerial passivity proponents, no court has yet concluded that such a decision is not governed by the business judgment rule. Second, the decision to employ a particular means of defense may also be protected by the rule. Where the action taken is consonant with traditional management powers, such as making acquisitions, initiating law suits, or issuing authorized shares, and has no effect other than the possible enhancement or dilution of the company’s value, the fact that such action occurs in the context of a battle for corporate control is irrelevant. As with other business decisions, such tactics must survive on their own merits, subject to scrutiny only for failure of a duty of care.

1. The Decision to Resist or Deter Hostile Suitors

Applying the business judgment rule to the preliminary decision to deter a takeover is not erroneous because the issues of control and corporate policy cannot readily be separated. Like other decisions bearing on the value of the shareholders’ investment, the decision by incumbent management to retain control and pursue a continuation of current corporate policy has been accepted by the courts as a decision within the management’s discretion.144

144. See, e.g., Panter v. Marshall Field & Co., 646 F.2d 271, 295 (7th Cir.), cert. denied, 454 U.S. 1092 (1981); Treadway Cos., Inc. v. Care Corp., 638 F.2d 357, 382-84 (2d Cir. 1980); Crouse-
To conclude that the business judgment rule applies to the preliminary issue of resistance, however, merely begins the analysis. As with other decisions committed to the discretion of management, the requisites of the business judgment rule must be satisfied. This means, primarily, that management must actually make a decision. That is, if incumbent management enjoys the prerogative of passing upon such offers and overtures, management must meet the concomitant responsibility of actually reviewing these options in good faith and with due care. The business judgment rule "has no role where directors have either abdicated their functions, or absent a conscious decision, failed to act."145

With respect to hostile share acquisitions and changes in corporate control, the requirement that management actually exercise its discretion has a clear role. A policy or mechanism which has the purpose or effect of precluding consideration of any and all takeover offers simply is not protected by the business judgment rule. Abdication of discretion is not the exercise of discretion. Incumbent management cannot declare that maintaining the status quo is a preemptory principle of its review of takeover proposals.

While it may seem a rare circumstance where proof of such a position or practice may occur, actual corporate maneuvers may speak more clearly than corporate policy statements. In Panter v. Marshall Field & Co.146 the primary claim was that "the defendants breached their fiduciary duty as directors to the corporation and its shareholders by adopting a secret policy to resist acquisition regard-

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less of benefit to the shareholders."147 While the Seventh Circuit found that the plaintiffs had not presented sufficient evidence to reach the jury on this issue,148 nonetheless, the possibility exists that such a showing may be made in a future case.149

2. Implementing the Antitakeover Decision

If the incumbent management decided not to facilitate a hostile takeover attempt, but did not act to prevent such an occurrence, even the most extreme critics of antitakeover activity would be satisfied.150 Such a scenario, however, is highly unlikely. Indeed, it may be part of management's duty to actively resist proposals that management does not consider to be in the best interests of the shareholders. Several courts have indicated that current management has just such an obligation.151

Properly applied, the business judgment rule has a real, albeit limited, role in the review of the means adopted or recommended by management to deter a corporate takeover. If managerial discretion is

147. Id. at 293.

148. Id. at 295-97. The Seventh Circuit's conclusion on this issue is questionable. The court determined that, since each prior rejection of an offer was individually protected by the business judgment rule, the series of rejections was likewise protected. The majority of the court failed to recognize that the sum of the parts might, as a whole, prove what each part alone failed to show. See id. at 299, 304-310 (Cudahy, J., dissenting).

149. Beyond the breach of fiduciary duty apparent from an unremitting refusal to consider all hostile offers, the directors' duty of care applies also to the decision to resist any individual overtue. Directors are required to reach an informed business judgment before taking action. The principle has equal applicability to the decision to reject a particular transaction. Particularly in the context of a tender offer where time and timing are crucial, the claim of breach of duty through failure to make an informed decision may be successful. See, e.g., Hanson Trust PLC v. ML SCM Acquisition, Inc., [Current] FED. SEC. L. REP. (CCH) ¶ 92,418 (2d Cir. Jan. 6, 1986) (approval of lock-up option in a three-hour late-night meeting not exercise of informed business judgment). Condec Corp. v. Lunkenheimer Co., 25 Del. Ch. 247, 230 A.2d 769, 776 (1967) ("I do not find that type of direct investigation, professional consultation or evidence of contradiction in the actions and explanations on the part of Condec officials which would lead the management of Lunkenheimer justifiably to believe that Condec's aspirations represented a reasonable threat to the continued existence of Lunkenheimer."). See generally Lipton, supra note 15, at 120-30 (prescribing steps to be taken by board of directors in evaluating takeover proposal).

150. This is the essence of the claim for "managerial passivity." See supra text accompanying notes 26-37.

to have any meaning in the corporate context, management must be free to make business decisions which, for better or worse, enhance or deplete the value of the corporation and the derivative value of the shareholders' investment. Monetary expenditures and entry into contractual arrangements, for example, are activities committed to management discretion. These activities also have the potential to decrease the intrinsic value of the corporation and traditionally, absent some ancillary effect (for example, discrimination among shareholders or infringement upon areas reserved by charter or statute to the shareholders), such activities have been protected by the business judgment rule.

The business judgment rule should continue to govern these traditional activities, irrespective of whether they arise or operate in the takeover context. Consider a simple but highly controversial example, the golden parachute. Substantively, these agreements are simply compensation arrangements for corporate management. Such compensation decisions are committed firmly to board discretion by statute. Moreover, these agreements, like all compensation agreements, have the possible effect of depleting the corporate treasury if value is not received in return.

Subject to a showing that the terms of such agreements are so ill-advised as to constitute a waste of corporate assets, the decision to employ golden parachutes is protected by the business judgment rule. It is difficult to see how any stricter standard of review can be applied to these agreements merely because they have operative effect only upon a change in corporate control. The question is whether such compensation agreements are reasonable and necessary to retain or attract quality corporate management. That they may deter a possible takeover, however, is not unlike the acquisitions in Panter. Outside of the takeover context, acquisitions and golden parachutes are merely traditional business decisions. Within the context of a battle for corporate control their essential nature remains the same.

152. See, e.g., DEL. CODE ANN. tit. 8, § 141(h) (1983).
154. This does not mean that all board activity within traditional powers and which does no more than affect shareholder equity is immune from attack. The business judgment rule has its limits in all contexts. Norlin Corp. v. Rooney, Pace Inc., 744 F.2d 255 (2d Cir. 1984), is exemplary. Fearing a takeover attempt following an outsider's purchase of 32% of Norlin's stock, Norlin's board transferred approximately 1,000,000 shares to a subsidiary and an employee stock ownership
Whether designated as defensive maneuvers or simply business decisions, the business judgment rule may apply initially to a host of activities by the target board. The key to its applicability is the role of plan (ESOP). No real consideration was received for the transferred shares and the board issued the shares despite a warning from the New York Stock Exchange that the company's stock would be delisted, which it was.

The Second Circuit enjoined these activities, despite the board's claim of protection by the business judgment rule. Initially, the court properly separated the decision to remain independent from the means employed to effect that result. Second, the court found that the means employed could not be justified even though all of the actions taken were within traditional management power:

The precipitous timing of the share issuances, and the fact that the ESOP was created the very same day that stock was issued to it, give rise to a strong inference that the purpose of the transaction was not to benefit the employees. . . . This is buttressed by the fact that the board offered its shareholders no rationale for the transfers other than its determination to oppose, at all costs, the threat to the company that Piezo's acquisitions ostensibly represented.

. . . . No real consideration was received from the ESOP for the shares.

. . . . In addition, Norlin's assertion [that delisting was not relevant because the stock would still be traded on the NASDAQ] does not contradict Judge Edelstein's finding that "delisting of securities generally is a serious loss of prestige and has a chilling effect on prospective buyers."

*Id.* at 265-66, 268.

This analysis by the court in *Norlin* is persuasive evidence of how the business judgment rule may be rebutted in the takeover context, even where the actions taken are within normal management discretion. While correct in result, the analysis of the court is flawed in one respect, namely that the court used the context of these actions, rather than their extremely deleterious effect alone, as grounds for finding the business judgment rule inapplicable.

This focus on the context of the activity—finding an action to be invalid if the "primary purpose" is to retain control—is unworkable and unnecessary. Any action in the context of a control battle (and many measures outside that context) will have ramifications which affect the result of that battle. Identifying the circumstances where the motive to retain control are primary simply provides the opportunity for arbitrary invalidation of such measures.

Moreover, as evidenced by *Norlin*, such a distinction does not materially assist in an analysis of the propriety of corporate activity. Management's actions in *Norlin* were indefensible under the business judgment rule. Any exercise of otherwise traditional management power to diminish the value of the corporation with no possible business justification is simply a breach of fiduciary duty. To attempt to identify and separate the motivational force behind these actions adds nothing to the analysis.

More fundamentally, the development of the primary purpose test was based on an analytical misperception. Courts originally employing this test did so because they perceived the issues of the decision to fight and the means adopted as the same. They were not about to require managerial passivity in all circumstances. The primary purpose test was thus adopted as a limitation, albeit insignificant, on management discretion.

As argued herein, however, these two issues are not only separable but indeed must be separated to make sense of the analysis of antitakeover activity. The decision to resist may be valid but the means employed may be condemned. With the recognition that the means employed must be independently justified, the excess baggage supplied by the primary purpose test can be discarded.
the board in using corporate assets, or otherwise exercising traditional corporate powers, in a manner that does not alter the basic division of authority within the corporation and that treats all shareholders equally. That the shareholders' investment may be enhanced or depleted by these actions recognizes the tremendous power allocated to management in American corporate law.

This conclusion, however, does not mean that all is well with traditional corporate law jurisprudence. Under the guise of the business judgment rule, the courts may have abdicated too much of their responsibility to enforce the duty of care. Placing some so-called defensive measures into the same category with other management decisions may cause the courts to reconsider their role and scrutinize all management decisions somewhat more closely. Movement in that direction may be very healthy for all shareholders of modern American enterprises.

3. Antitakeover Tactics Which the Business Judgment Rule Protects

This Article has stated that conduct within traditional board discretion which does not discriminate among comparably situated shareholders and does not alter the basic divisions of power within the corporation should be governed by the duty of care and the protection of the business judgment rule. Among the variety of defensive measures in vogue today, we can identify a number which should be judged at least in part by the requirements of the duty of care.

Consider, for example, the retail acquisitions made by the target board in Panter v. Marshall Field & Co. First, such acquisitions may create antitrust or other regulatory problems for a potential bidder. Additionally, even if no antitrust problems are created, these acquisitions may simply make the potential target company less desirable as an acquisition candidate. All acquisitions, whether undertaken where a change of control is imminent or in the relative luxury of day-to-day decisionmaking, can have these effects. The key questions are (1) whether the action is defensible on business grounds which are independent of a desire to defeat the takeover threat, and

156. This was the case in Panter, id. at 297; Brascan Ltd. v. Edper Equities Ltd., 477 F. Supp. 773 (S.D.N.Y. 1979); Anaconda Co. v. Crane, 411 F. Supp. 1210, 1216-19 (S.D.N.Y. 1975). If an acquisition makes a target less desirable as an acquisition candidate generally, this factor may clearly decrease shareholder value and should be one factor in reviewing the board's decision.
(2) whether the board carefully considered the acquisition, its price and alternative uses for the corporation's resources. If these standards are met, the business judgment rule protects the board from an error in judgment. The duty of care has been breached, however, when these standards are not satisfied.

Also falling within the ambit of traditional management discretion, save for the context of their adoption, are a variety of actions which generically have been referred to as "scorched earth" policies. One aspect of such a policy is the converse of the acquisitions in Panter, namely, the divestment of some or all of the company's assets. Whether such "asset redeployment" occurs by an outright sale or by the issuance of options, its effect on the value of the corporation and the justification for the sale is the appropriate focus of review.

