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Stakeholder Versus Stockholder: The Director's Proper Constituency in a Contest for Corporate Control

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STAKEHOLDER VERSUS STOCKHOLDER: THE DIRECTOR'S PROPER CONSTITUENCY IN A CONTEST FOR CORPORATE CONTROL

INTRODUCTION

Increasing concern over the effects of takeovers on the economy and society is evident from the amount of scholarly attention given to the topic. This concern is justified in light of the increasing number of unsolicited tender offers which have taken place in re-


2. Although securities regulations have failed to define the term "tender offer" clearly, courts have considered eight factors in determining the existence of a tender offer: (1) active and widespread solicitation of public shareholders for shares of an issuer; (2) solicitation made for a substantial percentage of the issuer's stock; (3) offer to purchase made at a premium over the prevailing market price; (4) terms of the offer are firm rather than negotiable; (5) offer contingent on the tender of a fixed maximum number of shares for purchase; (6) offer open for only a limited period of time; (7) offeree subjected to selling pressure; and (8) public announcements of a purchasing program concerning the target company precede or accompany rapid ac-
Corporations which wish to remain independent or which do not wish to be acquired by a particular offeror have responded to the escalation of takeover activity with novel and innovative plans. These defensive measures have an impact on a variety of interests. The representatives of these interests have focused attention on the legal, ethical, and practical questions faced by directors of corporations in resisting hostile tender offers or in implementing devices to deter future takeover attempts.

A major dilemma confronting management is its identification of the appropriate constituency to serve in evaluating a tender offer or in adopting anti-takeover devices. In a corporate control contest, directors are confronted with their traditional fiduciary duty to the shareholder to maximize the shareholders' wealth. Directors, however, also have a duty to the corporation as a whole and to the persons, or "stakeholders," whose lives are directly affected by the corporation. These persons include the corporation's employees, suppliers, customers, and local communities as well as its

cumulation of a large number of the target's stock. SEC v. Carter Hawley Hale Stores, Inc., 760 F.2d 945, 950 (9th Cir. 1985); see also Edgar v. MITE Corp., 457 U.S. 624 (1982); Hanson Trust PLC v. SCM Corp., 774 F.2d 47 (2d Cir. 1985).

3. See Trevor, Hostile Takeovers—the Corporate Killing Field One Year Later, Statement at National Investor Relations Institute, Spring Conference, Orlando, Florida, June 8, 1987 at 2–3. "One major company has gone 'into play' each and every week since March of 1985 in the United States. And we're talking about big firms and major traditional American names—such as Allied Stores, BankAmerica, Gillette, Goodyear, Owens-Corning, Phillips Petroleum, Sperry, Unocal and USX." Id.; see also Pozdena, Who Benefits From Takeovers?, BUYOUTS & ACQUISITIONS, Mar.–Apr. 1987, at 10 (acceleration in the prevalence of takeovers as a means to accomplish corporate combinations has generated concern among analysts about the effects of tender offers on the corporate sector and the stability of the financial system).

4. See Note, Defensive Tactics to Hostile Tender Offers—An Examination of Their Legitimacy and Effectiveness, 11 J. CORP. L. 651 (1986)(comprehensive discussion of the elements of a contest for corporate control including various anti-takeover devices).

5. The concern over takeovers encompasses not only investors' interests but also the interests of "stakeholders" in corporations, such as employees, suppliers, creditors, and local communities. The impact tender offers have on corporations and our society as a whole has been equated with problems such as the national debt and defense spending. Id. at 652–53. See Sommer, Hostile Tender Offer is Critical Issue for Congress, LEGAL TIMES, Jan. 21, 1985, at 19.


7. See Feinberg, The Directors' New Dilemma in the Takeover Crisis: A Special Report, INSTITUTIONAL INVESTOR, June, 1987, at 30. Directors are faced with competing interests, their primary duty to their shareholders, and their duty to the corporation as a whole and its future as a business enterprise. Id. at 46.

8. See, e.g., Smith v. Van Gorkom, 488 A.2d 858 (Del. 1985). "In carrying out their managerial roles, directors are charged with an unyielding fiduciary duty to the corporation and its shareholders." Id. at 872 (citing Loft, Inc. v. Guth, 23 Del. Ch. 138, 2 A.2d 225 (1938), aff'd, 5 A.2d 503 (Del. Super. Ct. 1939)).
shareholders.9

The possible deleterious impact of a takeover on these constituencies has caused many scholars to temper their positions as to the desirability of hostile tender offers.10 For many, the focus is no longer only on the traditional policy of protecting shareholder interests, but has broadened to include a wider array of interests.11

Consideration of these "stakeholder" interests by directors in takeover crises and other management decisions is supported by the courts,12 state anti-takeover legislation,13 amendments to various companies' articles of incorporation,14 and in the American Law Institute's recommendations on corporate governance.15 However,

9. See, e.g., Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985). The Delaware Supreme Court held that a corporation's directors in evaluating a defensive measure to a takeover, may properly consider the impact of such a measure "on 'constituencies' other than shareholders (i.e., creditors, customers, employees and perhaps even the community generally)." Id. at 955. See also Johnson, supra note 1, at 185.

10. Id. at 184 n.5.

11. Id.


13. See, e.g., MINN. STAT. § 302A.251, subd. 5 (1988 & Supp. 1989) which states:

In discharging the duties of the position of director, a director may, in considering the best interests of the corporation, consider the interests of the corporation's employees, customers, suppliers, and creditors, the economy of the state and nation, community and societal considerations, and the long-term as well as short-term interests of the corporation and its shareholders including the possibility that these interests may be best served by the continued independence of the corporation.


14. Control Data Corp. implemented such a provision in its corporate charter:

The Board of Directors of the Corporation, when evaluating any offer of another party to (a) make a tender or exchange offer for any equity security of the Corporation, (b) merge or consolidate the Corporation with another corporation, or (c) purchase or otherwise acquire all or substantially all of the properties and assets of the Corporation, shall, in connection with the exercise of its judgment in determining what is in the best interests of the Corporation and its stockholders, give due consideration to all relevant factors, including without limitation the social and economic effects on the employees, customers, suppliers and other constituents of the Corporation and its subsidiaries and on the communities in which the Corporation and its subsidiaries operate or are located.

Lipton I, supra note 1, at 110 n.37.

15. See PRINCIPLES OF CORPORATE GOVERNANCE; ANALYSIS AND RECOMMENDATIONS § 2.01 (Tent. Draft No. 2 1984). The American Law Institute outlined its recommendations defining the corporate objective as follows:

A business corporation should have as its objective the conduct of business activities with a view to enhancing corporate profit and shareholder gain, except that, whether or not corporate profit and shareholder gain are thereby enhanced, the corporation, in the conduct of its business

(a) is obliged, to the same extent as a natural person, to act within the boundaries set by law,
an expansion of the director's traditional fiduciary duty may be misfocused when the principal tenets of corporation law are considered.\textsuperscript{16}

Subordinating shareholders' interests to other constituencies effectively abandons the long-standing and fundamental principles upon which management of a business corporation is based—the corporate directors' duty to maximize financial returns to shareholders.\textsuperscript{17} The inconsistency in the concept of "stakeholder" interests is that a board of directors, which is accountable to everyone, in reality is accountable to no one.\textsuperscript{18} Consideration of stakeholder interests by directors making decisions concerning tender offers may seem appropriate in some limited circumstances.\textsuperscript{19} Proper protection of shareholder interests, however, accomplishes the same result without prostituting the traditional doctrines of corporation law.\textsuperscript{20}

This Note examines the traditional view of the corporate enterprise and contrasts it with the development and influence which the stakeholder model has exerted on corporate management within the context of a hostile tender offer. Second, this Note studies the quandary confronting directors torn between conflicting goals—preserving the corporate entity for the benefit of many constituencies by resisting a takeover attempt, or seeking the highest immediate return for its shareholders by acquiescing to a hostile bid. Third, this Note reviews some common strategies used by management to resist hostile tender offers and some of the criticisms of these plans. Finally, this Note examines the economic utility of takeovers and the propriety of contesting tender offers with defensive strategies and suggests that constituent interests are most adequately preserved by a policy

\textsuperscript{16} See Carter, To Whom is a Corporate Director a Fiduciary?, 9 Nat. L.J. 21, 22 (July 6, 1987)(discussing corporate directors' liability to shareholders for breach of fiduciary duties).

\textsuperscript{17} See infra notes 21-215 and accompanying text.

\textsuperscript{18} See Easterbrook & Fischel I, supra note 1, at 1192. Accountability to the holders of conflicting interests arguably will ultimately harm both groups and "reduc[e] the willingness of people to entrust their money to [directors]." See also Fiedler, DAYTON HUDSON'S PYRRHIC VICTORY, CORP. REP. MINN. Sept. 1987, at 59. Provisions in state anti-takeover statutes have been criticized as diluting the director's traditional duty of care owed to shareholders. Id. at 64.

\textsuperscript{19} See Gordon & Kornhauser, Takeover Defense Tactics: A Comment on Two Models, 96 Yale L.J. 295, 295 n.1 (1986)(a takeover can redistribute wealth to shareholders without increasing economic output in cases such as the downward renegotiation of employee contracts or leveraged acquisitions transferring wealth from bondholders).

\textsuperscript{20} See Easterbrook & Fischel I, supra note 1, at 1190-92.
which aggressively and exclusively promotes shareholder wealth but which adopts a benign approach to tender offers.

I. TRADITIONAL VIEW

The traditional view\(^\text{21}\) of the corporation advocates that directors have a fiduciary relationship to the corporation and with its shareholders of a type similar to the relationship which a trustee has to a trust and with its beneficiaries.\(^\text{23}\) Courts have often applied fiduciary obligations to directors of corporations as "quasi-trustees."\(^\text{24}\) Although directors are not trustees in the pure legal sense, their relationship to the corporation and its stockholders involves responsibilities and obligations similar to that in a trust relationship.\(^\text{25}\)

A corporation, however, could not conduct business if its directors were held to the same standard as ordinary fiduciaries, who may not

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21. The "traditional model" of the corporate enterprise restricts the discretion of corporate boards to those acts which maximize the present return on the shareholder's investment. This view is based upon the legal conception of the corporation as an instrumentality which has as its exclusive purpose the accumulation of wealth for its owners. The following statement by economist Milton Friedman epitomizes the traditional view:

A corporate executive's responsibility is to make as much money for the stockholders as possible, as long as he operates within the rules of the game. When an executive decided to take action for reasons of social responsibility, he is taking money from someone else—from the stockholders, in the form of lower dividends; from the employees, in the form of lower wages; or from the consumer, in the form of higher prices. The responsibility of a corporate executive is to fulfill the terms of his contract. If he can't do that in good conscience, then he should quit his job and find another way to do good. He has the right to promote what he regards as desirable moral objectives only with his own money. If, on the other hand, the executives of U.S. Steel undertake to reduce pollution in Gary for the purpose of making the town attractive to employees and thus lowering labor costs, then they are doing the stockholders' bidding. And everybody benefits: The stockholders get higher dividends; the customer gets cheaper steel; the workers get more in return for their labor. That's the beauty of free enterprise.