157. See, e.g., Bodell v. General Gas & Elec. Corp., 15 Del. Ch. 420, 140 A. 264, 266 (1927) ("The controlling principle is that the substance of a business decision or transaction... will not be reviewed or scrutinized by a court as long as the acts of the directors... were performed in good faith, in the exercise of their best judgment, and for what they believed to be the advantage of the corporation and all its stockholders.").

158. See, e.g., Muschel v. Western Union Corp., 310 A.2d 904, 908 (Del. Ch. 1973) (disparity between the actual price of company stock involved in a merger and a fair price could lead to the conclusion that the decision to proceed with the merger "was not due to an honest error of judgment, but rather to bad faith, or to reckless indifference to the rights of others interested."). Compare Royal Indus., Inc. v. Monogram Indus., Inc., [1976-77 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 95,863, at 91,131 (C.D. Calif. Nov. 29, 1976) (primary purpose of acquisition by target of tender offer held to be to create an antitrust obstacle to the bid and for directors to maintain control; court suggested little or no business justification for acquisition).

159. "A scorched earth defense seeks to convince the offeror that the target's defense will be so vigorous as to reduce its value to the offeror." Gilson, supra note 46, at 776 n.3.

160. See, e.g., Whittaker Corp. v. Edgar, 535 F. Supp. 933 (N.D. Ill. 1982), aff'd without opinion, Nos. 82-1305, 82-1307 (7th Cir. Mar. 3, 1982):

When confronted with a threatened change in control, a board of directors of a target company may engage in a corporate transaction with a third party that the board determines in its business judgment to be in the best interests of shareholders. In so doing, the board of directors may enter into various arrangements with the third party to promote consummation of the transaction even though to do so might cause the hostile tender offer to withdraw.

Id. at 951. A variation on such options are some types of "crown jewel warrants" which may be issued to common stockholders or a friendly party by the target corporation. The securities entitle the holder to purchase certain assets or lines of business at a preferential price. Even in Mobil Corp. v. Marathon Oil Co., 669 F.2d 366 (6th Cir. 1981), where the Court of Appeals for the Sixth Circuit ruled that section 14(e) of the Securities Exchange Act of 1934 (the "Exchange Act") had been violated by United States Steel in connection with obtaining options from Marathon to purchase a substantial asset of Marathon, as well as newly issued stock, the circuit court "left undisturbed" the district court's finding that the directors of Marathon had not breached their fiduciary duty in granting such options, because such options were granted for a proper corporate purchase: "to obtain the best possible deal for Marathon shareholders in the face of an inevitable takeover." Marathon Oil Co. v. Mobil Corp., 530 F. Supp. 315, 325 (N.D. Ohio 1981).
Extreme injury to the corporation by such tactics without a positive business purpose is simply a breach of fiduciary duty.\footnote{161}{Compare Hanson Trust PLC v. ML SCM Acquisition, Inc., [Current] FED. SEC. L. REP. (CCH) ¶ 92,418 (2d Cir. Jan. 6, 1986) (invalidating lock-up options); Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., [Current] FED. SEC. L. REP. (CCH) ¶ 92,357 (Del. Nov. 1, 1985) (invalidating lock-up options); and Joseph E. Seagram & Sons, Inc. v. Abrams, 510 F. Supp. 860, 861 (S.D.N.Y. 1981) ("It is inconceivable that an alleged flourishing enterprise has authorized its board to subject the assets and charter of the company to a scorched earth policy to be accomplished in the name of an exercise of business judgment."); with Bacine v. Scharffenberger, Nos. 7862, 7866, slip op. (Del. Ch. Dec. 11, 1984) (denying request for preliminary injunctive relief against consummation of a sale of assets and liquidation of the corporation, scheduled to be voted upon at special shareholder meeting on the following day). At its extreme, such policies may result in "corporate suicide," namely, liquidation. See Prentice, Target Board Abuse of Defensive Tactics: Can Federal Law Be Mobilized To Overcome The Business Judgment Rule?, 8 J. CORP. L. 337, 343 (1983). A valid basis for refusing to sanction such a tactic is that shareholder approval typically is required for such extreme measures. Compare Katz v. Bregman, 431 A.2d 1274 (Del. Ch. 1981) with Story v. Kennecott Copper Corp., 90 Misc. 2d 333, 394 N.Y.S.2d 353 (Sup. Ct. 1977). See generally Block & Miller, The Responsibilities and Obligations of Corporate Directors in Takeover Contests, 11 SEC. REG. L.J. 44, 62 (1983). See also GM Sub Corp. v. Liggett Group Inc., No. 6155, slip op. (Del. Ch. Apr. 25, 1980) (denying a temporary restraining order enjoining the sale of a subsidiary—allegedly the corporation's prize asset. The court noted that the corporation had engaged an investment banking firm, that the investment banking firm had solicited nine bids, and that the highest of these bids was 22 times the earnings of the subsidiary), rev'd on other grounds, 415 A.2d 473 (Del. 1980).} Similarly, where a series of board actions severely harms the corporation, the board should not be able to avoid liability by claiming that each action alone might simply be ill-advised. There is a difference between an isolated bad business judgment and a policy of destruction. The cumulative effect of a combination of corporate actions may be devastating although each measure alone is only slightly injurious. Where a successful "offeror would be left with nothing but smoldering ash,"\footnote{162}{Minstar Acquiring Corp. v. AMP Inc., 621 F. Supp. 1252 (S.D.N.Y. 1985).} a court should not hesitate to find a breach of fiduciary duty.\footnote{163}{See, e.g., Joseph E. Seagram & Sons, Inc. v. Abrams, 510 F. Supp. 860, 861 (S.D.N.Y. 1981).}

This Article has adopted the position that board actions should not be subject to a stricter standard of review simply because a takeover may be threatened. Conversely, the existence of a takeover threat, standing alone, does not justify antitakeover actions. This does not mean that the terms of the takeover proposal are irrelevant for purposes of satisfying the duty of care as it relates to the means employed to deter the takeover. The board is still bound to act in the shareholders' and the corporation's best interest in pursuing possible alternative courses of action, even where one alternative is a possible change in control. While the takeover context should not invalidate a
particular business decision per se, the takeover proposal does provide a frame of reference for judging competing options.

Some defensive measures may immediately enhance the target shareholders' investment vis-a-vis the terms of the hostile takeover. One example is the attempt to locate a better deal by finding a "white knight." In these circumstances, the frame of reference is the terms of the competing hostile bid. It is well recognized that creating an auction atmosphere may benefit the target shareholders. Thus, rather than invalidate the friendly offer, the terms of the hostile offer may provide a substantial justification for undertaking the alternative transaction.


The battle for control of Crown Zellerbach Corporation, a battle fought between incumbent management and Sir James Goldsmith, provides one recent example of how measures within the traditional authority of the board can be employed to violate the duty of care.

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164. A "white knight" is a corporation that comes to the aid of another corporation which is the target of a takeover attempt. The "knight" rescues the embattled firm by agreeing to acquire it on better terms than the pursuer would provide. In some cases, rather than acquiring the target corporation immediately, the "white knight" is issued options or warrants on the target's stock which may be exercised or triggered by further hostile activities by the original tender offeror.

165. See supra notes 28 and 144.

166. As a preliminary step to negotiating a competing offer, the potential "white knight" may require some advantage, e.g., a right to buy stock or assets should the friendly arrangement become fact. These arrangements must also be justified by the adequacy of the board's consideration and the agreement's reasonableness under the business judgment rule. See Treadway Cos., Inc. v. Care Corp., 638 F.2d 357 (2d Cir. 1980):

The critical fact, in our view, is that the Treadway board was simply not acting to maintain its own control over the corporation. Rather, in approving the stock sale, they were moving Treadway toward a business combination with Fair Lanes. Fair Lanes had made the stock sale a precondition to further merger talks. From all that appears, Fair Lanes and Treadway had every intention of carrying through with that merger. Hall testified that Fair Lanes had been interested for some years in a possible merger with Treadway; and Care has not offered any evidence to suggest that the merger talks were a sham or a pre-text, or that the Treadway directors did not seriously wish to pursue the merger.


167. The duty to insure shareholders' interests can likewise validate board recommendations of
On July 19, 1984, Crown's board issued certain special warrants to its common shareholders. The rights represented by these warrants were designed to deter an unfriendly takeover by allowing the holders to buy two shares of the surviving entity for the price of one. The rights were not exercisable until someone either acquired twenty percent of the company's stock or made an offer for thirty percent or more of the stock. Until the rights were triggered, the warrants could be redeemed by Crown's board for fifty cents each. These rights are one fairly simple example of a "poison pill."

In October, 1984, Sir James Goldsmith began to amass shares of Crown stock. By mid-May, 1985, he held 19.9 percent of these shares and was threatening to trigger the shareholders' rights, unless the warrants were redeemed by Crown's board. The board made no attempt to redeem the warrants, and when Goldsmith purchased an additional one-tenth of a percent of Crown's stock, he triggered the rights.

As a matter claimed to fall within the proper exercise of business judgment, the Crown Zellerbach poison pill provision is indefen-
sible. The essence of the protection of the business judgment flows from the exercise of that judgment, namely, making an informed business decision. The board, whether deciding to accept or reject such a merger proposal, must rationally consider the proposal on its merits. The business judgment rule "has no role where directors have . . . abdicated their functions."\(^1\)

The Crown board abdicated its statutory duties.\(^2\) The board certainly had the power to issue warrants as a matter within its designated authority,\(^3\) but it breached its fiduciary duty by issuing warrants of this type. Once someone acquired twenty percent of the company, anyone attempting to merge with Crown, whether friendly or not, would be subject to the provisions of the poison pill. The rights were no longer redeemable. Once triggered, these rights "effectively preclude[d] Crown from merging with a third party and engaging in certain other transactions."\(^4\) The board, the shareholders and the company simply could not entertain any future merger prospects.\(^5\) The abdication of duty is clear and the extent of harm to the shareholders is incalculable.\(^6\)

by discriminating among shareholders and corporate principles of distribution of power by shifting from the shareholders to the board all right to consider whether to sell their shares. See infra text accompanying notes 185-253.


178. Under Delaware law, as with other states, the board initially passes on merger proposals. DEL. CODE ANN. tit. 8, § 141 (1983) provides, in pertinent part:

(a) The business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors, except as may be otherwise provided in this chapter or in its certificate of incorporation. If any such provision is made in the certificate of incorporation, the powers and duties conferred or imposed upon the board of directors by this chapter shall be exercised or performed to such extent and by such person or persons as shall be provided in the certificate of incorporation.

In the specific context of a proposed merger of domestic corporations, a director has a duty under DEL. CODE ANN. tit. 8, § 251(b) (1983), along with his fellow directors, to act in an informed and deliberate manner in determining whether to approve an agreement of merger before submitting the proposal to the stockholders. DEL. CODE ANN. tit. 8, § 251(b) (1983) provides in pertinent part: "The board of directors of each corporation which desires to merge or consolidate shall adopt a resolution approving an agreement of merger or consolidation." (emphasis added).

179. See DEL. CODE ANN. tit. 8, §§ 151(a), 141(a), 141(c) (1983).


182. Like the converse situation, where an ill-advised merger is accepted, there may be an
In *Moran v. Household International, Inc.*, the Delaware Supreme Court cited the battle between Crown Zellerbach and Goldsmith to counter the SEC's contention that poison pill provisions, such as those in *Moran* and *Crown Zellerbach*, "will deter not only two-tier offers, but virtually all hostile tender offers." The Supreme Court of Delaware contended that Goldsmith's obtaining control of Crown Zellerbach proves the fallacy of the SEC's contention. But it is the court's reasoning in *Moran* that is fallacious. Goldsmith gained control not by tender offer, but by open market purchases. Moreover, it is possible that he did so at a much cheaper price than otherwise practicable precisely because Crown's poison pill, once triggered, deterred all "white knights" from rescuing Crown. To the extent that this was true, Crown's shareholders suffered at the hands of its board—and Household International's shareholders have the potential to share in the same dubious distinction.

B. Discrimination Among Shareholders in Target Defensive Maneuvers

All shareholders of a given class or series of common stock have an ownership right in the corporation which corresponds to the percentage of the common stock owned. This is fundamental to traditional corporate governance. Among common stockholders, four rights of ownership are identifying characteristics of their interest. First, common shareholders have a right to a pro rata share in the earnings of the corporation, after payments to preference stock, upon declaration of a dividend by the board of directors. Second, common shareholders are the residual owners of the corporation. In the event of the corporation's liquidation, the balance of the corporation's attempt to determine the fair value of the shares by analogy to the appraisal rights granted in the merger situation. See *Smith v. Van Gorkom*, 488 A.2d 858 (Del. 1985); Weinberger v. UOP, Inc., 457 A.2d 701, 712-15 (Del. 1983). But the true loss to the shareholders in terms of lost opportunity can only be a matter of speculation. See supra note 17 for empirical evidence on the returns accruing to target corporation shareholders from mergers and acquisitions. Moreover, a breach of duty of care, unlike a clear violation of statutory requisites on allocation of powers or discrimination among shareholders, is not likely to result in voiding of the rights granted. The claim is not that the board had no authority to act, but that it acted without due care.

assets, after payment of creditors and distributions to preferred stockholders, belongs to the common shareholders for distribution on a pro rata basis.\textsuperscript{186} Third, common shareholders have a right to vote in the election of directors and upon other matters concerning the governance of the corporation.\textsuperscript{187} Notably, common shareholders must normally approve business combinations or other fundamental changes.\textsuperscript{188} And fourth, common shareholders normally have preemptive rights so as to retain their pro rata interest in the enterprise.\textsuperscript{189}

It is well accepted that directors and management may not confer benefits upon one group of shareholders without doing likewise for other shareholders in the same class.\textsuperscript{190} The rationale for this position is basic—all shareholders of a given class hold the same claim to corporate assets. They each expect similar pro rata portions of earnings or corporate wealth to devolve to them in the event of any corporate


\textsuperscript{187} H. Henn & J. Alexander, \textit{supra} note 185, §§ 124, 157, 189.

\textsuperscript{188} Id. § 346.

\textsuperscript{189} Id. §§ 124, 127. It is common practice, however, for the charter specifically to remove preemptive rights, particularly with respect to the issuance of additional stock in large publicly traded companies.

distributions or the corporation's liquidation.\textsuperscript{191}

The most common of corporate distributions, dividend payments, exemplify the requirement that shareholders of the same class be treated equally by the corporate directors and officers. Though most corporate statutes do not deal explicitly with the subject,\textsuperscript{192} case law establishes that each shareholder must receive a pro rata distribution, proportionally equivalent to the amount paid to the remainder of the security class.\textsuperscript{193} This requirement conforms to investor expectations and reduces the risk perceived in purchasing securities by removing uncertainty as to how the investor will be treated in corporate distributions vis-à-vis other shareholders. Moreover, equality requirements are not limited to dividend distributions; they also apply to corporate liquidations.\textsuperscript{194} Thus, equality in all distributions provides an important check on management's ability to divert assets or control to a favored group, including itself.

The newest wave of antitakeover defenses wreaks havoc on these basic rights and interests of shareholders by flaunting the norm of equality. Though these newest defenses, often encapsulated in a poison pill security, may appear superficially to treat shareholders equally, in substance they may discriminate among shareholders by altering voting rights, share values or the right to participate in corporate distributions.

1. Discrimination in Voting Rights: Corporate Distributions Which Convey Different Voting Powers to Shareholders

The requirement of shareholder approval for various business combinations, coupled with the board of directors' relatively easy access to voting power through the corporate proxy machinery, has popularized the alteration of shareholder voting rights in constructing takeover defenses. One vehicle for such defenses, dependent upon

\textsuperscript{191} See H. HENN & J. ALEXANDER, supra note 185, at §§ 72, 124 at 286-87, 382, 383.


shareholder approval, has been the supermajority amendment to the corporate charter.195 A second, more recently developed technique, which is keyed to shareholder voting rights, involves the alteration of voting power within a class or series of shares by distributing rights to selected shareholders via a dividend of poison pill stock.

Poison pill stocks can carry several types of toxin. One of the most invidious characteristics of recent issues has been a provision that creates discriminatory voting power among members of a class or series of shares.196 The goal of the board, in altering the voting power through the poison pill distribution, is to impose, through its own unilateral action, a supermajority requirement or veto power with respect to the corporation’s merger with, or acquisition by, unwanted suitors.

This tactic is exemplified by the poison pill stock at issue in Asarco, Inc. v. M.R.H. Holmes A Court.197 Asarco’s board of directors utilized previous shareholder authorization for an issue of “blank check” preferred198 to carry out a major portion of its defensive efforts. Asarco sought to issue new Series C Preferred shares as a dividend to its common stockholders. One-tenth of a share of the new preferred was to issue for every share of Asarco common stock outstanding.199

195. See supra note 53 and infra notes 272-74. See generally Gilson, supra note 26.

196. See, e.g., Unilever Acquisition Corp. v. Richardson-Vicks, Inc., 618 F. Supp. 407 (S.D.N.Y. 1985). Because of the many variations in poison pill preferred securities, some generalizations are necessary. The effectuation of supermajority requirements through the vehicle of poison pill preferred has appeared in several recent provisions, sometimes in the form of a veto power vested in a particular class or series of securities. As noted previously, this Article posits that actions which effect an institutionalized shift in control from the majority to the minority shareholders, or to the board of directors, for decisions which are reserved by corporate norms to the majority are presumptively invalid. Though various poison pill preferred provisions may execute such an institutionalized shift, primary discussion of this aspect of poison pills is reserved for the text accompanying notes 232-53, infra. For examples of the characteristics often incorporated into poison pill preferred, see infra text accompanying notes 197-201 and 204-68.


198. “Blank check” preferred is stock authorized by the shareholders, the rights and preferences of which may be determined by the board of directors at a later date. The ostensible purpose for a board to secure authorization for “blank check” preferred stock traditionally was to give the board flexibility in securing financing for the corporation. With the increasing use of poison pill preferred stock, it is presumable that a proxy now seeking such authorization would be required to disclose the potential use of such securities as a takeover deterrent. See supra text accompanying notes 97-100. See also H. Henn & J. Alexander, supra note 185, §§ 125, 160.

199. Each one-tenth of a share of the preferred stock was to be entitled to a quarterly dividend of ten cents if any dividend was declared, with priority given to the preferred over any common stock dividend. The Series C stock was also to be entitled to a $15 liquidation preference for every one-tenth share of preferred issued. The preferred also carried with it the right to purchase one-seventh of a share of Asarco’s common stock at a cash price of 50% of the average market price for
The Series C shares were to possess no ordinary voting rights until any person or group became the beneficial owner of more than twenty percent of either Asarco's common stock or its Series C Preferred. At that time, each one-tenth of a share of the preferred stock, except the Series C holdings of the party owning more than twenty percent, would have five votes on all matters submitted to the common stockholders. No similar voting increase, however, would inure to the holder of the twenty percent block of stock which triggered the increase in voting power. The unequivocal effect of this differentiation among shareholders was a virtual foreclosure of any opportunity to gain control of Asarco by hostile share acquisition.

Although a takeover defense may not be voided merely because of its effectiveness, the court in Asarco found the means used to carry out this defense unlawful under New Jersey law. In addressing the alteration in corporate structure effected by Asarco's directors in adopting the poison pill provision, the district court appropriately focused on the discriminatory means employed by the directors to carry out their decision to resist the takeover:

Equality of voting power among stockholders of the same class, or at least among the same series of a class that has more than one series, is a basic concept in corporate law. In Faunce v. Boost Co., 15 N.J. Super. 534, 83 A.2d 649 (Ch. Div. 1951) Judge (later Justice) Haneman, noted that "The right to vote is a basic contractual right. It was an incident to membership or of property in the stock, of which the stockholder or member cannot be deprived without his consent." At 539.

Asarco common stock during March of 1987, the right to be exercisable between April 1 and June 30, 1987. Asarco, 611 F. Supp. at 469-72.

200. An insurgent group would have been foreclosed from any opportunity for a business combination with Asarco that was not approved by Asarco's board, because the insurgents would have had to acquire in excess of 85% of both the common and Series C preferred stock before simple majority voting power could be obtained. There was no possibility for acquiring this much voting power given that an affiliate of Asarco already had voting control of 18% of Asarco's common stock. Id. at 470-71. The voting provision of the preferred stock thus would have constituted a nearly complete and total defense to any hostile acquisition, though Asarco did permit an unrealistic means for acquiring the corporation in accordance with the terms of the poison pill provisions.

All voting rights of the Series C stock were to be extinguished by an offer for any and all outstanding shares of both the common and Series C stock at a "fair price." A fair price for the common stock was to be the greater of (1) the highest price paid by the offeror in the past two years, or (2) a price determined to be fair by a nationally recognized investment banking firm selected by the Asarco Board. A fair price for the Series C Preferred Stock was to be the higher of (1) the highest price paid by the offeror in the past two years, or (2) the liquidation preference of the Preferred Stock plus accrued dividends. Id. at 472. Thus, the acquisition price for the preferred stock alone would have been unilaterally raised by the board to a minimum of $466.5 million for any acquisitor, friendly or hostile, not receiving a percentage of the preferred as a dividend on a common stock holding.
The language of the New Jersey statutes clearly suggests that voting rights may be different among different classes or series, but nowhere is it suggested that voting rights may be different within a class or series.\textsuperscript{201}

Assuming that a board has the authority to determine the rights and preferences of "blank check" stock, it still cannot use this authority to discriminate between shareholders within the same class.\textsuperscript{202} The board must fulfill its fiduciary duties to all shareholders, which means treating similarly situated shareholders in a like manner. Where such disparity of treatment is effected through unilateral board action, it is simply invalid.\textsuperscript{203}

2. Discrimination in Value: Corporate Distributions Which Convey Substantively Different Values to Shareholders

Another case addressing issues of discrimination in a takeover context is \textit{Minstar Acquiring Corp. v. AMF Inc.}\textsuperscript{204} In \textit{Minstar}, a corporation headed by Irwin Jacobs acquired a substantial portion of AMF's stock. Minstar quickly undertook a tender offer for sufficient additional shares to obtain majority control of AMF. In response, AMF attempted to construct a time bomb sufficient to leave Minstar

\textsuperscript{201} Id. at 477. Accord Unilever Acquisition Corp. v. Richardson-Vicks, Inc., 618 F. Supp. 407 (S.D.N.Y. 1985) (applying Delaware law).

\textsuperscript{202} Cases such as Providence & Worcester Co. v. Baker, 378 A.2d 121 (Del. 1977) (permitting a sliding voting scale so that large shareholders had proportionally less voting power per share than small shareholders), are not contrary to this conclusion. In \textit{Baker}, all shareholders purchased their shares with the voting provisions, which favored small over large shareholders, already in place. There was no alteration of the share contract running between the corporation and its shareholder. All purchasers of shares entered into ownership of the corporation upon an equal basis, implicitly aware that their voting power would not increase in direct proportion to the number of the corporation's shares held beyond a certain quantity.

If a sliding voting scale, such as was at issue in \textit{Baker}, had been imposed by unilateral action of the board, such action would be void. In this case, there would be an alteration of existing equity interests and impairment of the voting right existing in the share contract as entered into by the shareholder. This type of interference by the board with the contractual relationship between the corporation and its owners is unacceptable.

\textsuperscript{203} Impairment of shareholder voting rights may affect more than simply a shareholder's ability to participate in control or governance of the corporation. Evidence exists that stock with limited or nonexistent voting rights is less valuable than comparable shares with full voting power. \textit{Cf.} Lease, McConnell & Mikkelson, \textit{The Market Value of Control in Publicly-Traded Corporations,} 11 J. Fin. Econ. 439 (1983); Dodd & Warner, \textit{On Corporate Governance: A Study of Proxy Contests,} 11 J. Fin. Econ. 401 (1983).