22. Under the "pure market" model of the corporation, a term often utilized in economic analysis, profit maximization is attained through the operation of market forces. See Solomon & Collins, Humanistic Economics: A New Model For the Corporate Social Responsibility Debate, 12 J. CORP. L. 331, 333 nn. 10–14 (1987).


25. See Pomeroy v. Simon, 17 N.J. 59, 64, 110 A.2d 19, 22 (1954). The relation is not one of a trustee in the technical sense because title to corporate property is in the corporation rather than in the directors. \textit{Id}. 
have the smallest degree of self-interest in a transaction.\textsuperscript{26} By the very nature of his or her position, a corporate director has a certain amount of self-interest in everything he or she does.\textsuperscript{27} In corporate transactions, therefore, directors are held to the rule which governs trustees and prohibits the use of trust property for the trustee's personal gain.\textsuperscript{28} Although they are collaterally benefited in their positions, directors have the duty to administer the corporation's business for the benefit of its stockholders, and to exercise their best skill and judgement solely in the interests of the corporation.\textsuperscript{29}

As "quasi-trustees," corporate managers are charged with the duty to maximize the business' profits in order to enhance the stockholders' return on their investments.\textsuperscript{30} This duty is generally carried out without considering the potentially adverse impact it has on other matters unrelated to shareholder returns.\textsuperscript{31} As owners of the corporation,\textsuperscript{32} stockholders traditionally have been entitled to employ managers dedicated to conducting the business of the corporation for their benefit alone.\textsuperscript{33}

The limitation on directors' attention to goals other than profitability is illustrated by \textit{Dodge v. Ford Motor Co.}\textsuperscript{34} Dodge exemplifies the director's traditional duty to maximize shareholder wealth.\textsuperscript{35} In the


"The very fact that the director wants to enhance corporate profits is in part attributable to his desire to keep shareholders satisfied so [he may maintain his seat on the board]." \textit{Id.} In situations which otherwise would involve a conflict of interest for ordinary fiduciaries, the business judgment rule "postulates 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 motivation." \textit{Id.}

\textsuperscript{27.} \textit{Id.}


\textsuperscript{29.} \textit{Id.}

\textsuperscript{30.} \textit{See Easterbrook & Fischel I, supra note 1, at 1191.}

\textsuperscript{31.} \textit{See supra} notes 21–22 and accompanying text.

\textsuperscript{32.} A shareholder is possessed of the legal attributes of ownership of the corporation, including, the right to control, the risk of loss, and the right to retain profits. When a shareholder does not run the corporation himself, he must employ managers willing to subordinate their interests to his economic goal in order to maximize his profits. Hetherington, \textit{Fact and Legal Theory: Shareholders, Managers, and Corporate Social Responsibility} 21 Stan. L. Rev. 248, 250 (1969). \textit{But see} A. Berle & G. Means, \textit{The Modern Corporation and Private Property} (1932). The modern reality of the centralization of managerial power in a board of directors severely limits a shareholder's opportunity to exercise any type of meaningful control. In most public corporations the board has evolved into a self elected, self perpetuating, and self-interested group of managers. \textit{Id.} at 119–25.

\textsuperscript{33.} \textit{See A. Berle & G. Means, supra note 32, at 119–25.}

\textsuperscript{34.} 204 Mich. 459, 170 N.W. 668 (1919).

\textsuperscript{35.} \textit{See Easterbrook & Fischel I, supra note 1, at 1191.}
1919 action by minority shareholders to compel the Ford Motor Company to pay dividends,36 Henry Ford and other directors instituted a plan to share the corporation's profits with the public.37 Ford's directors chose to substantially reduce the price of the company's automobiles38 rather than to pay dividends out of an enormous accumulated surplus.39 This price reduction would have immediately diminished stock value and shareholder returns.40 In affirming the lower court's ruling compelling Ford to pay dividends, the Michigan Supreme Court asserted that Ford's directors were obligated to conduct the business of the corporation exclusively for the benefit of its shareholders41 and that the directors' discretion extended only to choosing the most appropriate means to accomplish that end.42 The court concluded that permitting the directors to withhold dividends in order to further altruistic goals would release corporate directors from their fiduciary duty and allow them to change the purpose of the business from a device designed to enhance shareholder wealth to one designed to enhance public welfare.43

In 1939, the Delaware Supreme Court, in Guth v. Loth, Inc.,44 similarly set out the traditional role of the board of directors and its duty to protect and enhance the shareholders' financial interest in the corporation.45 Guth illustrates that a director may not subordinate the interests of the corporation or its shareholders to his or her own interests.46 Guth involved a corporate director who diverted a potentially lucrative business opportunity,47 producing Pepsi-Cola syrup

36. Dodge, 204 Mich. at 474, 170 N.W. at 673.
37. Henry Ford was clearly the prominent force of the Ford Motor Company in the early 1900s; no plan or operation could have been carried out without his consent. Ford thought that his company had made too much money. Although profits could have been even greater, Ford sought to share the company's wealth with the general public. Henry Ford's ambition was to "employ still more men, to spread the benefits of this industrial system to the greatest possible number, to help them build up their lives and their homes." Id. at 505, 170 N.W. at 683.
38. The plan called for a reduction in the price of a car from $440 to $360. Id.
39. Id.
40. Id.
41. Id. at 507, 170 N.W. at 684.
42. Id.
43. Id.
44. 23 Del. Ch. 255, 5 A.2d 503 (1939).
45. Id. at 270, 5 A.2d at 510. The Delaware Supreme Court concluded that corporate directors and officers, while technically not trustees, stand in a fiduciary relation to the corporation and its shareholders which demands "peremptorily and inexorably, the most scrupulous observance of his duty. . . ." Id.
46. Id.
47. Id. The rule of corporate opportunity prevents a corporate director from seizing a business opportunity from the corporation if the corporation is financially able to undertake it. See, e.g., Science Accessories Corp. v. Summagraphics Corp.,
for the bottling company, away from the corporation in order to undertake the venture himself.\textsuperscript{48} In upholding the Chancery Court's assessment of damages,\textsuperscript{49} the Delaware Supreme Court reiterated the long-standing rule commanding a corporate director to protect the interests of shareholders and to refrain from any activity which may deprive the corporation of profit.\textsuperscript{50}

Although the concept of the corporation has changed and the discretion afforded directors has been broadened since \textit{Dodge} and \textit{Guth}, the directors' traditional fiduciary relationship to shareholders has been maintained in modern corporation law.\textsuperscript{51} Most states have codified the common law rules regarding management's fiduciary obligations.\textsuperscript{52} Minnesota, for example, outlines a director's standard of conduct to encompass this duty. Specifically, subdivision 1 of Minnesota Statutes section 302A.251 provides that "[a] director shall discharge the duties of the position of director in good faith, in a manner the director reasonably believes to be in the best interests of the corporation..."\textsuperscript{53}

While a statutory framework outlining directors' accountability to the corporation is important, the crucial rules regarding fiduciary duty have been developed by the courts on a case by case basis.\textsuperscript{54} Because the issues and facts involved in decisions contemplated by corporate boards are often very complicated, general legislation alone offers little guidance for predicting important outcomes or planning transactions.\textsuperscript{55} Case law scrutinizing directors' decisions has given meaning to abstract codes.\textsuperscript{56}

\textsuperscript{48} Guth, at 258-66, 5 A.2d at 505-10.
\textsuperscript{49} The Chancery Court ordered that all shares of Pepsi-Cola stock held by defendant Guth be transferred to the complainant. Loft, Inc. v. Guth, 23 Del. Ch. 138, 191, 2 A.2d 225, 248 (1938).
\textsuperscript{50} Guth, 23 Del. Ch. at 268, 5 A.2d at 510.
\textsuperscript{51} \textit{See}, e.g., Hanson Trust PLC v. ML SCM Acquisition, Inc., 781 F.2d 264, 273 (2d Cir. 1986); Smith v. Van Gorkom, 488 A.2d 858, 872 (Del. 1985); Aronson v. Lewis, 473 A.2d 805, 811 (Del. 1984).
\textsuperscript{52} \textit{See}, e.g., \textit{DEl. CODE ANN. tit. 8, § 141 (1983 & Supp. 1988)}; \textit{MINN. STAT. § 302A.251, subd. 1 (1988)}.
\textsuperscript{53} \textit{MINN. STAT. § 3024.251, subd. 1 (1988)}.
\textsuperscript{54} \textit{See} \textit{I R. BALOTTI & J. FINKELSTEIN, THE DELAWARE LAW OF CORPORATIONS AND BUSINESS ORGANIZATIONS at Ixviii (Supp. 1986)}.
\textsuperscript{55} \textit{Id.}
\textsuperscript{56} \textit{Id.}
Among the leading cases lending guidance as to the director's fiduciary responsibility to shareholders is the 1985 decision of Smith v. Van Gorkom. The decision in Van Gorkom is important because it establishes the minimum level of care which directors must exercise before their decisions are protected by the business judgment rule.

In Van Gorkom, the directors of Trans Union Corporation approved a nonhostile merger of the corporation into a wholly-owned subsidiary of Marmon Group, Inc. Shareholders of Trans Union subsequently sued, claiming they had received an inadequate price for their stock.

In determining whether the Trans Union directors properly approved the merger, the Delaware Supreme Court did not merely defer to the directors' business judgment. Rather, the court undertook an extensive review of the board's decision-making process. The court concluded that the Trans Union directors breached their fiduciary duty to the corporation's shareholders by

57. 488 A.2d 858, 872 (Del. 1985).
58. For an extensive review of the Van Gorkom decision, see Chittur, supra note 56, at 505-43.
60. Van Gorkom, 488 A.2d at 863.
61. Id. at 871. The board did not adequately consider what was the "intrinsic" value of the corporation. Despite the fact that the fifty-five dollar per share price the shareholders received for their stock was well in excess of the current market price, there was no way for the board to know without further consideration whether such price was reasonable. Id. at 877.
62. Id. at 874 (corporate directors are required to avail themselves of all material information regarding a transaction that is available to them); see also Aronson v. Lewis, 473 A.2d 805, 812-13 (Del. 1984).
63. Van Gorkom, 488 A.2d at 874; see, e.g., Wander & LeCoque, Boardroom Jitters: Corporate Control Transactions and Today's Business Judgment Rule, 42 Bus. Law. 29, 38-39 (1986). The court focused on a number of factors:

(i) The directors did not take sufficient time to properly study and analyze the proposed merger and the issues involved—i.e., the directors based their decision almost entirely upon the president's (Van Gorkom) twenty-minute oral analysis of the merger transaction, were unaware that Van Gorkom himself had orchestrated the transaction and had suggested the price himself to the buyer, failed to ask about and were unaware of the terms of the merger agreement, and approved the merger in the course of one hastily called two-hour board meeting;

(ii) The director's failed to obtain any written documentation in support of the merger price—i.e., no consultation was made of management or any investment advisor as to the "intrinsic value" of the company and no fairness opinions or valuations were given as to the fairness of the merger, nor did the board insist on such formal evaluations before making their decisions; and

(iii) The directors failed to review any of the documents prepared in con-
failing to marshal adequate information regarding the value of the corporation's stock before recommending the merger. In reaching its decision, the Van Gorkom court applied a gross negligence standard to the conduct of the directors—a standard which has become known as the directors' duty of care.

Although the decision in Van Gorkom has been criticized, it does caution directors to consider the appropriate standard of care when contemplating complex business transactions. It also serves to remind directors of their traditional duty in representing the financial interests of the shareholders. In Van Gorkom, this duty specifically involved obtaining the best possible price for the shareholders' stock.

Most of the cases currently involving the directors' duty to shareholders arise from disputes concerning management's resistance to unsolicited tender offers or from management's use of anti-takeover devices that allow directors to resist non-negotiated takeovers without prior stockholder approval. In a contest for corporate control posed by an unsolicited tender offer, a corporation's board of directors is charged by its fiduciary duty to exercise due care in connection with the proposed merger—i.e., the directors were not given, nor did they request, copies of any of the key merger arguments.

Id. 64. Van Gorkom, 488 A.2d at 893.
65. Id. at 873 (citing Aronson, 473 A.2d at 812). But see Hanson Trust PLC v. SCM Corp., 781 F.2d 264, 273 (2d Cir. 1985) (applying a "reasonable diligence" standard).
66. See generally supra note 58.
67. See Burgman & Cox, Corporate Directors, Corporate Realities And Deliberative Process: An Analysis of the Trans Union Case, 11 J. CORP. L. 311, 313 (1986)(Smith v. Van Gorkom is typically referred to as the Trans Union case and has been criticized as being incongruent with corporate reality, and because it raises questions as to the standard of care owed by directors which would be difficult for judges to resolve).
68. Van Gorkom, 488 A.2d at 872.
69. Id. at 874.
71. See Note, supra note 4, at 668–69.
deciding whether to endorse the tender offer or to deploy defensive measures.\textsuperscript{72} The 1986 decision of \textit{Revlon, Inc. v. MacAndrews \& Forbes Holdings Inc.}\textsuperscript{73} provides an excellent example of directors' traditional duty to protect stockholder investments.\textsuperscript{74}

In \textit{Revlon}, the board of directors of Revlon instituted a series of defensive measures\textsuperscript{75} to thwart a hostile takeover attempt by Pantry Pride, Inc.\textsuperscript{76} As part of its strategy, Revlon attempted a defensive repurchase of its own stock, commonly known as a self-tender offer.\textsuperscript{77} The rationale behind Revlon's efforts to reacquire its shares was essentially to prevent Pantry Pride from obtaining enough Revlon stock to gain control of the corporation.\textsuperscript{78} By repurchasing its own stock, Revlon sought to bolster the market price of its shares in order to deter Pantry Pride from raising its hostile bid.\textsuperscript{79}

The self-tender attempted by Revlon's board involved the issuance of debt securities in the form of senior subordinated notes in exchange for shares to be acquired from Revlon stockholders.\textsuperscript{80} This transaction changed the status of the stockholders who participated in the exchange from owners to creditors of the corporation.\textsuperscript{81} The noteholders' creditor status is significant because it transformed the Revlon directors' duty. Although the directors maintained a responsibility to protect the value of the noteholders' investment, under the

\begin{verbatim}
72. \textit{Id.} at 668.
73. 506 A.2d 173 (Del. 1986).
74. \textit{Id.} at 176–80.
75. \textit{See Note, supra note 4, at 661–67; see also infra notes 171–206 and accompanying text.}
76. \textit{Revlon}, 506 A.2d at 176–77. Revlon instituted a "poison pill" in the form of a Note Purchase Rights Plan and attempted a "self-tender offer" by offering to repurchase its own stock from its shareholders. Revlon also courted a "white knight" by granting Forstmann & Little Co. the option to purchase its Profitable Vision Care and National Health Laboratories divisions. \textit{Id.} at 176–79.
77. \textit{See generally Wander \& LeCoque, supra note 63, at 56–58. A self-tender offer involves an offer by a corporation to purchase its own shares for cash or debt instruments with value in excess of the acquiring entity's bid. The rationale of the self-tender is that it allows the shareholder the choice of selling his shares to obtain cash or notes, or to retain his stock in the belief that ownership of the company will provide greater returns. \textit{Id.}
78. \textit{Revlon}, 506 A.2d at 177.
79. \textit{Id.}
80. \textit{Id.} Under the self-tender offer, Revlon offered to repurchase up to 10 million shares of its own stock, exchanging one senior subordinated note (a corporate debt security, with a $47.50 principle payable at 11.75 percent along with one-tenth of a share of $9.00 Cumulative Convertible Exchangeable Preferred Stock) for each common share reacquired.
81. \textit{See generally B. Manning, \textit{A Concise Textbook on Legal Capital} 1–15 (1977)} (a comprehensive discussion involving the relative rights accruing to equityholder and debtholders).
\end{verbatim}
traditional view of the corporation, that responsibility was subordinate to the directors’ fiduciary duty to the remaining shareholders. 82

A problem with the transaction arose when the self-tender failed to deter Pantry Pride from raising the stakes in the contest for control of Revlon. 83 Revlon’s board, concerned that the company would fall into unfriendly hands, unanimously agreed to sell the company’s stock to a more desirable suitor and consented to a leveraged buy-out by Forstmann and Little Co. 84

Under the terms of the buy-out, Forstmann Little was to assume Revlon’s liability for the $475 million debt incurred by the issuance of notes in Revlon’s attempted self-tender. 85 To reach such an agreement with Forstmann, however, Revlon waived certain covenants 86 of the note indenture which protected the interests of the debt holders.

When Revlon announced the terms of its merger with Forstmann Little, specifically the waiver of the note covenants, the value of the notes immediately began to fall. 87 When the value of the notes fell, the Revlon board was deluged by calls threatening litigation. 88

During Revlon’s negotiations with Forstmann Little, Pantry Pride persisted in its efforts to acquire the corporation. 89 Pantry Pride stated that it would engage in fractional bidding for Revlon’s stock and threatened to top any Forstmann Little offer. 90 Fearful that Pantry Pride would complete its hostile acquisition and confronted with seemingly impending litigation over its issuance of debt, the Revlon board agreed to a lock-up 91 arrangement with Forstmann. 92

Under the arrangement, Forstmann Little agreed to support the value of Revlon’s notes in the market in exchange for a lock-up op-

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82. See Easterbrook & Fischel I, supra note 1, at 1190-92.
83. Revlon, 506 A.2d at 177.
84. Id. at 178.
85. Id.
86. Id. The notes contained covenants which limited Revlon’s ability to incur additional debt, sell assets, or pay dividends unless otherwise approved by the independent (non-management) board members.
87. Id. The notes which originally traded near par, around $100, dropped to $87.50 approximately one month after they were issued.
88. Id.
89. Id.
90. Id.
91. A “lock-up” or “crown jewel” defensive tactic occurs when a target corporation grants a company which is a more desirable suitor, commonly known as a “white knight,” the option of purchasing highly valued assets of the corporation. This tactic is designed to make the target corporation a less attractive target in the eyes of the hostile acquirer and is usually triggered by a contingency such as a hostile bidder’s acquisition of a set percentage of the target’s stock.
92. Revlon, 506 A.2d at 178.
tion on two of Revlon’s most profitable divisions.93 The lock-up granted Forstmann Little the option to purchase Revlon’s Vision Care and National Health Laboratories divisions at a fraction of their market value94 in the event another bidder acquired forty percent of Revlon’s shares.95

The lock-up arrangement effectively ended an intense bidding contest for Revlon without requiring Forstmann Little to significantly increase its bid for the corporation.96 Pantry Pride challenged the arrangement seeking to enjoin the transfer of the lock-up assets to Forstmann Little.97

The Supreme Court of Delaware affirmed the Chancery Court’s holding that Revlon directors had breached their duty of loyalty by making concessions to Forstmann out of concern for the noteholders.98 Rather than maximizing the sale price of the corporation, the Revlon board instead sought to protect the interests of the corporation’s creditors.99 The court held that the Revlon board inappropriately allowed their fundamental duty of maximizing shareholder profits to be subordinated to the interests of other stakeholders in the corporation.100

While recognizing the importance of various constituencies’ interests in a takeover situation,101 the court would not allow those interests to transcend the directors’ obligation to the shareholders.102 Revlon stands as a significant statement of the directors’ traditional duty to maximize shareholder investment once the breakup of the

93. Id.
94. Id. Revlon granted Forstmann the option to purchase its Vision Care and National Health Laboratories divisions for $525 million, $100–175 million below the value ascribed to them by Lazard Freres, Revlon’s investment banker.
95. Id.
96. Id. at 184.
98. Revlon, 506 A.2d at 185.
99. Id. at 184.
100. Id. at 185.
101. Specifically, the court stated:
The Revlon board argued that it acted in good faith in protecting the noteholders because Unocal permits consideration of other corporate constituencies. Although such considerations may be permissible, there are fundamental limitations on that prerogative. A board may have regard for various constituencies in discharging its responsibilities, provided there are rationally related benefits accruing to the stockholders.
102. Id. at 184. The Revlon court held that concern for noninvestor interests is inappropriate when a bidding contest for the corporation is taking place. When such an action is in progress, the object of the directors should no longer be to maintain the corporate enterprise, but to sell it to the highest bidder. Id.
corporation becomes inevitable.103

Revlon, however, does not completely resolve the dilemma with which directors are faced when a takeover bid has been made.104 The decision provides guidance into the directors' responsibility to the shareholders only once a takeover becomes imminent.105 Prior to that point, directors must serve competing constituencies. They must either maintain the corporate enterprise for the benefit of its stakeholders and the speculative future gain of its shareholders,106 or effectively undertake an auction to obtain the greatest immediate return for the corporations' stock.107

II. Stakeholder View

The traditional view of the corporation is based upon the economic perspective of the corporate entity as an aggregation of shareholder interests for the purpose of accumulating wealth.108 The stakeholder theory, on the other hand, exhorts much broader social objectives.109 The stakeholder model views shareholders as merely one constituency of the corporation.110 The theory postulates that

103. Id.

104. See supra notes 8-9 and accompanying text. The court's rationale seems to imply that the directors may preserve the corporate enterprise even in the face of a tender offer which may be profitable to the shareholders. See Revlon, 506 A.2d at 182.

105. The Revlon court stated:
The duty of the board . . . changed from the preservation of Revlon as a corporate entity to the maximization of the company's value at a sale for the stockholders' benefit. This significantly altered the board's responsibilities under the Unocal standards. It no longer faced threats to corporate policy and effectiveness, or to the stockholders' interests, from a grossly inadequate bid. The whole question of defensive measures became moot. The directors' role changed from defenders of the corporate bastion to auctioneers charged with getting the best price for the stockholders at a sale of the company.

Id.; see also Lipton III, supra note 1, at 41 (Revlon should not restrict the capacity of a target's board to act for broader constituencies when the target is not yet for sale).


107. Id.

108. For a discussion of the traditional view of the corporation, see supra notes 21-22 and accompanying text.

109. Cf. Fischel, The Corporate Governance Movement, 35 VAND. L. REV. 1259, 1265 (1982); Mashaw, Corporate Social Responsibility: Comments on the Legal and Economic Context of a Continuing Debate, 3 YALE L. & POL'y REV. 114, 115 (1984); Stone, Corporate Social Responsibility: What it Might Mean if it Were Really to Matter, 71 IOWA L. REV. 557 (1986). Historically, the role of the corporation in society has been the cause of much controversy. Disagreement over the corporate entity's function results from the economic, social, and political powers which a corporation may exercise. The stakeholder theory emerges from contentions that the corporation and its management have a "social responsibility" or duty to serve communal interests in addition to the interests of its stockholders.