\textsuperscript{204} Minstar Acquiring Corp. v. AMF Inc., 621 F. Supp. 1252 (S.D.N.Y. 1985). For further discussion of Minstar's acquisition of AMF see Ross, \textit{Irwin Jacobs Lands A Big One—Finally, Fortune,} July 8, 1985, at 130; \textit{Minstar's Jacobs to Sell AMF Businesses; Most of Corporate Staff Has Been Fired,} Wall St. J., Aug. 30, 1985, at 5, col. 2.
with only "scorched earth" if it gained control over AMF. Instrumental in AMF's defense was the issuance, as a dividend, of non-transferable poison pill warrants. These warrants were issued solely to persons holding AMF stock prior to a specified date, and the warrants were to be of substantial value upon any change in corporate control, because a change in corporate control would trigger the holder's power to exercise the warrants. The warrants had a six-month expiration date or, alternatively, they were redeemable at a nominal cost by the board. Once the rights were triggered, however, they were no longer redeemable, but they were still non-transferable.

The court found that the poison pill warrants constituted an illegal form of discrimination among shareholders under New Jersey law. The court in Minstar analogized the discrimination created by AMF's rights plan to other cases involving discrimination which resulted from more traditional corporate distributions:

We recognize that the Board was empowered to issue as a dividend these rights to all common shareholders pursuant to the corporate charter. However, the nontransferability of the rights constituted a division of the

205. Minstar Acquiring Corp. v. AMF Inc., 621 F. Supp. 1252, 1255-56 (S.D.N.Y. 1985). AMF's "scorched earth" plan amended stock option and incentive plans to eliminate performance requirements, increased benefits for a retirement annuity plan, established golden parachutes and made the trusts to fund these added benefits irrevocable upon a change in corporate control.

206. The rights were to become exercisable upon a 30% or greater accumulation of AMF stock by a person not "having proposed a plan to acquire all the remaining shares on terms which are deemed fair by the board of directors." Id. at 1256. The rights also entitled their holders to an annual dividend of 15.5% calculated on the liquidation value of $172.50. Id. at 1257.

207. Id. at 1256. In Minstar, the court engaged in a two-tiered analysis to determine whether to enjoin the defensive actions of AMF. First, the court held that AMF's board was within its power in resisting Minstar's advances. Although the court questioned whether the business judgment rule should be applied to determine the validity of a target corporation's defensive actions, it relied on prior New Jersey cases and applied the business judgment rule to justify the initial decision by AMF's board to resist Minstar's advances.

Once the court determined that AMF's decision to resist was justified, it then turned to the second step in the analysis—whether the means employed by the AMF board violated either fundamental principles of corporate governance or the directors' fiduciary duty to the shareholders. The court found it irrelevant that the rights were issued in the midst of a battle for corporate control. Moreover, the court did not even consider whether AMF's defensive actions were taken pursuant to a proper corporate purpose, nor whether AMF's directors had breached their fiduciary duties to the shareholders. Rather, the court's decision to enjoin the defensive actions of AMF was based upon a determination that the directors had exceeded their power in governing the corporation. Minstar thus exemplifies an analysis focusing on the means of resistance to hostile share acquisitions, rather than merely the decision to resist.

208. Id. at 1258. The non-transferability distinguished the rights from ordinary dividends, ownership of which can be transferred prior to actual payment. Accord Unilever Acquisition Corp. v. Richardson-Vicks, Inc., 618 F. Supp. 407 (S.D.N.Y. 1985).
common stock into two classes (pre-May 20, post-May 20). The bundle of rights possessed by pre-May 20 shareholders is significantly greater than those that would be possessed by purchasers of the common stock on the open market, post-May 20. We consider this discriminatory reclassification of the common stock as improper. We believe that the Board may not do this without shareholder approval under New Jersey Law. N.J. Stat. 14A:9-12(e).209

Thus, board actions that discriminate among shareholders of a given class, such as those involved in Asarco and Minstar, are invalid. That the distributions in both cases were made to all shareholders on a superficially pro rata basis does not affect this conclusion. In each case, the distributions in the hand of the would-be corporate acquisitor were of substantially lesser power or value. Such distributions are invalid based upon their discriminatory treatment of shareholders of the same classes or series of stock.

3. Discrimination in Share Repurchases: Greenmail and Selective Self-Tender Offers

When the directors of a target corporation become aware that an individual, group or another corporation has begun to accumulate shares of stock in the target, their response, if any, is essentially up to their discretion. However, as in all other matters, these directors must operate within the confines of the statute and the common law norms which govern their corporation. These principles are not temporarily repealed by what may be a hostile bid for corporate control. If the corporate directors cannot discriminate among shareholders prior to a hostile share accumulation, neither should they have the power to discriminate after a hostile share accumulation has begun.

Provisions must be made, however, for the corporate directors to protect the corporation from genuine threats to its well-being (as opposed to threats merely to incumbent control). In response to threats to its corporate well-being, but for other purposes as well, it has come to be accepted that a corporation may repurchase or redeem its shares. In Delaware, site of the most controversial recent cases, there

209. The court found any such change in the voting structure of the corporation must be approved by shareholders. The court in Minstar also expressly notes its difference with the Delaware Supreme Court in Unocal. Minstar, 621 F. Supp. at 1258. See also Asarco, Inc. v. M.R.H. Holmes A Court, 611 F. Supp. 468 (D.N.J. 1985). Yet another ground for issuance of the injunction was the non-transferability of the rights, which the court found constituted an "unreasonable restraint" upon transferability of securities. Minstar, 621 F. Supp. at 1258. Accord Unilever Acquisition Corp. v. Richardson-Vicks, Inc., 618 F. Supp. 407 (S.D.N.Y. 1985).
is specific statutory authority for a corporation to deal in its shares.\textsuperscript{210}

Both logic and the laws which govern corporate distributions that arise outside of takeover battles support applying the principle of equality to corporate repurchases of stock. Consistency would require a rule that repurchases must be carried out on a pro rata basis. The essential rationale for this treatment is that repurchases are like other corporate distributions, particularly when they are made at a premium over market price.\textsuperscript{211} Indeed, statutory treatment of corporate stock repurchases is very similar to the treatment afforded other types of corporate distributions.\textsuperscript{212}

There is, however, some inherent conflict between the distribu-

\textsuperscript{210} Section 160 of the Delaware Corporation Law states that "[e]very corporation may purchase, redeem, receive, take or otherwise acquire, own and hold, sell, lend, exchange, transfer or otherwise dispose of, pledge, use and otherwise deal in and with its own shares ..." \textsc{Del. Code Ann. tit. 8, § 160} (1983). \textit{See also} \textsc{N.Y. Bus. Corp. Law §§ 202(a)(14), 513 (McKinney 1963); Model Business Corp. Act Ann. § 6.31 (3d ed. 1985); H. Henn \& J. Alexander, supra note 185, § 183, at 474.

Traditionally, there have been two means of challenging repurchases of shares by the board to squelch insurgent threats to control. First, shareholders have often challenged the board's decision to resist a merger or acquisition offer. With respect to these challenges, boards that have acted in good faith have been afforded the protection of the business judgment rule. The alternate shareholder challenge has been based upon a claim that corporate assets were being wasted in the repurchase of the corporation's shares at a premium price from parties hostile to management. Where the board has been informed and has made a good faith decision, these challenges have also failed to prevail over the presumption of legality established by the business judgment rule for such board actions. Since the price to be paid when a corporation repurchases its shares has its primary effect upon the value of those shares remaining outstanding, the framework discussed in the text accompanying notes 139-84, supra, would support the continued evaluation of these claims of waste under the business judgment rule. \textit{See generally} Nathan \& Sobel, supra note 25.

\textsuperscript{211} \textit{In re} Roco Corp. 21 B.R. 429, 434 (Bankr. 1st Cir. 1982) (The purchase by a corporation of its own stock is a form of shareholder distribution.). H. Henn \& J. Alexander, supra note 185, § 335, at 936. ("[P]urchase by a corporation of its own shares ... sometimes has an effect similar to a dividend, and is subject to analogous legal limitations and tax consequences.") \textit{See also} CBS Inc. Accepts 6.4 Million Shares In Tender Offer, Wall St. J., Aug. 2, 1985, at 20, col. 1. (In Turner Broadcasting's hostile attempt to take control of CBS, CBS responded with a self-tender offer. Turner Broadcasting tendered its shares because, it said, "the CBS self tender is in essence a dividend being made available to all CBS shareholders.")

\textsuperscript{212} The Model Business Corporation Act has common provisions governing "distributions," which include dividends, redemptions and other share repurchases. \textit{Model Business Corp. Act Ann. §§ 1.40(6), 6.40} (3d ed. 1985). \textit{See also} Brudney, supra note 190, at 1106. That some shareholders may benefit to different degrees in a repurchase, depending on whether or not they sell or tender their shares to the corporation, does not change the norm that shareholders should be afforded a like opportunity to sell as are other similarly situated owners. While most state statutes do not require repurchases to be made on a pro rata basis, it is clear from the cases that the distribution of corporate assets which results from a repurchase should not result in favored treatment to any group of shareholders, whether it be monetary advantage or maintenance of control. Petty v. Penntech Papers, Inc., 347 A.2d 140 (Del. Ch. 1975); Cheff v. Mathes, 41 Del. Ch. 494, 199 A.2d 548 (1964); Brudney, supra note 190, at 1108. \textit{See also} Bradley \& Wakeman, \textit{The Wealth Effects of
tional norm of equality and share repurchases. Unless the desire of management is to take the corporation private, some limitation must be placed upon the number of shares to be repurchased. More fundamentally, unlike the right of shareholders of the same class to be treated alike by the corporation with respect to corporate distributions, shareholders usually hold no right to have the corporation repurchase their shares. The ability to sell is an incident of share ownership; the right to sell to the corporation is not.

Still, the repurchase by the corporation of its own shares, while not precisely a distribution as in the case of dividends or liquidation payments, is analogous to such distributions. Repurchases by the corporation thus can also give rise to possible problems of discrimination. If the repurchase of shares is made by a publicly held corporation whose securities are actively traded, and the repurchase is made in the open market or made privately at market price, the conflict between equality and the board's power to repurchase shares is of little consequence. It is when a premium over market price is paid, however, that the conflict between selective treatment and corporate norms creates difficulties.

The two primary actions which raise these issues in the current struggles for corporate control are the payment of greenmail and the exclusionary self-tender offer. These repurchases each involve the apparent favoring of one group of shareholders over another. In the context of other types of corporate distributions, such discriminatory treatment would clearly be struck down as violative of the basic norms relating to equality of treatment. Although there is usually no right to have the corporation buy back a holder's shares, selective repurchases implicate the duty of management to act on behalf of all shareholders. Thus, the favoring of one shareholder over another is not a pure question of business policy to be protected by the business judgment rule.

Discriminatory treatment unrelated to a fundamental shareholder right traditionally has been subjected to judicial review pursuant to a standard of intrinsic fairness.213 Balancing the principle of

213. Indeed, prior to Unocal it was apparently the generally held belief that any reacquisition of shares by a corporation would be subject to a test of fairness. See H. HENN & J. ALEXANDER, supra note 165, § 240, at 652 ("[Acquisition] by the corporation of some of its outstanding shares which unduly favors one group of shareholders over another constitutes a breach of the directors' fiduciary duties.").
equality and the directors' discretion in repurchasing shares is achieved by requiring that the payments accomplish a purpose that is fair to all shareholders.

a. Greenmail and Intrinsic Fairness

The payment of greenmail to a corporate raider provides a strong test for this analysis. Reconciling such premium repurchases with standards of shareholder equality has usually been based upon the argument that the repurchase was for the corporation's benefit in thwarting a hostile acquisition. A premise of this argument is that the averted acquisition would have been detrimental to the corporation and that by avoiding it, the corporation and all its shareholders have benefited. Herein lies the basis for purported equality. First, the corporate raider is treated fairly because the corporation repurchases his stock at a premium price, and second, to those shareholders who do not receive a premium price for their shares, there is instead the benefit of protection from a hostile raider who would damage the corporation and the shareholders' investment interests. The directors approving the purchase should have the burden of establishing these benefits to the various groups of shareholders.