110. Stone, supra note 109.
employees, consumers, suppliers, and the general public are sufficiently affected by a corporation's activities to merit consideration in decisions which impact their interests.111

The stakeholder model is based in part upon the concession theory112 or pure political model113 of the corporate enterprise. This view, which broadens the constituency of corporate managers, provides that the government may condition corporate status on an organization's practice of activity which meets the criteria of social utility114 and public responsibility.115 The concession theorist believes that because an entity is permitted by the state to possess corporate status, it is required to protect the interests of the persons affected by the corporation, perhaps even to the detriment of its shareholders' interests.116 Under this view, in addition to stockholders, a corporate manager's constituency is made up of employees, suppliers, and the general public.117

This concept of increased corporate responsibility is not new.118 America's earliest corporations were established to effect social

111. See Dodd, For Whom Are Corporate Managers Trustees?, 45 Harv. L. Rev. 1145, 1149 (1932). In 1932 Professor E. Merrick Dodd initiated the controversy over which constituencies' corporate managers validly represent in conducting the business of the corporation. Amidst the social trepidation of the Great Depression, Dodd argued that corporate boards must effectively act as trustees for a wide variety of constituencies in addition to shareholders. With the recent acceleration in takeover activity and concern for various interests which are impacted by the phenomenon, attention is once again drawn to the issue examined by Dodd over five decades ago. Lipton III, supra note 1, at 33.

112. The concession theory essentially demands a quid pro quo from the corporation in the form of socially beneficial activity in exchange for citizens' grant, through government, of the special privileged and powers inherent in the corporate form. See Dahl, Governing the Giant Corporation in CORPORATE POWER IN AMERICA 11 (R. Nader & M. Green eds. 1973).

113. The "pure political" theory views the corporate entity as an institution exercising power over individuals who have no control over its activities. The model considers social responsibility to be the furtherance of social objectives which will benefit the groups affected by the corporation—its employees, suppliers, the local community and society in general. See Solomon & Collins, supra note 22, at 336 nn. 35-39.

114. Under the concession theory a corporation must provide public services or undertake activity which is beneficial to society as a whole. For example, it is argued that corporations further the social interest of economic growth by providing an instrumentality for the aggregation of capital. See id. at 339; see also Fischel, supra note 109, at 1269.

115. Id. Conversely, corporations must refrain from activities which are detrimental to the public interest and must be accountable for such activities. See Solomon & Collins, supra note 22, at 332 n.2.

116. See id. at 341.

117. Id.

objectives. At the end of the eighteenth and during the early nineteenth century, corporations originated to undertake such activities as constructing roads and bridges to enhance transportation, establishing banks and savings institutions to provide a reliable source of credit and currency, and organizing manufacturing concerns to free the American economy of its dependency on European industries. However, as general incorporation laws replaced the special charter during the late nineteenth century, the corporation lost its intimate connection with public objectives.

The concept of the corporate enterprise as a device to maximize shareholder wealth replaced notions of the corporation as an instrument to achieve public good. Aspirations for social welfare were no longer congruent with the profit motives of companies' shareholders. In this era, many American financial empires were built on self-interest.

By the beginning of the 1980s, however, due largely to an escalating demand for corporate responsibility, the view of the corporation as a social instrumentality had come almost full circle. Concern for social welfare has had an enormous impact on corporate governance. Like the public utilitarianism of America's earliest corporations, the operation of modern corporate entities reflects

120. See Seavoy, supra note 118, at 30.
121. See Werner, Corporation Law in Search of its Future, 81 Colum. L. Rev. 1611, 1620-27 (1981) (author describes both the Berle view and the Brandis view concerning the effect of general incorporation law on legislative control over corporations. Berle was concerned that the general incorporation laws destroyed state regulation while Brandis thought that general incorporation laws, in their late nineteenth-century form, were a high point in state control over corporations).
122. Id. at 1615-20 (author also compares Berle's and Brandis's view on the effect of the special charter and outlines their arguments concerning the impact of legislative power over the granting of special charters in early American history).
123. See generally J. Hurst, supra note 119, at 46.
124. Id. at 70-71.
125. Id.
126. Id.
128. Id. at 1310.
130. See Epstein, supra note 127, at 1310. The public service character of the corporation arises out of the delegation of fundamental economic functions to the corporate enterprise by the American economy. Id.
an expanded social responsibility. The deeply-felt need of the American public to limit a corporation's power and to render it socially accountable has significantly affected the management of contemporary corporations.

In the past decade, the explosion of takeover activity has deepened concerns over the effect of mergers on society. Interest groups which are affected by averse business combinations have become increasingly active. Takeovers, particularly hostile takeovers, have been criticized as detrimental to societal interests. Critics allege that takeovers impinge research and development and thus impair productivity, cause plant closings and thus result in lost jobs, and displace corporate assets resulting in the loss of valuable tax revenues.

Many commentators, mindful of the possible pernicious effects of

131. See Stone, supra note 109, at 217.
132. See Epstein, supra note 127, at 1310.
133. See supra note 3.
134. See supra note 3.
135. See Lipton III, supra note 1, at 43-46 (a critique of takeover regulations encompassing the rights of various interest groups).

Corporate boards confronted with hostile tender offers have gone to great lengths to obtain public support for their decision rejecting hostile bids, often hiring public relations firms to help them wage their battle. In response to an unsolicited tender offer by Britain's Grand Metropolitan PLC, Pillsbury ran a full page ad in a Minneapolis newspaper depicting the Pillsbury Doughboy sporting boxing gloves and containing the following caption:

Our Board recognized that Pillsbury has the potential to grow and prosper and to generate substantial returns to our shareholders. We understand that the Pillsbury family of employees is the most critical factor in our future growth and we intend to see that their interests are protected. In response to our duty to all of our constituencies, we have put the gloves on the Pillsbury Doughboy. And we're taking other steps necessary to protect our employees, our communities, and the trust the consumer has placed in us for so many years.

Minneapolis Star Tribune, Oct. 19, 1988, at 7D.

136. See, e.g., Act of Apr. 25, 1984, ch. 488, 1984 Minn. Laws 470. The Minnesota Legislature, in a prelude to enacting Section 80B.01-13 of Minnesota Statutes, found the following concerning the detrimental impact of tender offers:

Takeovers particularly, hostile takeovers,

(1) exaggerate the tendency of many businesses to focus on short-term performance to the detriment of such long-term societal interests as increased research and development, improved productivity, and the modernization of physical plant and employee capabilities;

(2) are often inconsistent with the economic interests of shareholders;

(3) in many instances threaten the jobs and careers of Minnesota citizens and undermine the ethical foundations of companies, as when jobs are eliminated and career commitments to employees are breached or ignored;

(4) often result in plant closings or consolidations that damage
takeovers, have argued that directors of target companies have a responsibility to consider interests of noninvestor groups when confronted by a tender offer. Proponents of this view advocate that the scope of discretion afforded to directors in the context of ordinary business decisions under the business judgment rule should be expanded to encompass decisions of boards in corporate control contests. Employing such expanded discretion, directors would be able to implement defensive strategies to validly protect employees, suppliers, customers, and the communities in which the corporation operates.

Recently, the acceleration of takeover activity has subjected decisions made by corporate boards to heightened attention. Courts have begun to re-evaluate their function in reviewing board decisions which impact the corporation's ownership structure. Because takeover decisions have a more immediate effect on shareholder wealth than do operating decisions and of the inherent implication of board self-interest in takeover decisions, courts have applied a modified interpretation of the business judgment rule to assure that the interests of shareholders are taken into account.

Id.

137. See, e.g., Lipton I, supra note 1, at 119–20 (arguing that directors should be cognizant of issues of national policy and should not sacrifice the interests of stakeholders when the question is solely whether or not shareholders may have an opportunity to immediately realize profit on the sale of their shares); see also Steinbrink, Management's Response to the Takeover Attempt, 28 CASE W. RES. 882, 889–90 (1978).

138. See Lipton I, supra note 1, at 120. Lipton argues that the decisions confronting a director arising from a takeover bid are not distinct from other fundamental business decisions. He urges that corporate boards are frequently faced with decisions which may have as significant an impact on the corporation as a hostile tender offer. But see Wander & LeCoque, supra note 63, at 42 (authors see corporate operating decisions and corporate control decisions as distinctly different types of decisions that should not be compared).

139. See Lipton I, supra note 1, at 110.

140. See Wander & LeCoque, supra note 63, at 42 (the impact of corporate control decisions may be such that they determine whether or not the existing group of shareholders will continue to exist).

141. Recognizing that shareholders may not be adequately represented by a potentially self-interested board of directors, courts have assumed the role of protectors of shareholder rights. See, e.g., infra notes 147–48.
In applying the rule, courts have recognized that takeover decisions possess a prominent business character. Therefore, the impact a tender offer has upon non-investor interests is listed among the criteria directors may consider when deciding whether to embrace a hostile bidder or to adopt measures to ward off a perceived threat.\(^{142}\)

Increasingly, the business judgment rule has been used in the context of the hostile tender offer to shield management from attack and liability for implementing defensive measures to resist takeovers.\(^{143}\) *Unocal Corp. v. Mesa Petroleum Co.*,\(^{144}\) exemplifies such use of the rule. The Delaware Supreme Court upheld the use of a self-tender offer implemented by the Unocal directors to resist an unsolicited tender offer by Mesa Petroleum.\(^{145}\) More importantly, however, the court

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142. However, the principles upon which the business judgment rule is founded, care, loyalty and independence, must first be satisfied. *See Revlon, Inc., v. MacAndrews & Forbes Holdings Inc.*, 506 A.2d 173, 180 (Del. 1986).

143. *See*, e.g., *Panter v. Marshall Field & Co.*, 646 F.2d 271, 293–94 (7th Cir. 1981)(rule presumes business judgment was expressed, plaintiff must show by inference that impermissible motive predominated the decision-making); *Crouse-Hinds Co. v. InterNorth, Inc.*, 654 F.2d 690, 702 (2d Cir. 1980)(court must respect directors’ decisions unless there is evidence of fraud or bad faith); *Cheff v. Mathes*, 199 A.2d 548, 555 (Del. 1964)(directors will not be penalized for honest mistakes in judgment, if the judgment appeared reasonable at the time of the decision); *Bennett v. Propp*, 187 A.2d 405, 411 (Del. 1962)(a lack of prior knowledge and an emergency combined to create an exception to the general rule that directors who use corporate funds to preserve control commit a wrong).

144. 493 A.2d 946 (Del. 1985).

145. *Id.* at 949–53. A minority shareholder making a hostile offer for the Unocal corporation’s stock filed a complaint to challenge the decision of the Unocal board of directors to effect a self-tender offer by the corporation for its own shares. The hostile tender offer entailed a two-tier “front loaded” cash tender offer for 64 million shares or approximately 37% of Unocal’s outstanding stock at a price of $54 per share. The “back-end” was designed to eliminate the remaining publicly held shares by an exchange of securities with a purported worth of $54 per share but which Unocal aptly termed “junk bonds.” The self-tender offer provided that if the minority shareholder acquired 64 million shares of Unocal stock through its hostile offer, Unocal would buy the remaining 49% outstanding shares for an exchange of debt securities having an aggregate par value of $72 per share. The Supreme Court of Delaware held that the board of directors, having acted in good faith and after reasonable investigation, found that the two-tier “front loaded” cash tender offer was both inadequate and coercive, and that the board was vested with the power and duty to oppose the proposed tender offer and to effect a self-tender by the corporation for its own shares. *Id.*

Similarly, the district court in *Gelco Corp. v. Coniston Partners*, 652 F. Supp. 829 (D. Minn. 1986), *aff’d in part, vacated in part*, 811 F.2d 414 (8th Cir. 1987) upheld the use of a “poison pill” defensive strategy by the Gelco board of directors. The “poison pill” essentially involved a “rights plan” whereby the holder of each right (excluding the acquiring entity) could purchase $126 worth of Gelco stock for $63 in the event of a hostile takeover. In examining the action of the Gelco board in implementing the rights plan and other defensive strategies, the court held the board had to show reasonable grounds for believing the takeover posed a threat to the corpora-
resolved that the business judgment rule would be extended to apply to all board decisions addressing a takeover bid.\textsuperscript{146} Although the Unocal court applied the business judgment rule to the directors' decision, it placed an initial burden on Unocal.\textsuperscript{147} This burden required the board of directors to show they had reasonable grounds to believe that Mesa's ownership of Unocal stock posed a danger to Unocal's policy and effectiveness.\textsuperscript{148}

Unocal is significant to the stakeholder model because it provides broad criteria for directors to evaluate a tender offer.\textsuperscript{149} The Delaware Supreme Court stated:

If a defensive measure is to come within the ambit of the business judgment rule, it must be reasonable in relation to the threat posed. This entails an analysis by the directors of the nature of the takeover bid and its effect on the corporate enterprise. Examples of such concerns may include: . . . the impact on "constituencies" other than shareholders (i.e., creditors, customers, employees, and perhaps even the community generally). . . .\textsuperscript{150}

Unocal illustrates that the business judgment rule may be used to broaden the scope of the directors' traditional fiduciary duty.\textsuperscript{151} Application of the business judgment rule in this context allows stakeholder interests to be furthered, possibly at the expense of shareholder interests.\textsuperscript{152}

In Moran v. Household International, Inc.,\textsuperscript{153} the Delaware Supreme Court took the Unocal modified business judgment rule analysis one step further.\textsuperscript{154} The determination legitimizes a corporate board's

\textsuperscript{146} Unocal, 493 A.2d at 954. The Unocal court concluded that corporate boards should be no less entitled to the respect they would otherwise be accorded in the realm of business judgment. "Because of an omni-present specter that a board may be acting primarily in its own interests, . . . there is an enhanced duty which calls for judicial examination at the threshold before the protections of the business judgment rule may be conferred." \textit{Id.}

\textsuperscript{147} Id. at 955. The threshold examination imposed by the Delaware Supreme Court placed the burden on target directors to establish: (1) that they had reasonable grounds for believing that a danger to corporate policy existed; and (2) that the defensive measure adopted by the board was reasonable in relation to the threat posed. \textit{Id.}

\textsuperscript{148} \textit{Id.}

\textsuperscript{149} See supra notes 146-47.

\textsuperscript{150} Unocal, 493 A.2d at 955.

\textsuperscript{151} Analysis of the takeover bid includes examination of the adequacy of the price offered, the nature and timing of the offer, the risk of nonconsummation of the combination, and the quality of the securities offered in the exchange. \textit{Id.}

\textsuperscript{152} See Wander & LeCoque, supra note 63, at 34-38 (interests may be considered only if there are rationally related benefits for the shareholders).

\textsuperscript{153} 500 A.2d 1346 (Del. 1985).

\textsuperscript{154} Id. at 1351. The Delaware Supreme Court extended the analysis set out in
decision to implement strategies designed to counteract prospective takeover attempts. The board of directors of Household International, Inc. adopted a shareholder rights plan. This poison pill was motivated by the directors' fear that the corporation may have been vulnerable to a future averse acquisition.

After concluding that the Household board had the statutory power to adopt the Rights Plan, the court examined the directors' fiduciary duty in undertaking the strategy. The Moran court allowed the board to assert the business judgment rule because the directors had met the initial burden set out in Unocal. The court concluded that the Household directors had reasonable grounds for believing the corporation was vulnerable to a takeover that could damage the company. The court held that the Rights Plan was a reasonable defense mechanism to protect the corporation and that implementation of the plan was within the valid business judgment of the Household directors.

The Delaware Supreme Court decision in Moran validates prospective anti-takeover strategies. However, Moran's greater significance to the stakeholder model lies in the Delaware Chancery Court's analysis

Unocal to a situation in which the board took actions designed to defeat a hostile takeover bid even though no actual tender offer had been made. Id. (without affirmative evidence of legislative intent to limit the applicability of the relevant statute, the court declined to impose such a solution).

Under the right's plan each shareholder was to receive one right for each share of the corporation owned. The right would become exercisable upon the occurrence of either of two triggering events; first, if anyone acquired twenty percent or more of the corporation common stock; or secondly, if anyone publicly announced a tender offer to purchase at least thirty percent of Household's common shares. The effect of the rights plan was to give shareholders different options before and immediately after an acquiring entity consummated a business combination with Household, Inc.

Once either of the triggering events occurred, each right entitled a shareholder to purchase a share of preferred stock for $10,000. If the shareholder did not exercise the right prior to a merger, the right would “flip over” on the acquiring entity, entitling the shareholder to purchase $200 of the company's common stock for $100. In essence the plan was designed to dilute a hostile acquirer's capital structure and increase any potential financing of a hostile takeover significantly. Id. at 1348-49.

The Household directors were concerned with the increased prevalence of “bust-up” and “two-tiered” tender offers which it perceived as a danger to the corporation, its stockholders, and its employees. Id.; see also Note, Protecting Shareholders Against Partial and Two-Tiered Takeovers: The “Poison Pill” Preferred, 97 Harv. L. Rev. 1964, 1967 (1984)(shareholder rights plans discourage both partial and two-tiered takeover bids).

The court concluded that the Delaware General Corporation Law §§ 141, 151 & 157 (8 Del. Laws 141, 151, 157 (1983)) empowered the board to adopt the rights plan.

See supra note 147.

Id. at 1357.
ysis of the case. The Chancery Court’s analysis demonstrates the influence of the stakeholder model on judicial determinations, by the court’s willingness to allow directors to justify their actions according to the interests of one or more corporate constituencies. The Chancery Court was influenced by the Unocal court’s expansive definition of the corporate enterprise which included creditors, customers, employees, and the community generally. Regarding anti-takeover strategies, the court stated “[s]uch actions by a target board, if taken to protect all corporate constituencies and not simply to retain control, have been consistently approved under the business judgment rule.”

Notwithstanding the absence of consideration of this issue in the Delaware Supreme Court’s analysis, and the subsequent clarification of the scope of the directors’ concern in the Revlon decision, the Chancery Court’s statement in Moran reflects a judicial tendency to expand the discretion of corporate directors and to broaden the scope of their accountability to encompass a corporation’s stakeholders.

A recent upheaval in takeover legislation has further complicated the fiduciary quandry confronting directors. This notable change evolved as a result of CTS Corp. v. Dynamics Corp. of America. In CTS, the United States Supreme Court upheld the constitutionality of the Indiana Control Share Acquisition Act. The CTS decision

163. Id.
165. Moran, 490 A.2d at 1079.
166. In affirming the Chancery court’s decision, the Delaware Supreme Court did not consider its dictum regarding consideration of “all corporate constituencies.” See Moran, 500 A.2d 1346. See also Comment, supra note 164, at 869 (“it is possible that the Unocal court’s reference to ‘other constituencies’ was merely an incautious dictum unintended to effect a change in duty owed to shareholders by directors”).
167. See Comment, supra note 164, at 869 n.120.
168. See supra note 165 and accompanying text.

The Indiana Act applies to any issuing public corporation incorporated in Indiana unless the corporation amends its articles of incorporation to opt out of the Act. An issuing public corporation is defined as a corporation that has:

(1) one hundred (100) or more shareholders;
(2) its principle place of business, its principle office, or substantial assets in Indiana; and
(3) either:
   (A) more than ten percent (10%) of its shareholders resident in Indiana;
   (B) more than ten percent (10%) of its shares owned by Indiana residents; or
   (C) ten thousand (10,000) shareholders resident in Indiana.
has cleared the way for states to enact legislation which previously and almost exclusively had been the province of the federal government\(^{171}\) and the Williams Act.\(^{172}\) The significance of \textit{CTS} to directors is illustrated by the numerous state anti-takeover laws enacted in the months following the \textit{CTS} decision.\(^{173}\)

\emph{Id.} at § 23-1-42-4.

Rights are vested in these shares to the extent that the shareholders of the issuing public corporation approve a resolution. \emph{Id.} at § 23-1-42-9(a).

Thus the pre-existing disinterested shareholders of a corporation dictate whether the acquiring entity will gain voting rights to the acquired shares. This is accomplished at the next scheduled meeting of the shareholders or at a specially scheduled meeting called by the acquiring management. \emph{Id.}

An acquiring entity can require the management of a corporation to hold a “special meeting” within fifty days if it files an acquiring person statement, requests the meeting, and pays the expenses of the meeting. If the shareholders do not vote to permit the vesting of voting power in the shares, the target corporation may, at its option, redeem the control shares from the acquiring entity at the fair market value. \emph{Id.} at § 23-1-42-7.

171. The traditional instrument for protecting shareholders faced with a tender offer has been the Williams Act. 15 U.S.C. § 78m(d)-(e) & 78n(d)-(f)(1982 & Supp. 1987). The act regulates tender offers by requiring dissemination of information and by promoting investor free choice. The intent of such a regulatory scheme is to place opposing parties in a takeover contest on a level playing field. State statutes which conflict with this policy of neutrality have been struck down as violative of the supremacy clause. Under the pre-emption doctrine, a state law will be held unconstitutional if it stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress. U.S. Const. art. VI, cl. 2. \emph{See}, e.g., Edgar v. MITE Corp., 457 U.S. 624, 639 (1982).

The United States Supreme Court held, however, that the Indiana Act was consistent with the provisions and purposes of the Williams Act. The Court concluded that the Indiana Act protects independent shareholders from the coercive aspect of tender offers by allowing them to vote as a group, thereby furthering the purposes of the Williams Act by placing investors on equal grounds with the hostile bidders. \textit{CTS}, 107 S. Ct. at 1639.

The Court has also examined the Indiana Act to assure that it did not adversely affect interstate commerce by subjecting tender offers to inconsistent regulations. \textit{Edgar}, 457 U.S. at 640–44. The commerce clause empowers Congress to regulate commerce among the several states. U.S. Const. art. I, § 8, cl. 3.