214. See, e.g., Herald Co. v. Seawell, 472 F.2d 1081 (10th Cir. 1972); Cheff v. Mathes, 41 Del. Ch. 494, 199 A.2d 548 (1964). While a repurchase of shares from parties seeking control of the target corporation may provide a benefit to target corporation shareholders where the acquiring party is truly a "raider" seeking to loot the corporation of its assets, in general, such repurchases or "greenmail" payments are probably detrimental to shareholders. Bradley & Wakeman, supra note 212, at 301. ("[P]rivately negotiated repurchases of single blocks from stockholders unaffiliated with the firm reduce the wealth of non-participating stockholders. In contrast to the evidence for general repurchases, no positive wealth effect offsets the significant repurchase premium paid to the selling stockholder. Indeed, the wealth loss to non-participating stockholders is significantly greater than the premium paid. This evidence is inconsistent with the shareholders' interest hypothesis and supports the hypothesis that managers in their self-interest use single block repurchases to eliminate threats to their control over the firm's resources."); Dann & DeAngelo, Standstill Agreements, Privately Negotiated Stock Repurchases, and the Market for Corporate Control, 11 J. FIN. ECON., 275 (1983) ("Standstills and premium buybacks reduce competition for corporate control and provide differential treatment of large block stockholders. The analysis indicates a statistically significant negative average effect on non-participating stockholder wealth associated with standstill agreements. Negotiated premium repurchases are also associated with negative, but less significant, stockholder returns. The evidence is inconsistent with the hypothesis that these management actions are in the best interests of non-participating stockholders.").

215. The claim that "greenmail" actually benefits a corporation's shareholders is made in a recent article exploring the economics of these payments. Macey & McChesney, A Theoretical Analysis of Corporate Greenmail, 95 YALE L.J. 13 (1985).

216. See, e.g., Crane Co. v. Harsco Corp., 511 F. Supp. 294, 305 (1981). In that shareholder approval may be obtained for any repurchase of shares, it serves to insulate to some degree the directors from claims based on discrimination. Since the purchasing of the insurgent's shares will
b. Exclusionary Self-Tenders and Intrinsic Fairness

The Delaware Supreme Court's decision in Unocal Corp. v. Mesa Petroleum Co.217 focused on the propriety of the defensive actions taken by Unocal's board of directors in fending off a hostile tender offer by T. Boone Pickens and his Mesa Petroleum Company. The defensive action called into question was a tender offer by Unocal's board for approximately twenty-nine percent of Unocal's own shares at a substantial premium over market price. Unocal sought to make itself a less attractive acquisition by drawing down its substantial cash accounts through its repurchase of shares. Mesa sought to participate in this very attractive distribution of cash to Unocal shareholders by tendering its shares, but it was excluded from the offer and denied the same pro rata treatment afforded other Unocal shareholders.218

Both the propriety of the target board's resistance to a tender offer and the possibility for the wasting of corporate assets arose in Unocal. However, the main issue was Mesa's exclusion from Unocal's tender for its own shares. In its analysis under the business judgment rule, the Delaware Supreme Court's finding that Unocal's board had exercised its good faith judgment in resisting Mesa's tender offer was quite correct. In analyzing the exclusion of the shares owned by Mesa usually be accomplished prior to their obtaining a majority of the shares, or the insurgent's shares may be denied a vote on the endorsement of the repurchase transaction, a ratification of the directors' actions through shareholder vote is persuasive evidence that shareholders have benefited on a par with the insurgents who received a premium price for their shares.

A first step in attaining legitimacy for any defensive measure should be shareholder approval. For many defensive measures, shareholder approval can be obtained prior to any threat to corporate control. Golden parachutes and fair price provisions are examples of defensive measures that can be implemented prior to an attack by corporate raiders. Thus, these measures can and should be approved by shareholders when they are implemented. That shareholder approval may be more difficult to obtain after a tender offer for the corporation's stock has been made is perhaps only fair, given that director motives may be more suspect once an offer has been made and that shareholders may be put on notice for the first time that their shares may carry more value than they previously believed. For defenses based upon the selective repurchase of shares, the problem of obtaining shareholder approval is more acute. Since it is obvious that a selective repurchase or greenmail payment can only be made after the corporate insurgent has accumulated shares, the requirement of shareholder approval of the repurchase would greatly limit the director's flexibility to make what may often be a sound investment in the continued success of the corporation.


218. Besides the case discussed here, Pickens also sued Unocal in a California district court to have Unocal's exclusionary self-tender invalidated under the federal securities laws, but to no avail. Unocal Corp. v. Pickens, 608 F. Supp. 1081 (C.D. Cal. 1985). Had Unocal been forced to include Mesa in the repurchase plan, Mesa would have stood to profit by as much as $178 million. See Unocal Is Ordered To Include Pickens In Buyback Offer, Wall St. J., April 30, 1985, at 3, col. 4.
from Unocal’s self-tender offer, however, the court’s rationale was quite incorrect.

The opening sentence of the opinion states that the court is confronted with “an issue of first impression in Delaware—the validity of a corporation’s self-tender for its own shares which excludes from participation a stockholder making a hostile tender offer for the company's stock.” The court gave this issue limited attention, however, focusing instead on the validity of Unocal’s decision to resist Mesa’s tender offer and finding that, since the decision to resist was proper, the discriminatory exclusion must be reviewed under the business judgment rule.

The Delaware Supreme Court justified the Mesa exclusion by reference to a line of Delaware cases which involved the premium price repurchase of shares from parties hostile to incumbent control. Relying on these cases, the court stated that “it is now well established that in the acquisition of its shares a Delaware corporation may deal selectively with its stockholders, provided the directors have not acted out of a sole or primary purpose to entrench themselves in office.” This statement is erroneous as a matter of fact and disingenuous as a matter of judicial analysis. The cases relied upon establish no such proposition.

The five cases cited by the court in *Mesa* establish that a board’s decision to resist a tender offer is governed by the business judgment rule. These cases also establish that if this decision is carried out through a share repurchase, challenges to the repurchase by shareholders claiming a wasting of corporate assets are also governed by the business judgment rule. None of the cases cited by the court in *Unocal*, however, addressed the propriety of unilateral action by the board to repurchase shares on a discriminatory basis. Although

221. *Unocal*, 493 A.2d at 954.
222. If the repurchases made in the five cases cited by the court had all been made on the open market, or even if the repurchases had been privately negotiated at market price, a lawsuit would probably not even have been bought. The issues in these cases are the board’s power to resist a hostile overture and corporate waste resulting from an allegedly excessive premium payment.
the Delaware Supreme Court is correct in asserting that these cases involve situations where a corporation dealt selectively with its shareholders, it is wrong when it states that any of these cases decided a challenge to the propriety of the type of discriminatory treatment involved in Unocal. Contrary to the court’s representation, no authority existed in Delaware, prior to Unocal, for the proposition that the business judgment rule governs a challenge to the discriminatory repurchase of a corporation’s shares effected for a deliberately discriminatory purpose.

In Unocal, the Delaware Chancery Court, in granting Mesa a shares without doing so on a pro rata basis. The court in Martin held that a corporation could repurchase shares from a dissentent faction, without making a similar offer to all shareholders, upon the affirmative vote of the shareholders. Indeed, under the statute at issue in Martin, shareholder approval was required to reduce the corporation's capitalization through any retirement of shares. Id. at 299. The safeguard of shareholder approval in a “greenmail” case is precisely what is advocated herein when it is feasibly obtainable. When the exigencies do not permit the corporation to obtain shareholder approval, the courts are urged then to verify that there is no unfairness in the repurchase. The court in Martin stated that:

We see no sound reason why it should be held as a matter of law that the method of reducing capital by purchasing shares at private sale for retirement may not be invoked simply because the purpose or motive of the reduction is to eliminate a substantial number of shares held by a stockholder at odds with management policy, provided of course that the transaction is clear of any fraud or unfairness. Id. at 302 (emphasis added). Insofar as the court in Martin made these determinations, this Article totally agrees with the case, the corporation having gained shareholder approval for its actions and no unfairness being found.

224. Cheff v. Mathes, 41 Del. Ch. 494, 199 A.2d 548 (1964), involved a shareholders' derivative suit to hold directors of the target company “liable for loss allegedly resulting from improper use of corporate funds to purchase shares of the company.” Id. at 549-50 (emphasis added). Bennett v. Propp, 41 Del. Ch. 14, 187 A.2d 405 (1962), was a suit for an accounting alleging waste and improper use of corporate funds in repurchasing shares. Martin v. American Potash & Chem. Corp., 33 Del. Ch. 234, 92 A.2d 295 (1952) is discussed at note 223, supra. Kaplan v. Goldsamt, 380 A.2d 556 (Del. Ch. 1977), was a derivative suit charging defendant directors with issuance of false and misleading proxy statements and “waste of corporate assets.” Id. at 558 (emphasis added). Kors v. Carey, 39 Del. Ch. 39, 158 A.2d 136 (1960), similarly involved a claim that directors had improperly used and wasted corporate funds in repurchasing stock and had paid an excessive price in purchasing the assets of another business. Id. at 137-38. The particular pages cited indicate that “directors, while bound to deal with stockholders as a class with scrupulous honesty, may in the exercise of their honest business judgment adopt a valid method of eliminating what appears to them a clear threat to the future of their business by any lawful means.” Kors, 158 A.2d at 141 (citing McPhail v. L.S. Starrett Co., 257 F.2d 388 (1st Cir. 1958)). As a statement of the law governing a board's decision whether to resist a hostile offer, this language is unassailable. But as a guide to evaluating the permissibility of a particular means of resistance, it begs the question. Whether the means employed are lawful is precisely the issue for determination. None of these cases approved of selective dealings with shareholders in the nature of the action taken by Unocal's board.

225. Court to Decide Today Whether Unocal May Bar Mesa Group's Tender of Shares, Wall St. J., April 29, 1985, at 2, col. 3 ("[T]he company [Unocal] has said it isn't able to cite a legal precedent for its exclusion.").
temporary restraining order, had recognized that directors could not discriminate among their shareholders.\textsuperscript{226} The chancery court found only one case, \textit{Fisher v. Moltz},\textsuperscript{227} which had dealt with a challenge to the discriminatory repurchase of shares.\textsuperscript{228} The \textit{Fisher} decision simply recognized that statutory authority existed for a Delaware corporation to repurchase its shares.\textsuperscript{229} In Fisher, the court ruled that a prerequisite to any share repurchase is a proper corporate purpose for the repurchase. The chancery court in \textit{Mesa} also began its inquiry with whether a proper corporate purpose might exist for a corporation's self-tender offer. But section 160 of the Delaware Corporations Code involves the right to repurchase, not the right to discriminate. Thus, the chancery court in \textit{Mesa} addressed the legality of discriminating among shareholders from a perspective of fairness in the board's governing of the corporation.

The chancery court held that a proper corporate purpose, by itself, was insufficient to justify a selective tender offer. Unocal must also demonstrate the fairness of its tender offer to all shareholders, and this the chancery court deemed most unlikely. In stating its holding, the chancery court noted that "legally or equitably impermissible conduct cannot be justified by the fact that it was motivated by a proper corporate purpose."\textsuperscript{230} Unfortunately, the Delaware Supreme Court did not reach this level of analysis. Instead, the supreme court determined that since Unocal's initial decision to resist the Mesa offer was justified by the business judgment rule, the means employed by Unocal to resist Mesa's offer would also be reviewed under the business judgment rule.