In \textit{CTS}, however, the Court held that the Indiana Act reflected a state’s valid concern in promoting stable relationships among the parties involved with Indiana corporations and thus did not violate the commerce clause. \textit{CTS}, 107 S. Ct. at 1650–51.


173. \emph{See} Bandow, \textit{Are Hostile Takeovers Good for the Economy?}, 63 Bus. Soc. Rev. 45 (1987). For a listing of the numerous state anti-takeover statutes and a comprehensive discussion of their variations, see Veasey, Finkelstein & Shaughnessy, \textit{The Delaware Takeover Law: Some Issues, Strategies and Comparisons}, 43 Bus. Law 865, 876–80 (1988). Notwithstanding minor differences, state anti-takeover laws essentially fall into four categories: (1) control share acquisition statutes which require shareholder approval of acquisition of shares surpassing a specific threshold within a specified period of time; (2) supermajority statutes requiring that an acquisition of shares be
Such anti-takeover laws have had an exacerbating effect on the dilemma confronting directors. This effect is due primarily to the increased influence the statutes exert on corporate boards to consider non-investor interests when contemplating takeover decisions. The pervasive effect of the stakeholder theory in the anti-takeover statutes is clearly visible.

First, the interests of non-investor constituencies are directly promoted by provisions in such statutes calling for managers to consider employees, customers, suppliers, and creditors in situations where control of the corporation is likely to change. The statutes acknowledge that the interests of these stakeholders may be best served by the company's continual independence.

Second, the stakeholder model's effect on the vexatious issue facing directors is indirectly enhanced by the anti-takeover law. Such statutes greatly increase the likelihood of proxy contests and thus, arguably increase litigation and decrease the likelihood of the takeover.

The capacity which anti-takeover laws have to pre-empt takeovers, however, remains to be seen. Several commentators have argued that Indiana-type statutes may in fact make it easier for raiders to capture target corporations. Others argue that the extended period for the tender under many of the statutes will prompt proxy

approved by a specified supermajority of the company's shareholders; (3) cash-out statutes which require a purchaser acquiring a specified number of a corporation's shares to give prompt notice to the remaining shareholders and upon demand, pay a cash amount equal to the value of the shares on the day prior to the day in which threshold is reached; and (4) five-year freeze out statutes which prohibit an investor who acquires a specified percentage of shares from engaging in certain business combinations with the corporation for a five year period. Id.

174. See supra note 13.
175. Id.
176. Id.
177. Id.
179. Section 23-1-42-7(b) of the Indiana Control Share Acquisition Act extends to fifty days the period in which a potential acquiring entity may require target management to call a special shareholder meeting. This adds thirty days to the twenty day period allowed for a shareholder vote under section 44e-1 of the Williams Act.
180. See Bartlett, supra note 178, at 179. Bartlett argues that a board's ability to pick up votes in proxy fights by virtue of their management status may frustrate a takeover that may be obviously beneficial to shareholders.
181. Id.
182. Id. Martin Lipton and others have argued that legislation similar to the Indiana control share statute could assist an acquiring entity by making it easier to put a company into play. Lipton argues that because directors are required to call a shareholders meeting upon demand of the holders of a substantial share of the company arbitragers theoretically can buy large amounts of the potential target's stock and as "disinterested shareholders" vote to grant the raider voting privileges.

http://open.mitchellhamline.edu/wmlr/vol15/iss2/7
contests which in turn will increase litigation and frustrate hostile acquisitions. 183

While the future effect of anti-takeover legislation is uncertain, the lawmakers' motivation in enacting such statutes is clear. 184 Fearful of raiders' tendency to dismantle companies and to close plants and lay off workers, state legislators are attempting to protect home town businesses. 185 States, unions, and local communities have a view of the corporation distinct from the customary legal conception of the business enterprise. 186 The states see corporations as customers, suppliers, employees, and tax dollars. Unions see jobs. Local communities see charitable contributions and civic sponsorship. 187

Often, however, anti-takeover statutes are not enacted at the resolve of such corporate constituencies, but rather through such constituencies at the behest of large corporations lobbying to entrench control in their current localities. 188 In the face of impending tender offers, powerful corporate hierarchies have been able to play on the insecurity of legislators 189 to frustrate tender offers, seemingly without regard to the financial interests of their shareholders. 190 Local legislators, influenced by employee groups and sensitive to the potential loss of tax revenue, have become accomplices to directors' self-interested abandonment of the traditional duty owed to their shareholders. 191

The dilemma posed to directors is an ethical as well as legal question. Though directors may validly and legally consider the interests of non-investor groups in takeover situations, 192 they must also care-

183. See supra note 180 and accompanying text.
184. Id.
185. Id.
186. See supra notes 21–23 and accompanying text.
187. See Bartlett, supra note 178, at 182; see also Law, A Corporation is More than its Stock, 64 HARV. BUS. REV. 80 (1986).
188. See Bandow, supra note 173, at 45. In the face of a hostile takeover by Dart Drug, Dayton Hudson applied political pressure to push the Minnesota Control Share Acquisition Act through. Dayton Hudson hired five different lobbying firms, organized an employee letter writing campaign, and mobilized charities it had supported to lobby for the act. Id.; see also Fielder, supra note 18, at 59.
189. As "hometown" businesses have become targets of takeovers, such as Dayton Hudson (Minnesota), Gillette (Massachusetts), Greyhound (Arizona), Boeing (Washington), G. Heileman Brewing (Wisconsin), Harcourt Brace Jovanovich (Florida), and Burlington Industries (North Carolina), they have prompted their legislatures to enact anti-takeover legislation. Bandow, supra note 173, at 45.
190. Id. It is argued that legislation promoted by the corporate establishment is motivated more by the hierarchy's interest in protecting their positions on the board than by their desire to protect shareholder interests.
191. Id.
fully examine the ethical questions which arise. Directors must ascertain for whom they are acting when responding to a hostile tender offer—their stockholders, their stakeholders, or themselves.

III. THE DIRECTOR'S DILEMMA

Proponents of the stakeholder view argue that it is not only appropriate for directors of a target company to consider interests of non-investor groups, but that it is also their duty\(^\text{193}\). These proponents would allow shareholder interests to be subordinated to those of other constituencies in situations where a takeover would adversely affect the stakeholders\(^\text{194}\). This would hold true even if the tender offer constituted an opportunity for shareholders to profit\(^\text{195}\).

Authority supporting consideration of employees, customers, and suppliers in the decision-making process\(^\text{196}\) grants little guidance as to how these interests should be considered by directors who also owe a fiduciary duty to shareholders\(^\text{197}\). Little attention has been given to the question as to whether corporations can pursue a policy of furthering stakeholder interests in a manner consistent with their traditional charge of maximizing shareholders' investments\(^\text{198}\).

Although it is increasingly recognized that many groups have a strong interest in the activities of corporations\(^\text{199}\) and much pressure is being exerted on management to recognize these interests\(^\text{200}\), the courts, for the most part, have adhered to the traditional view\(^\text{201}\). Most contemporary cases have refused to require directors to consider interests apart from the shareholders\(^\text{202}\).

Notwithstanding a handful of recent decisions exhorting the protection of stakeholder interests\(^\text{203}\), the Delaware Supreme Court in Revlon\(^{A.2d}\ 1346\) (Del. 1985); Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985).
\(^\text{193.}\) See Easterbrook & Fischel I, \textit{supra} note 1, at 1190 n.81.
\(^\text{194.}\) Id.
\(^\text{195.}\) Id.
\(^\text{196.}\) See, e.g., Gelco Corp. v. Coniston Partners, 652 F. Supp. 829, 850 (D. Minn. 1986); Unocal, 493 A.2d at 955.
\(^\text{198.}\) Id.
\(^\text{199.}\) See Johnson, \textit{supra} note 1, at nn. 5–8.
\(^\text{200.}\) See Block & Miller, \textit{supra} note 197, at 68.
\(^\text{201.}\) See Easterbrook & Fischel I, \textit{supra} note 1, at 1191 n.86.
\(^\text{202.}\) See, e.g., Local 1330, United Steel Workers v. United States Steel Corp., 631 F.2d 1264, 1282 (6th Cir. 1980)("community interests" in continued operation of steel plants could not prevent the company's directors from closing the plants due to unprofitability). \textit{But see} Freedman v. Barrow, 427 F. Supp. 1129, 1147 (S.D.N.Y. 1987).
\(^\text{203.}\) See \textit{supra} note 196.
continues to be the protection of shareholder interests.\textsuperscript{204}

That duty is triggered only once it becomes inevitable that a tender offer will be successful.\textsuperscript{205} Until a takeover becomes imminent, an expansive definition of the corporate enterprise to include creditors, customers, employees, and the community generally, would seem to continue as long as the directors can show that the defensive strategies which they are deploying also benefit the company’s stockholders.\textsuperscript{206} These recent Delaware judicial determinations and various states’ anti-takeover legislation result in current uncertainty surrounding the priority and scope of concern for non-investor constituencies of the corporation.\textsuperscript{207} This uncertainty intensifies the dilemma confronting directors who must remain accountable to the corporation.\textsuperscript{208}

When the interests of equityholders are the directors’ exclusive concern, boundaries exist for assessing the permissibility of board actions.\textsuperscript{209} Without this reference point, the restrictions on the conduct of directors are largely extinguished. If a board is allowed to justify its decisions by acknowledging the various interests of one or more constituencies, its duty is diffused.\textsuperscript{210} A manager who is simultaneously responsible to interests which oppose one another cannot possibly be accountable to either.\textsuperscript{211}

Without the traditional precepts establishing the paramount priority of shareholder interests, directors are granted an almost unlimited degree of discretion.\textsuperscript{212} Within the performance of their business judgment, directors are allowed to implement defensive strategies to maintain a corporation’s independence in favor of its stakeholders. Such strategies are allowed to stand as long as the corporation’s continued existence arguably, albeit collaterally, benefits its shareholders.\textsuperscript{213} Presumably this would hold true even where a tender offer may be highly profitable for the shareholders.

Whether or not one believes that takeovers serve a beneficial or

\textsuperscript{204} Revlon, 506 A.2d at 182 (consideration for other constituencies is not appropriate where an auction for the corporation is effectively in progress); see also GAF Corp. v. Union Carbide Corp., 624 F. Supp. 1016, 1019-20 (S.D.N.Y. 1985).

\textsuperscript{205} See supra note 105.

\textsuperscript{206} Revlon, 506 A.2d at 182.

\textsuperscript{207} See Lipton III, supra note 1, at 41 (noting that the Revlon decision made the scope of consideration of non-investor constituencies less certain).

\textsuperscript{208} See Feinberg, supra note 7, at 30.

\textsuperscript{209} Cf. Comment, supra note 164, at 869.

\textsuperscript{210} Id.

\textsuperscript{211} See Easterbrook & Fischel I, supra note 1, at 1192 (suggesting that directors’ divided interest will ultimately harm society by reducing the trust people have for corporate directors).

\textsuperscript{212} See Comment, supra note 164, at 870.

\textsuperscript{213} See, e.g., Revlon, 506 A.2d at 182.
inimical purpose, and whether one endorses the stakeholder model over the traditional view, the current application of the business judgment rule creates an ethical uncertainty for directors. Within their discretion, directors may validly choose from a multitude of strategies and devices to resist or to accept a hostile tender offer. In exercising their judgment in a corporate control transaction, directors must favor the constituency to whom they commit their responsibility. However, to sustain the interests of one is effectively to forsake the interests of the other.

IV. ANTI-TAKEOVER MEASURES

Consistent with the discretion allowed them under the business judgment rule, directors may use their good faith business judgment to resist an unsolicited tender offer. Under this premise they are empowered to implement a wide variety of defensive measures to thwart an undesirable takeover bid.

A. Repurchase of Stock From Hostile Bidder

A defensive measure often used against takeovers is the repurchase, by a target corporation, of its own shares from a potential hostile bidder who has accumulated a significant amount of the corporation's stock and who is perceived as a danger to the corporation's independence. This practice, commonly known as the payment of "greenmail," usually involves acquiring the shares by paying a premium over the market price.

Analysts have criticized such stock repurchases, arguing that greenmail is unfair to stockholders because it amounts to an involuntary redistribution of corporate assets. Shareholders are deprived of the chance to vote on the disbursement of corporate funds which otherwise would be available for distribution in the form of dividends. Another reason greenmail is unfair to shareholders is because it distributes corporate funds unevenly, discriminating unfairly.

214. See supra text accompanying note 192.
215. Wander & LeCoque, supra note 63, at 41–44.
216. Block & Miller, supra note 197, at 52–53.
217. Id.
218. See Note, Greenmail: Targeted Stock Repurchases and the Management-Entrenchment Hypothesis, 98 HARV. L. REV. 1045, 1045 n.3 (1985)(greenmail has been defined as "a targeted repurchase of securities at a premium price from an investor who holds more than 3% of the corporation's stock and has held the stock for less than two years"). See generally Gordon & Kornhauser, supra note 19.
219. See Note, supra note 218, at 1046.
220. Id.

http://open.mitchellhamline.edu/wmlr/vol15/iss2/7
in favor of the potentially hostile shareholder who holds a large block of the shares.\footnote{222}

\section*{B. The Poison Pill}

A second type of anti-takeover measure is commonly referred to as a "shareholder rights plan" by those who favor the tactic and as a "poison pill" by those who do not.\footnote{223} This device is probably the most innovative and possibly most popular tactic recently used to thwart takeovers.\footnote{224} In this type of defensive tactic, a hostile tender offer triggers previously positioned articles of incorporation or by-laws which require the corporation to grant the shareholders a stock issuance option.\footnote{225} The stock issuance option, known as a "flip-in" provision, grants the target's stockholders the right to purchase the corporation's shares at a very low price.\footnote{226} This practice operates to dilute the hostile bidder's stock and frustrates its ability to accomplish the takeover.\footnote{227} A similar type of stipulation, known as a "flip-over" provision, grants rights to purchase the raider's shares to the shareholders.

The chief criticism of the poison pill, as with most defensive tactics, is that it deprives shareholders of the opportunity to take advantage of the premium stock prices which are usually offered by the bidder in a hostile takeover attempt.\footnote{228} Another criticism of the tactic is that it may be used by inefficient management to protect their positions. Both of these criticisms are supported by the traditional view of enhancing shareholder welfare.\footnote{229}

\section*{C. Golden Parachute}

Another anti-takeover tactic, the "golden parachute,"\footnote{230} involves

\footnotesize{\begin{itemize}
\item \footnote{222} Id.
\item \footnote{223} See Gordon & Kornhauser, supra note 19, at 311 n.45.
\item \footnote{225} Note, supra note 4, at 662-63.
\item \footnote{226} See id. at 36.
\item \footnote{227} Id.
\item \footnote{228} See Wander & LeCoque, supra note 63, at 46. Poison pills evade the shareholder approval process generally required for major changes in the corporation's structure. These devices arguably represent an attack on shareholder democracy. Id.
\item \footnote{229} See supra notes 21-22 and accompanying text.
\item \footnote{230} See Comment, Golden Parachutes: Ripcords or Rip Offs?, 20 J. MARSHALL L. REV. 237 (1986). The "golden parachute" vividly creates the image of the corporate executive bailing out of the corporate airplane which is under hostile assault, pulling the ripcord of his corporate issued parachute and landing safely in a heap of corporate money outside enemy lines. Id. Golden parachutes are executive employment contracts that provide for various forms of post-employment contracts and compensation for corporate executives who lose their positions upon a change in corporate}

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contractual provisions which guarantee top executives cash settlements if their corporations are purchased in a takeover.\textsuperscript{231} The rationale is that hostile bidders will be deterred if they are forced to pay existing management millions of dollars.\textsuperscript{232}

Proponents argue that "golden parachutes" protect shareholders' interests by allowing directors, when evaluating takeovers, to make decisions predicated solely on the tender offer's merits, without concern for their own self interests.\textsuperscript{233} Critics, on the other hand, maintain that directors, when faced with such a lucrative opportunity cannot exercise independent judgment regarding takeovers.\textsuperscript{234} Other opponents argue that directors should not need incentive to exercise their fiduciary duties.\textsuperscript{235}

\section*{D. Lock-up Agreements}

Another anti-takeover tactic, the "lock up,"\textsuperscript{236} also referred to as

\begin{itemize}

231. In Buckhorn, Inc. v. Ropak Corp., 656 F. Supp. 209, 232 (S.D. Ohio 1987) a modified business judgment rule was applied by the U.S. Court of Appeals to determine the reasonableness of the board's decision to enact an "at-will acceleration" golden parachute for Buckhorn's CEO. The Buckhorn board amended the CEO's employment contract to include: (1) an extension of the term of employment for an additional six years; (2) an acceleration of the pension right upon a change in control; and (3) a severance pay clause which entitled him, upon a change of control, to receive the present value of his future salary due under the terms of the contract. \textit{Id.} at 216.

The court, relying on Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 954 (Del. 1985), weighed the reasonableness of the defensive measure in relation to the threat posed. It found that the significant cost of the CEO's at-will acceleration of pension benefits in light of the potential need for the CEO's continued services in conjunction with the directors' failure to demonstrate the insufficiency of the prior pension protection raised the specter of unreasonableness in the board's actions as being self-serving rather than for the benefit of the corporation and its shareholders. \textit{Buckhorn}, 656 F. Supp. at 226.

232. \textit{See} Kesner & Dalton, \textit{supra} note 221, at 21. "Many golden parachutes, for example, do not just cover one or two top executives. United Technologies covers some 64 managers; Kimberly Clark protects 80 executives; and Beneficial's agreements include an astonishing 234 'key' executives." \textit{Id.}

233. \textit{Id.}

234. \textit{Id.}


In a lock-up situation, the management of a target company grants to a white knight an option to purchase an amount of stock sufficient to enable the white knight to gain control of the target company. A lock-up prevents
the "crown jewel" defense, occurs when a target corporation's board grants a preferred suitor the option to purchase key corporate assets or a large block of newly-issued stock. This option may benefit shareholders by inducing a reluctant but friendly corporation to enter a bidding contest. By placing the target's most valuable assets in "friendly" hands beyond the reach of unwanted bidders, "friendly" corporations are given a competitive advantage in a bidding contest.

The criticisms of "lockups" highlight a director's dilemma in trying to serve competing constituencies. The primary criticism is that "lockups" impinge upon the natural forces of the marketplace by chilling bidding contests that potentially enhance shareholder investments.

Lockups also may allow directors to entrench themselves in their positions may be detrimental to shareholders' interests, and may favor stakeholder interests. For example, in Revlon, the shareholders' interests were adversely affected when a "lockup" was granted in exchange for the preferred bidder's agreement to support the investment of Revlon's noteholders. Because there was no concomitant increase in the bidder's offer, the strategy was viewed

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237. A contract to sell valuable assets to a friendly acquirer is known as a "crown jewel." Distinct from a lock-up device, it usually refers to the sale of hard assets rather than stock. Id. at 489.

238. See infra note 251 and accompanying text.

239. See Comment, supra note 236, at 489-90. Although commonly referred to as "lock-ups," "crown jewel" devices are more accurately described as "leg-ups" in that they do not preclude competitive bidding but merely give one bidder a distinct advantage and thereby deter further bidding. Id.


241. See Wander & LeCoque, supra note 63, at 51.

242. Id.

243. See supra notes 207-15 and accompanying text.

244. See, e.g., Mobil Corp. v. Marathon Oil Co., 669 F.2d 366, 375-76 (6th Cir. 1981)(lock-ups held manipulative under Section 14(e) of the Williams Act because they created an artificial ceiling for the price of stock which circumvented the national forces of the market). But see Schreiber v. Burlington N., Inc., 472 U.S. 1 (1985)(fully disclosed lock-ups were held not manipulative).

245. See Wander & LeCoque, supra note 63, at 52.

246. See Note, supra note 240, at 1077 (discussion of the potential benefits of "reasonably structured" lock-up devices).


248. Id.

249. Forstmann did not increase its price per share bid for Revlon but rather
as an attempt to subrogate shareholder interests in order to confer benefits on other constituencies.250

E. The White Knight

A last gasp tactic frequently used by directors to fend off unsolicited takeover attempts involves employing a "white knight" to acquire the company, frequently at a higher price or on more favorable terms than the undesirable offer.251 This is not, however, a prevalent method of defense. Due to the difficulty in finding an acceptable merger partner in a limited amount of time, directors have usually employed other defensive measures to forestall the tender offer until a desirable suitor can be found.252

Although white knights sound like they may be protectors of corporations, this is not always the case.253 Because white knights frequently pay a higher price per share than their hostile counterparts, they may become financially unstable as a result of the transaction.254 While stockholders of the acquired firm may benefit from receiving a higher price for their shares if they choose to cash out of their investment, other constituencies may suffer due to the takeover.255 Critics argue that the change in management following a "friendly" takeover with a white knight may result in more lost jobs than if the hostile merger had been consummated.256

V. Analysis

The defensive measures described above illustrate but a few of the numerous and innovative techniques devised by management to resist hostile takeovers.257 These tactics show that operation of the business judgment rule will shield directors from liability in implementing defensive measures provided they reasonably believe there is a valid business reason for resisting an unsolicited tender offer.258

agreed to replace the notes previously issued by Revlon with newly issued securities. Id.

250. Id. at 179.
251. See Block & Miller, supra note 197, at 52.
252. Id. at 53.
253. See Kesner & Dalton, supra note 221, at 23.
254. Id.
255. Id.
256. Id.
257. See Note, supra note 4, at 661-66.
It has been argued that defensive measures motivated by the desire to serve stakeholder interests or the directors' own self interests\(^{259}\) are often harmful and contrary to the traditional goal of maximizing shareholder wealth.\(^{260}\) However, the propriety of defensive tactics and the precise impact of the tender offer phenomenon continues to be the subject of fervent debate among takeover scholars.\(^{261}\) Essentially, two divergent views have emerged.

Professors Easterbrook and Fischel,\(^{262}\) Bebchuk,\(^{263}\) Gilson,\(^{264}\) and Jarrel\(^{265}\) contend that takeovers serve beneficial purposes and have argued for restraints against the use of anti-takeover measures by corporate boards. Although these commentators differ as to the degree of usefulness of such measures in certain circumstances,\(^{266}\) for the most part, they advocate a position of minimal interference with

\(^{259}\) One view is that the most common motivation for implementing anti-takeover strategies is the directors' desire to maintain control of "their" companies. See Kesner & Dalton, supra note 221, at 18.