With equality as a general guide to corporate distributions, and corporate stock repurchases constrained both by the need to demonstrate a proper corporate purpose and fair treatment to all shareholders, the path that should have been taken by the Delaware Supreme Court in \textit{Unocal} becomes clear. The first step is to determine whether the board exercised informed, good faith judgment in determining that Mesa's tender offer was inadequate. Upon doing so, the board's

\textsuperscript{227} No. 6068, slip op. (Del. Ch. Dec. 28, 1979), reprinted in 5 DEL. J. CORP. L. 530 (1980).
\textsuperscript{228} The chancery court also noted both \textit{Mesa's} and \textit{Unocal's} concurrence that \textit{Fisher} "states the legal principles governing a company's selective purchase of its stock." Mesa Petroleum Co. v. Unocal Corp., No. 7997, slip op. at 3 (Del. Ch. April 29, 1985), rev'd, 493 A.3d 946 (Del. 1985).
\textsuperscript{229} See DEL. CODE ANN. tit. 8, § 160(a) (1983).
\textsuperscript{230} \textit{Mesa Petroleum}, slip op. at 7.
power to resist this offer properly was established. The court should then have examined the means employed by Unocal in resisting Mesa's offer. This the supreme court did only superficially, for had the court made a thorough analysis of the specific defense involved, it would have invalidated the exclusionary self-tender offer made by Unocal.

Both greenmail and exclusionary self-tender offers require analysis under an intrinsic fairness standard. In contrast to selective repurchases from corporate insurgents, however, an exclusionary self-tender by a corporation cannot be justified by the protection it affords to those against whom it discriminates. The exclusion of the raider's shares from the tender offer cannot be justified as intrinsically fair to all stockholders. The premium payments are to be made to all shareholders except the insurgent, and the supposed benefit afforded by the self-tender is also to be conferred upon all shareholders save the insurgents. It is obvious there can be no intrinsic fairness in the target board's treatment of its unwanted suitor as compared with its other shareholders. Plainly, the selective self-tender is, in almost all imaginable cases, illegal as an unfair form of discrimination among shareholders.

Both greenmail and exclusionary self-tenders have come under attack as wasteful or abusive defensive actions. In its Unocal decision, the Delaware Supreme Court fumbled its opportunity to deal with both of these discriminatory, and often abusive, defensive tactics when it failed to establish consistent principles for analyzing these responses to hostile share acquisitions. In both greenmail and exclusionary self-tender offer cases, affirmation of the fundamental norms of equality in corporate governance and equality in shareholder rights is a sufficient basis for overturning defensive actions which are not justified under a standard of intrinsic fairness, without impairing the basic premise of the business judgment rule.

C. Defensive Techniques and the Separation of Powers in the Corporation

Thus far, this Article has analyzed several antitakeover tactics,

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231. See supra note 19, discussing proposed federal legislation. The SEC is also currently considering proposing new rules that would prohibit a company from making selective tender offers for its own shares. The rule would be designed to eliminate exclusionary self-tender offers like that made by Unocal Corporation in its conflict with Mesa Petroleum Company. Proposed SEC Rule on Tender Offers By Issuers, 17 SEC. REG. & L. REP. (BNA) 1310 (July 12, 1985).
such as nonredeemable poison pills and exclusionary self-tenders, and has found that they either violate traditional corporate norms or the fiduciary obligations of the board. In this section, the Article examines measures which protect incumbent management by shifting the ability to make or approve changes in control from the shareholders to the board. If management approval is required for corporate control to shift, no change in control may take place unless incumbent management is compensated.

Even where the board takes action which affects all shareholders in a similar manner, it is not immune from attack. Fiduciary duties still constrain the board’s activities. As discussed in part IV, section A, even otherwise traditional business decisions must not be so extreme as to either effectively cripple the corporation or else result in an abdication of the discretion delegated to the board to act as the management organ of the corporate entity.

Admittedly, where the board acts pursuant to traditional authority and takes actions which affect all shareholders in a like manner, restrictions on judicial review of these activities are justifiably substantial. Given the limits of the board’s role, it must have substantial freedom within those limits to act on behalf of the corporation. The enabling character of the typical state corporation statute and the business judgment rule provides this necessary cushion.232

Some of the most recent antitakeover measures, however, do not treat shareholders in an unequal manner and otherwise appear to be within the board’s statutory power. As exemplified by Moran v. Household International, Inc.,233 redeemable preferred stock rights which make a hostile share acquisition or merger prohibitively expensive have become popular.234 Board-imposed contingent supermajority provisions or designated shareholder veto powers have also been attempted.235 These provisions initially may be justified by statutory or charter provisions which enable the board to determine the rights and preferences of authorized but unissued stock.236

233. 500 A.2d 1346 (Del. 1985).
236. For example, DEL. CODE ANN. tit. 8, § 151(g) (1983) provides in pertinent part:
But the board, even when its actions affect all shareholders similarly, is not limited solely by the requirements that it not waste the corporation's assets or completely abdicate its role as corporate overseer. The opposite of abdication of power is usurpation of power. While the board must exercise its discretion to protect the shareholders and enhance the corporation, it must also act within the scope of its authority.

It has been stated that "corporate law is constitutional law" and actions by the board which alter the traditional separation of powers within the corporation violate the corporate constitution. When this alteration shifts control from the shareholders to the board, for matters committed by statute or principle to the former, the board usurps the shareholders' functions and rights. It is in this respect that some recent antitakeover devices, such as "redeemable" stock warrants or rights and "contingent" supermajorities may be invalid.

One fairly common aspect of poison pill stock distributions is a "flip-over" provision which grants a right of redemption or convertibility at an extremely favorable price or ratio. The purpose and effect of such a provision is to make specific transactions, either a sub-

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When any corporation desires to issue any shares of stock of any class or of any series of any class of which the voting powers, designations, preferences and relative, participating, optional or other rights, if any, or the qualifications, limitations or restrictions thereof, if any, shall not have been set forth in the certificate of incorporation or in any amendment thereto but shall be provided for in a resolution or resolutions adopted by the board of directors pursuant to authority expressly vested in it by the provisions of the certificate of incorporation or any amendment thereto, a certificate setting forth a copy of such resolution or resolutions and the number of shares of stock of such class or series shall be executed, acknowledged, filed, recorded, and shall become effective, in accordance with § 103 of this title. . . . When any certificate filed under this subsection becomes effective, it shall have the effect of amending the certificate of incorporation.

237. M. Eisenberg, supra note 135, at 1.

238. The focus in this section is on the shift in control from the shareholders to the board caused by these devices. These provisions may have other effects which make them subject to challenge. The redeemable poison pill, for example, once triggered, divests the board of all power to act, resulting in an abdication of managerial obligations. See supra text accompanying notes 168-84. The board-created supermajority, contingency aspect aside, shifts control among the shareholders. See infra text accompanying notes 254-86.

stantial share acquisition or a merger, prohibitively expensive.\textsuperscript{240} As discussed earlier, to the extent that such a feature results in preemption of all possible mergers, its adoption is a breach of fiduciary duty by the board of directors.\textsuperscript{241}

Rarely, however, is such a provision included without reserving for the board the power to defuse it. The board typically either has the right to redeem the preferences or warrants for a nominal price,\textsuperscript{242} or else the poison pill provisions are not operative if the transaction is approved by a specified percentage of the board.\textsuperscript{243} One set of rules applies if the transaction is approved by incumbent management, otherwise, another set of rules apply. Moreover, the cost of proceeding without board approval makes the latter option unfeasible. In essence, then, any person desiring to undertake any transaction identified in the terms of the poison pill must first negotiate with the board.

It is not disputed that, under many statutes, the board of directors initially evaluates many issues that ultimately require shareholder action, such as mergers or charter amendments.\textsuperscript{244} Indeed, if director-adopted poison pill provisions did nothing more than confirm these existing prerogatives, their effect on the separation of corporate powers would not be an issue. But their potency as antitakeover devices is measured by the breadth of the transactions to which they apply, because most poison pill provisions are designed to deter any significant hostile share acquisition, whether or not it would ultimately result in a merger.

\textsuperscript{240}See, e.g., Horwitz v. Southwest Forest Indus., Inc., 604 F. Supp. 1130, 1132-33 (D. Nev. 1985) ("In either event, the cost would be so high as to make any merger unfeasible."). If these provisions allowed shareholders to purchase the target corporation's shares at such a discount, the directors would likely be liable for waste of corporate assets. These provisions, however, allow purchase of the raider's shares at this rate. See supra note 121.

\textsuperscript{241}See supra text accompanying notes 168-84. Another common feature of these poison pills is the requirement of supermajority approval for fundamental changes or other identified transactions. Such provisions disturb the norm of majority rule and may be invalid on this basis. See infra text accompanying notes 258-71. To the extent that such a requirement is contingent on board approval, the analysis in this section would invalidate it. For an example of such a rare occurrence, see Asarco v. M.R.H. Holmes A Court, 611 F. Supp. 468 (D.N.J. 1985).


\textsuperscript{243}See, e.g., Telvest, Inc. v. Olson, No. 5798, slip op. (Del. Ch. March 8, 1979) (supermajority voting requirements not applicable if transaction approved by two-thirds of board).

\textsuperscript{244}See, e.g., DEL. CODE ANN. tit. 8, §§ 242, 251 (1983) (amendment of charter and merger).
The contingent nature of the rights and obligations created by these provisions is the key to their invalidity. Their purpose is to expand the scope of transactions for which management approval is required. Their effect is to redistribute rights properly residing with the shareholders—such as voting on a merger or selling shares pursuant to a tender offer—to the board. These provisions directly restrict the rights of shareholders as a group to vote on fundamental corporate changes, and they indirectly impinge on the rights of shareholders as individuals to dispose of their shares. In sum, these devices seek to reach beyond the boardroom to preempt actions at the annual shareholders’ meeting and to chill transactions between private individuals in the marketplace. As succinctly stated by one court, "[i]n the present case the defensive device . . . is calculated to alter the structure of the corporation, removing decisions in takeover matters from individual stockholders and reposing them in the Board."²⁴⁵

An effective contingent poison pill, such as that adopted in Moran v. Household International, Inc.,²⁴⁶ has the same effect as a lock-up option²⁴⁷—it deters future bids by potential suitors. When a lock-up option is granted to a third party in the context of active multiple-party bidding for the target corporation, bidding stops and the third party effectively controls the target’s future. Target shareholders are deprived of the benefit of the auction. As the Delaware Supreme Court recently held in Revlon v. MacAndrews & Forbes Holdings Inc.,²⁴⁸ a board which grants a lock-up option under these circumstances may breach its fiduciary duty to the corporation and its shareholders.

A contingent poison pill similarly prevents overtures by potential bidders. The difference between a lock-up option and a contingent poison pill is that with the poison pill, it is the target’s board of directors, not a third party, that holds the option which prevents hostile suitors from seeking control. Since any attempt to merge or consolidate with the target while the poison pill is in place is tantamount to financial suicide, negotiation with the target’s board becomes an effective prerequisite to obtaining control.

Although the board of directors of a corporation is empowered to act on behalf of the company’s shareholders to manage the corpo-

²⁴⁶. 500 A.2d 1346 (Del. 1985).
²⁴⁷. See supra notes 159-66 and accompanying text.
ration, the courts have not viewed favorably attempts by the board to alter the fundamental structure of the corporation. Where such actions affect the corporate control apparatus or the right of majority shareholder power, the scrutiny is particularly intense. Both by voting on fundamental changes in the corporate structure and by selling their shares, the shareholders are exercising rights inherent in the owners of a business enterprise. Thus, action by a corporate board is invalid if it directly and unilaterally alters the corporate structure as it concerns the separation of these functions between the shareholders and the board.

There is no doubt that the shareholders could, by affirmative majority vote, abdicate their right to tender their shares to any suitor who did not obtain board approval. The contingent poison pill, however, allows the target board to reach "the plateau of plenary negotiating authority" without shareholder approval. This unilateral usurpation of shareholder discretion alters the basic structure of the corporation. Thus, the poison pill in Moran, like the lock-up option in Revlon, should have been condemned.

Accepting that the board cannot unilaterally effect such a shift in control, a significant question remains. Can the shareholders, as a group, act to divest themselves of the prerogatives provided by statute and common law norms? This issue arises in connection with charter

249. See, e.g., Joseph E. Seagram & Sons v. Conoco, Inc., 519 F. Supp. 506, 514 (D. Del. 1981); Holly Sugar Corp. v. Buchsbaum, [1981-1982 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 98,366, at 92,240 (D. Colo. 1981). But see Treco, Inc. v. Land of Lincoln Savings & Loan, 572 F. Supp. 1455, 1460 (N.D. Ill. 1983) (directors' amending of bylaws to increase percentage of shareholder vote required to amend bylaws sustained on basis of the business judgment rule). See also Plaza Sec. Co. v. O'Kelley, No. 7932, slip op. (Del. Ch. Mar. 5, 1985) (corporation enjoined from enforcing bylaw imposing waiting period and review process in the event of any attempt to take action on corporation's behalf by written shareholder consent; the bylaw was adopted in direct response to the announcement by a shareholder, who was seeking to acquire control of the corporation, of his intention to solicit consents for the purpose of removing the corporation's directors and replacing them with his own nominees, and conflicted, the court found, with a statutory provision giving shareholders the right to take immediate action by written consent unless otherwise provided in the certificate of incorporation).


251. See infra text accompanying notes 254-86.

amendments, such as a fair price provision, which give the board the discretion to waive certain shareholder rights. The validity of such an amendment depends upon the nature of majority shareholder control as an integral aspect of the nature of the modern American corporation, a subject addressed in the next section in connection with the validity of supermajority provisions.

D. The Allocation of Corporate Control Among Shareholders

An issue which parallels the allocation of corporate control between the board and shareholders is the allocation of control among shareholders. The allocation of control among shareholders may be determined in one of two ways. First, control may be reallocated through supermajority provisions approved by the shareholders. Alternatively, it may be reallocated through an issuance of preferred stock, if the voting rights of the preferred, as determined by the board of directors, include a requirement that a supermajority of the issued class approve the consummation of a merger or similar extraordinary transaction. Both of these alternatives raise issues concerning the role of majority control in the modern corporate enterprise.

1. The Norm of Majority Rule in the Allocation of Corporate Control

The shareholder voting provisions in early corporation statutes, and the cases arising thereunder, were based on the principle of protection for minority shareholders. Many corporations operated as little more than formally incorporated partnerships that required the affirmative approval of all owners to take corporate action. This orientation typically was reflected in early statutes by provisions governing shareholder action that often required unanimity or, at a minimum, two-thirds shareholder approval.

As the ownership of corporations became more widely dispersed, statutes requiring unanimity or near unanimous agreement among shareholders became impractical and unwieldy. A requirement of unanimity nearly guaranteed the inability of the corporation to act, and even management control over proxy machinery did not make

253. See generally Finklestein, supra note 52, at 297.
255. See generally 11 W. FLETCHER, supra note 193, at § 5769.
lesser percentage requirements for approval necessarily practicable.\textsuperscript{256} To facilitate the evolution of the corporation as a vehicle for large-scale industrial development, new corporation statutes were passed which gradually reduced the percentage of shareholder approval required for actions which concerned fundamental changes or extraordinary transactions. This trend towards lesser percentage approval requirements for shareholder action has culminated in the adoption, by almost all states, of statutes requiring only a simple majority vote.\textsuperscript{257}

Taking majority rule as the standard from which to analyze the adoption of "shark repellents" and other defenses, this Article concludes that when the board unilaterally adopts provisions which alter shareholder voting power or other elements of corporate structure, such action is invalid. Nonetheless, provisions similar, if not identical in effect, may, however, validly be adopted by a majority of the shareholders.\textsuperscript{258} In reaching this second determination, one must remain sympathetic to the interests of the minority shareholders, and recognize the limiting effect that structural changes resulting from antitakeover actions may have upon minority rights, particularly voting rights.\textsuperscript{259}

2. Board Created Reallocation of Control Among Shareholders

Reallocation of corporate control among shareholders by unilateral action of the board of directors is a relatively recent phenomenon. In contrast to the normal means of reallocating control, namely, supermajority provisions adopted by charter amendment, corporate boards have been achieving similar results through the issuance of preferred stock pursuant to prior blank check authorization of the shareholders. This type of reallocation of control is effected by at-

\textsuperscript{256} See generally D. Mueller, Public Choice 19-27 (1979); Easterbrook & Fischel, supra note 34, at 728 n.10.


\textsuperscript{258} This assumes that the corporation statute of the relevant jurisdiction requires only a majority vote for amending the charter and other similar extraordinary corporate actions, and that the corporation's shareholders have not acted previously to effect such an amendment which would increase the percentage vote required.

\textsuperscript{259} For this reason, this Article advocates an interpretation of the right to dissent and demand appraisal embodied in the major corporation statutes that would be activated by supermajority limitations upon voting rights or other fundamental changes in corporate structure as adopted by a shareholder majority. See infra text accompanying notes 285-86.
taching to the preferred stock a requirement that a supermajority of the class approve any modification of the preferred's rights or any business combination. In this way the board seeks to bypass the normal need for shareholder approval of the supermajority provision.

Such unilateral board action to either alter corporate structure or make other fundamental changes is invalid.\(^\text{260}\) Voting power reserved for the shareholders cannot be terminated without, at the minimum, majority consent.\(^\text{261}\) Unilateral board action in contravention of the norm of majority control is not supported by statute or case law. Even the rather broad, enabling-type language which allows amendment of the charter for greater-than-majority voting requirements is no help to corporate boards seeking these changes, since such language also requires shareholder approval.\(^\text{262}\)

The earliest case which analyzed board-created supermajority provisions is *Telvest, Inc. v. Olson*.\(^\text{263}\) In *Telvest*, the board of Outdoor Sports Industries, Inc. (OSI) sought to fend off Telvest's aggressive overtures by issuing a class of preferred stock which contained voting and conversion provisions designed to thwart any proposed business combination. The board of OSI attempted to vest a supermajority voting approval requirement\(^\text{264}\) in the preferred stock which would squelch simple majority approval of designated transactions by the common shareholders.\(^\text{265}\) A suitor not obtaining approval of the

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\(-\text{footnotes-}\)

\(^\text{260}\). Where a corporation does an act in the ordinary course of its business, through its board of directors or other officers, the consent of all or a part of the stockholders is not necessary unless required by statute or charter. But there are certain acts, mostly outside the ordinary business of the corporation, as to which the board of directors cannot act, either by the common law or because of a statute or charter provision, without the consent of all or a majority or a certain percent of the stock. 11 W. Fletcher, supra note 193, at § 5769.


\(^\text{263}\). No. 5798, slip op. (Del. Ch. March 8, 1979).

\(^\text{264}\). "The voting rights created by this so-called preferred stock provide for a supermajority vote of 80 percent in order to approve any business combination or transaction with any party who, at the time, is the owner of 20 percent or more of the outstanding voting stock of OSI." *Id.* The voting rights of the preferred were to also include a requirement that any approval include at least 50% concurrence of the outstanding shares of the preferred held by shareholders other than the holder of the 20% stake.

\(^\text{265}\). This supermajority voting provision was to be accomplished without shareholder approval through the issuance of previously authorized blank check preferred stock incorporating the supermajority voting rights. The court summarized the proposed alteration of voting power as follows:
board, or not making an offer which conformed to the exempting provisions of the preferred stock, would thus have triggered a shift in control among the shareholders.

While the charter of OSI provided for the possible issuance of preferred stock, the rights and preferences to be determined by the board at a later date, the question in this case was not the board’s authority to issue stock. Rather, the question concerned the board’s authority to include a supermajority provision as one of the incidents of that issuance, because such action seemingly conflicted with the statutory provision which allowed amendment of the corporate charter only by majority shareholder approval. Applicable standards of corporate governance, including the norm of majority rule and the voting rights contained in the stock of the corporation’s owners, mandate the approval of a majority of the shareholders. Unilateral action by the board in violation of such requirements should be deemed per se invalid. The court in Telvest explicitly adhered to this rationale in granting Telvest a preliminary injunction:

It seems more logical to conclude that where the holders of the common stock are given the right to approve certain transactions by only the majority vote required by the various applicable statutes, that right cannot be changed short of an amendment to the certificate of incorporation approved by the stockholders. I am aware of no policy evident in the Delaware Corporation Law, and I have been referred to none, which would empower a board of directors to alter existing voting rights of shareholders for the supposed good of the shareholders without permitting the shareholders to be heard on the matter.

[T]hrough the declaration of a purported stock dividend, OSI’s board has attempted to convert the voting rights of those same stockholders who would have had the power to approve or disapprove certain business combinations by majority vote—i.e., the holders of the common stock—into the power, in certain situations, to permit less than a majority of the present common stockholders to vote down a merger, sale of assets, etc. when it is being proposed by the owner of 20 percent or more of the outstanding common stock.

Id. 266. The voting rights of the preferred stock were not to have come into being if the OSI board, by two-thirds vote, had approved the acquisition of shares which would bring the purchasers’ total above 20%, or if similar approval had been given to a proposed business combination prior to the stock acquisition. Id.

267. The voting rights would not have been triggered by an offer for all OSI’s outstanding voting stock that had resulted in the transfer of at least 75% of such stock not held by the tendering party. Id.

268. The later case of National Educ. Corp. v. Bell & Howell Co., No. 7278, slip op. (Del. Ch. Aug. 25, 1983), involved, among other things, a similar supermajority provision effected through a dividend of preferred stock. The defendant, Bell & Howell, contended that Telvest effectively was overruled by action of the Delaware General Assembly, but the court did not reach an interpretation of this legislative action. Instead, the court stated its belief that Telvest was correct on its facts, and
A similar interpretation can be made of the poison pill preferred at issue in *Asarco.* Though the court invalidated the poison pill issued by Asarco’s board because it created discriminatory voting rights among shareholders of the same class, the goal of the board in creating these securities was to shift control from a simple majority of shareholders to those shareholders not holding a twenty percent stake in Asarco. Thus the discrimination among shareholders was merely the means for implementing a plan to shift control of the corporation from one group of shareholders to another, without first gaining shareholder approval. Although the court based its decision only on the invalidity of the discriminatory voting rights created within a single class of stock (the discriminatory means) the end sought to be achieved (structural change without shareholder approval) was also sufficient grounds for invalidating the actions of Asarco’s board.

Likewise, the court in *Minstar* found it impermissible that the AMF poison pill securities had shifted control among the shareholders. Though the primary shift in control occurred as the result of an increase in the power of the AMF board over the acceptance or rejection of tender offers, the triggering of the rights contained in the poisoned securities would have made the rights irredeemable and removed the effective veto power from the board. Instead, the veto power would then be vested in the nontendering shareholders holding their stock on the declaration date for the rights dividend. This result would have occurred since only shareholders of AMF on the declaration date were to receive the rights dividend and such dividend was nontransferable, thus necessarily preventing its voting rights from being conveyed to Minstar with any tendered common stock. The district court found this alteration in voting structure, absent shareholder approval, impermissible under New Jersey law.

These attempts at unilateral board amendments to the corporate charter are beyond the spirit of the enabling provisions of the corporate statutes, because the enabling provisions require that shareholder

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269. See supra text accompanying notes 197-201 discussing the provisions of the poison pill in *Asarco* in connection with analysis of the discrimination among shareholders.

270. This was after reposing primary control in the board itself through its power of redemption. See supra note 241 discussing this shift in corporate control from shareholders to the board.

271. See supra text accompany notes 204-09, discussing the factual setting of *Minstar.*
approval be obtained for modification of the norm of majority control. A different question is posed, however, once majority shareholder approval is obtained. Consistent application of the principles of corporate democracy seems to mandate validation of control shifts resulting from majority approved greater-than-majority voting requirements or other antitakeover actions.

3. Shareholder Approved Reallocation of Corporate Control

If the norm of majority rule is to be maintained, the enabling language of statutes which permit greater-than-majority voting requirements must be respected. Thus, the panoply of shark repellent charter amendments adopted by shareholders, including super-majority provisions, must be upheld absent other cause for invalidation. And while this issue is still subject to considerable controversy among the commentators, the only two cases to specifically consider the adoption of supermajority provisions by shareholders, Seibert v. Gulton Industries, Inc. and Seibert v. Milton Bradley Co., both upheld the supermajority provisions adopted by a simple majority.

The two cases are virtually identical—the only major difference is that the first arose under Delaware law while the latter arose under Massachusetts law. The plaintiffs' primary contention in these cases was that a supermajority voting provision, approved by a majority of the shareholders, violated the respective state corporation statutes because the provision was contingent on board approval of the matter. In each case, simple majority shareholder approval was required for business combinations having previously met with board approval. For those proposed business combinations not having the board's sanction, however, a supermajority approval of eighty percent in Gulton Industries, and seventy-five percent in Milton Bradley, was required. Thus, the ability of the majority of shareholders to shift power from the holders to the board (the issue left open in the previous section) was presented in these cases.

The plaintiffs contended that this contingency impermissibly cre-

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274. 405 N.E.2d 131 (Mass. 1980).
ated two voting standards for a corporate action, where a single fixed requirement was necessary. Both courts disagreed, however, with this contention. In *Gulton Industries*, the court premised its decision on the broad language of the Delaware corporation statute, finding that the shifting vote requirement did not violate any provision of the statute or any public policy.\(^\text{275}\) Citing *Gulton Industries*, the court in *Milton Bradley* found its statutory provisions analogous and reached a similar conclusion.\(^\text{276}\) In addition, the court in *Milton Bradley* held that the board’s discretion to effect a shift in the voting requirement did not amend or modify the bylaw change granting the supermajority for mergers.\(^\text{277}\) Thus, majority-approved shifts in control from the shareholders to the board were upheld. Moreover, even though each court addressed the validity of shareholder adopted supermajority provisions only by implication, it is clear in these cases that not only both courts, but also all the parties involved in the actions, readily accepted the legality of the amendments, absent the contingencies, as proper.\(^\text{278}\)

These cases are instructive on the strength of the modern mandate of majority shareholder power, both to shift control among the shareholders and to shift control from the holders to the board. While supermajority provisions which are contingent upon board approval are not explicitly provided for by statute, statutory authority does exist for straight supermajority provisions.\(^\text{279}\)

Some commentators have attempted to minimize the importance of such provisions by examining their historical origins and concluding that their alteration of the standard of majority control was a legislative response to the needs of the close corporation.\(^\text{280}\) This position, however, does not deal with the lack of legislative limitation on the use of supermajority provisions in publicly held corporations. Moreover, given the vastly increased use of supermajority provisions and the absence of any limitations imposed upon their use by state


\(^{277}\) Without shareholder approval, such amendment would have been in apparent violation of Massachusetts law.

\(^{278}\) Similar acceptance of the shareholder-adopted supermajority as valid under Delaware law can be gleaned from Young v. Valhí, Inc., 382 A.2d 1372 (Del. Ch. 1978). In that case, the issue was circumvention of a supermajority voting requirement for a merger, the validity of the supermajority provision was apparently unquestioned.

\(^{279}\) DEL. CODE. ANN. tit. 8, § 102(b)(4) (1983).

legislatures, the negative inference is that no such limitation is at least currently intended. Finally, although the potential for abuse is significant, the original intent of greater-than-majority voting requirements was to protect minority shareholders. It is thus quite reasonable to conclude that the open-ended application of these statutory provisions was, and still is, intended by state legislatures.

While it has been argued that shareholder approval of supermajorities and other shark repellent provisions is essentially, though perhaps not legally, ineffective due to shareholder apathy or ignorance, there is no basis to invalidate all such provisions absent other compelling reasons. If shareholder approval, as an endorsement of these antitakeover actions, is rejected in its entirety, all arguments premised upon the value of corporate democracy are logically diminished in strength. Consistency in the application of the norms of corporate governance requires that shareholder preference, as manifested by majority adoption of defensive acts, be recognized.

Statutes which require supermajority approval for adoption of supermajority provisions are not contrary to this result. The imposition upon majority rule created by such provisions is well within the powers of state legislatures to alter corporate structure. Additionally, statutes which require supermajority approval for the adoption of supermajority provisions address the primary concern of the critics of similar measures adopted by a mere majority of shareholders—a current simple majority should not be able to bind a greater future majority to the voting requirements. In essence, these statutes bring to supermajorities some of the desirable characteristics of simple majority voting while affording greater protection to minority shareholders.

a. Lock-Up Amendments as the Focus for Analysis of Shark Repellents

Though majority rule is clearly the norm in modern corporate

281. See Gilson, supra note 46, at 824.

282. Gilson’s position on shareholder approval is somewhat inconsistent with his desire to further shareholder democracy. He states that: “The conclusion that shark repellent amendments are invalid is not affected by shareholder votes that approve them.” Though he does moderate this blunt statement, he does so in the course of defining shark repellent amendments (provisions which are more difficult to repeal than to initially adopt), identification of which secures their invalidity regardless of share approval. Supermajority provisions and other shark repellents may have a role in some corporate structures, and shareholder approval is an essential element of adoption in such situations. The key is developing a consistent framework encompassing the adoption, effect and repeal.
governance, all major corporate statutes continue to allow the shareholders to adopt, by charter amendment, greater-than-majority voting requirements for shareholder action.283 This is the typical route followed by corporate boards wishing to enact shark repellents. The *modus operandi* of a board made anxious by the threat of hostile acquisition is to formulate its defenses, present them to shareholders and then lock-in the defenses. Defenses are locked-in by amending the charter or bylaws so that the vote required to repeal the defenses is increased from the simple majority required for adoption to a supermajority requirement, usually in the range of a sixty-seven to eighty percent affirmative vote. This maneuver is known as a lock-up provision and it is critical to the efficacy of all shareholder-adopted antitakeover measures.

Without lock-up amendments, shark repellent defenses are an exercise with limited substantive effect. If a hostile party could amend the corporate charter or bylaws through a mere majority vote, then any previously-enacted shark repellent amendment could be eliminated if the insurgents gained majority voting power and repealed the amendment. No supermajority provisions would need be met; rather, the insurgents could simply terminate the shark repellent by majority vote. Though some would contend this result is proper,284 recognition of an earlier majority’s power to alter the corporate structure through changes in voting rights demands the contrary. Thus, a current majority can lock-in charter amendments by requiring a supermajority vote before the amendments are repealed. Though there is conflict between the two majorities separated in time, the only reasonable resolution of the conflict demands that the prior majority’s power be recognized.

**b. Protecting Minority Interests from Majority Approved Lock-Up of Shark Repellent Provisions**

A shark repellent without a lock-up amendment, which effects only nominal changes in the corporate structure and in the governing powers of the corporation’s constituent parties, is a valid action of the corporation’s shareholders. The validity of a lock-up provision is


284. See, e.g., Gilson, *supra* note 46; Friedenberg, *supra* note 29.
more difficult to evaluate, however, when it pits the norm of majority rule and the enabling statute against the voting rights and investment interests of the minority shareholders. The minority shareholders may be bound by a shark repellent amendment without their approval or any ability to reverse the decision. Simply stated, the problem is whether the majority of shareholders should potentially be able to impair minority interests through a charter amendment which a like percentage of shareholders would be unable to repeal.

Although this Article has concluded that a majority must be allowed to adopt and lock-in supermajority voting, courts might construe such a shift in voting power as a fundamental corporate change. If this limitation is a fundamental corporate change, then it would trigger the minority shareholders' right to dissent and demand appraisal, just as such a right would exist for other fundamental corporate changes. If shareholders who are opposed to the adoption of shark repellents (which are accompanied by lock-up amendments) are to be afforded full and fair protection of their voting power and other investment interests, then they must be given the same remedies that apply to other fundamental corporate changes, namely, appraisal rights. Statutory language from which courts might analogize already exists in some jurisdictions. That lock-up amendments should trigger such rights conforms with the rationale behind the appraisal statutes.

Appraisal statutes were designed to allow majority rule to govern the corporation's operation, both in ordinary and extraordinary corporate actions. Embodied in the concept of the appraisal statutes, however, is the recognition that a dissenting minority will exist and when a change occurs, either in the rights granted to the shareholders or in the fundamental nature of the corporation, a financial safety valve which allows the dissenting shareholders to divert their investments into other vehicles is appropriate. Allowing dissenting shareholders to vacate the corporation may also prevent future disputes or lawsuits. This rationale is the same as that applying to other corporate transactions triggering the right to dissent and demand

285. See Minn. Stat. Ann. § 302A.471(a)(4) (West 1985) (granting appraisal rights upon limitation of voting powers). See also Model Business Corp. Act Ann. § 13.02 (3d ed. 1985). This section establishes appraisal rights for shareholders dissenting from (1) a merger or consolidation, (2) a plan of exchange, (3) the sale or exchange of substantially all corporate assets, and (4) amendment of the articles of incorporation that (i) "alters or abolishes a preferential right of the shares" or (ii) "excludes or limits the right of the shares to vote on any matter." (emphasis added).
V. CONCLUSION

This is an exciting time in the history of corporate governance. Merger and acquisition activity has flourished among both large and small companies, with hostile tender offers for several of the nation’s largest corporations attracting particular attention. The response of the nation’s corporate leaders to this phenomenon has been to consolidate their positions and attempt to create an atmosphere where they can cautiously review such overtures to determine the benefits and harms to the constituencies they represent. The speed and extent of this thrust and parry of takeover and antitakeover activity appears to have left courts and regulators without guidelines for evaluating the flurry of events.

In an era when federal legislation often is seen as the answer to all social, economic, and legal problems, the impetus is to increase the federal regulatory framework. This Article has dissented from that view, and also from the conclusion that current corporate management has no appropriate role in the debate over, or the results of, the takeover frenzy. Corporate managers are entrusted with responsibilities to their shareholders and part of that responsibility is determining the effect of a hostile share acquisition with respect to their companies and shareholders. Adopting this position allows one to then focus on the crucial issue of implementation: how can a balance be achieved between, on the one hand, the duties of management to act for the benefit of the shareholders and, on the other, the responsibilities of management not to impinge on the shareholders’ rights to control the corporation and be treated equally?

The current takeover/antitakeover atmosphere provides an appealing opportunity for evaluating the relations within the modern corporate structure and reaffirming several fundamental principles of corporate governance. These principles fill the void created by the

286. See, e.g., Eisenberg, supra note 250, at 72-74, 84-86. The merit of appraisal rights in this situation is demonstrated by the rapid decrease in stock prices that may accompany the adoption of anti-takeover measures. See J.M. Smucker Co. Holders Consider Anti-Takeover Step, Wall St. J., Aug. 1, 1985, at 8, col. 1 (“The proposal, which the jam maker characterizes as an anti-takeover measure, has been a factor in the $7.875 decline in the company's stock price this week.”); Hess, Holders Pass Measures to Block Hostile Takeover, Wall St. J., May 10, 1985, at 13, col. 3 (Midwest ed.); General Foods Acts to Block Any Takeover, Wall St. J., Sept. 23, 1985, at 16, col. 2; Revlon Shares Lose Their Gloss For Investors As Firm Sets Anti-Takeover Buyback Plan, Wall St. J., Aug. 28, 1985, at 43, col. 3. But see supra note 39.
highly-charged debate over the general propriety of "takeover" activity. This activity, and particularly the response of corporate management, implicates norms of corporate governance that have been almost ignored by the courts and the commentators in the current volatile business climate.

Reaffirming the duty of corporate management (1) to undertake traditional business decisions on the shareholders' behalf, (2) to treat shareholders of the same class equally, (3) to treat all shareholders fairly, and (4) to respect the prerogatives of ultimate control vested in the shareholders, provides the key to evaluating board activities in the takeover context, as in more typical business situations. Moreover, the norm of majority shareholder control requires the validation of shareholder actions which diminish the marketability of the corporation and the derivative value of holders' shares. These principles provide insights and prescriptive guidelines to analyze today's business activity.

Focusing on traditional principles of corporate governance also highlights the extensive discretion placed in the hands of corporate managers in the modern American business enterprise. Over the next few years the courts will have the opportunity to limit that discretion based on these fundamental norms of corporate operation. Their response to the challenge presented by today's takeover frenzy will define the extent of this discretion and the structure of tomorrow's corporation.