\(^{260}\) See Jarrell, Inside the SEC's Panel on Takeovers, 8 DIRECTORS & BOARDS 28, 28–33 (1983). According to an SEC Advisory Committee on Tender Offers, of approximately 100 cases examined in which management utilized defensive measures to defeat a hostile takeover attempt, the defensive strategies almost without exception resulted in large losses by the target corporation's shareholders. Id.

\(^{261}\) See, e.g., Easterbrook & Fischel II, supra note 1, at 8–9.

At present, the evidence as to the overall impact of unsolicited offers is unclear. Most of the research cited by proponents of takeover activity centers on stock price studies. These studies only examine stock prices over a short period of time and typically do not cover the period after completion of a merger. These studies thus fail to examine the long-term effects of takeovers on stock prices, and also fail to measure other important economic factors such as profitability. Id.

Furthermore, there is substantial disagreement as to whether stock prices accurately reflect economic value. The studies also fail to distinguish between hostile and friendly mergers. They cannot measure the effects, if any, that the threat of takeovers has on corporate management, nor do these studies conclusively measure the costs of takeovers. For example, the leveraging of corporate America has come along in part because of the takeover threat. Is this good or bad or neutral? Id. In sum, the evidence as to the benefits and costs of takeovers is, at best, debatable and inconclusive. Id.

\(^{262}\) See Easterbrook & Fischel I, supra note 1; Easterbrook & Fischel II, supra note 1; Easterbrook and Fischel III, supra note 1.

\(^{263}\) See Bebchuk I, supra note 1; Bebchuk II, supra note 1.

\(^{264}\) Gilson I, supra note 1; Gilson II, supra note 1; Gilson III, supra note 1.

\(^{265}\) Jarrell, supra note 260, at 28.

\(^{266}\) See supra notes 262–64. There exist fundamental differences in the views of Easterbrook and Fischel on the one hand and those of Bebchuk and Gilson on the other. Easterbrook and Fischel suggest total passivity on behalf of target directors, allowing shareholders to make decisions impacting the control of the corporation. Bebchuk and Gilson agree that tender offers are beneficial, but recognize also that some tender offers are inadequate and should be rejected. They argue that an auction situation may enhance shareholder wealth. Bebchuk and Gilson propose that in some cases the target directors may be faced by their fiduciary duty to thwart the takeover attempt. In such an event, the extreme position held by Easterbrook and
market forces. In their perspective, social and economic values encourage a nearly unrestrained market for corporate control.267

In contrast, Professor Lowenstein268 and Martin Lipton269 have argued that corporate managers ought to be able to resist hostile takeovers. Lowenstein advocates a more limited resistance designed to reduce shareholder coercion in tender offer situations.270 Alternatively, Lipton supports the view that the normal discretion afforded directors in other areas of corporate law should be extended to include their responses to takeover bids.271 Lipton has urged that the consideration of stakeholders' interests in corporate control contests should be within the scope of discretion accorded directors under the business judgment rule.272

In the final analysis, whether the current application of the business judgment rule, as a means of regulating the responses of directors to hostile takeovers, is adequate to balance the interests of those who may be affected, depends on one's view of who the board of director's constituency should be.273 Although this statement conveys the realities of the business judgment rule and recognizes the position of a growing number of advocates of the stakeholder model, it fails to consider that the goals of shareholders and stakeholders are not necessarily adverse.274

In 1981, Easterbrook and Fischel recognized a contiguity in the interests of shareholders and stakeholders and advanced what has become known as the passivity theory of tender offers.275 Under this view, managers are compelled to maximize shareholder wealth and

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267. See Bebchuk II, supra note 1, at 24.

268. See Lowenstein, supra note 1.

269. But see Easterbrook & Fischel III, supra note 1, at 8. Easterbrook and Fischel maintain that because investors hold diversified portfolios of stock, they will be on both sides of tender offer auctions, holding stock in both acquirer and the target. They postulate that investors who cannot gain from an auction only stand to lose from the transactional costs involved. Id. See also Lowenstein, supra note 1, at 300 n.208 (institutional investors own 35% of the outstanding shares traded on the New York Stock Exchange); Lipton I, supra note 1.

270. See Lowenstein, supra note 1, at 322–33.

271. See Lipton I, supra note 1, at 118–20.

272. Id.

273. See Block & Miller, supra note 197. The authors point out that there is little guidance for directors given the impossible task of balancing the competing interests of a multitude of stakeholders. Under the business judgment rule the directors may favor any interest, even their own, under the guise of what is in the "corporation's" best interest. Id. at 69–72.

274. See Easterbrook & Fischel I, supra note 1, at 1191 (urging that social welfare is enhanced if shareholder wealth is maximized).

275. See id. at 1161–64.
are not allowed to resist takeovers by the use of defensive tactics.276

Easterbrook and Fischel have argued that takeovers, by enhancing economic efficiency, usually improve the position of all who deal with the corporation.277 They argue that directors, by adequately protecting the interests of shareholders, assure that the positions of the groups affected by the corporation's operation are protected as well.278

The premise for this position is based on the efficient capital market theory.279 Under this model, corporations that are run efficiently will experience a weakened financial position.280 The model suggests that financially weak corporations assume a greater risk of becoming the subject of unsolicited tender offers.281 Although the passivity theory has been criticized,282 it relates most closely to the traditional model of shareholder wealth maximization in the free market system.

Essentially under the market efficiency view, managers of corporations who adopt anti-takeover measures are given undue and artificial market power.283 They have the ability to employ defensive strategies without proper accountability to their shareholders.284 Because inefficiently run corporations become the subjects of takeovers and because directors are allowed to escape adverse mergers through the employment of anti-takeover defenses, management’s

276. Id.

277. Id. But see Gordon & Kornhauser, supra note 19, at 295 n.1. The Authors point out that shareholder wealth maximization is not necessarily social wealth maximization. For example, the shutdown of an acquired firm's headquarters produces efficiency which benefits the shareholders, but at the expense of laid-off employees. Id.

278. The Authors argue that shareholder wealth maximization is a useful proxy for social wealth maximization. A transaction which does not meet the criteria to adequately protect shareholder interests certainly will not adequately protect constituent interests. Id.


280. See Fischel, supra note 279, at 5.

281. Id. at 5-7. But see Bunbaum, Corporate Legitimacy, Economic Theory and Legal Doctrine, 45 Ohio St. L. J. 515, 520 (1984)(to the extent that takeovers are motivated by factors other than inefficiency, the market system will not identify inefficiently managed firms as takeovers targets).

282. See infra note 292 and accompanying text.


incentive to run a more efficient business is removed. Managers do not have the looming anxiety of losing their seats on the board as the result of a takeover; therefore, their motivation to run their corporation more profitably is decreased.

According to Easterbrook and Fischel, takeovers promote efficiency by either replacing inefficient and incompetent directors or by motivating incumbent directors to run the corporation more efficiently. The argument that in an efficient market system stakeholder interests are protected by the directors' traditional fiduciary duty is premised on the directors' self-interest in maintaining their positions.

If directors adhere to their traditional fundamental task of shareholder wealth maximization, they must run an efficient corporation to do so. The enhanced wealth of the shareholders inures to the benefit of the various constituencies of the corporation. The benefits conveyed upon the stakeholder of a healthy corporation are most assuredly greater than those delivered by an inefficient corporation utilizing an anti-takeover strategy to maintain the status quo.

Notwithstanding its reliance on fundamental economic principles, the passivity theory has been extensively criticized. Opponents of the passivity theory point out that neoclassical conceptions do not always bear fruit in reality. The passivity theory of tender offers has been criticized primarily due to the fact that profitable corporations as well as unprofitable corporations often become the subjects of hostile acquisitions. Empirical evidence has recently revealed that potential acquirer's searches for possible targets have not so often focused upon inefficiently operated firms, but rather upon firms in the industrial segment in which the acquirer operates.

It makes perfect economic sense that greater compatibility may be realized if the acquirer and the target share similar markets, have overlapping product lines, and possess related technical orienta-

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285. *Id.* at 678-79.
286. *Id.*
287. *Id.*
288. See *Coffee I*, *supra* note 1.
289. See *Easterbrook & Fischel I*, *supra* note 1, at 1190.
290. *Id.*
291. *Id.*
292. See, e.g., *Coffee I*, *supra* note 1, at 1200–21; *Lipton II*, *supra* note 1, at 1233–56; *Lowenstein*, *supra* note 1, at 257–309.
293. See, e.g., *Lowenstein*, *supra* note 1, at 268.
294. See *supra* note 292.
295. See *Coffee I*, *supra* note 1, at 1206–21; see also *Wall St. J.*, Mar. 1, 1988, at 3, col. 1 (the current acquisition boom is principally being fueled by cash-rich corporations seeking targets in the same or allied industries).
The industry-specific character of the current takeover movement, however, does not reduce the veracity of the passivity theory. It simply changes the frame of reference in which the model must be analyzed.

Within an industrial segment, a potential acquiring corporation will seek to capture the best possible bargain among companies with similar business orientations. The most inefficiently operated corporation within such segment will be the company most likely to be available at a discount. Though profitable, the industry laggard will be the most vulnerable to a hostile takeover. Under Easterbrook and Fischel's concept of market efficiency, the laggard corporation must increase its profitability to escape the takeover. Thus, their market efficiency theory holds true but in a smaller universe.

CONCLUSION

Allowing directors to consider stakeholder interests in takeover situations increases inefficiency by granting them undue market power. The diseconomy created by the consideration on non-investor interests results in a misallocation of resources which ultimately will weaken the positions of stockholders and stakeholders alike.

Under the business judgment rule, as it is currently applied, corporate directors will continue to take steps to defeat tender offers which may be desirable and profitable for the corporation's shareholders. Given the heightened social concerns that the escalation in takeover activity has spawned, it becomes more and more likely that directors will justify resistance of such tender offers out of their consideration for employees, suppliers, creditors, or local communities. Directors may cite ill-begotten state takeover statutes or cases espousing an expanded corporate constituency as controlling authority. However, such considerations are misplaced if the stakeholders of all corporations are better served by a rule requiring a benign approach by management to tender offers.

Protection of the interests of those persons detrimentally impacted by the current tender offer phenomenon is an ambitious and even admirable goal. "But, it is one thing to say the law must allow for

296. See Coffee I, supra note 1, at 1213-14 nn.206-07.
297. Id. at 1214-15.
298. Id.
299. See Gilson & Kraakman, supra note 283, at 555.
300. See Lipton I, supra note 1, at 110. "The scramble by each of these constituencies to protect against sale or liquidation would cause major disruptions in the manner in which business is now conducted. These disruptions would favor the short-term at the expense of long-term planning that is essential in a high technology economy." Id.
such developments. It is quite another to grant uncontrolled power to corporate managers in the hope that they will produce that development."\textsuperscript{301}

\textit{Marc C. Luther}

\textsuperscript{301} Berle, \textit{supra} note 1, at 1372. The words of Professor Berle in response to Dodd's proposal for the advancement of stakeholder interests are no less true today than they were when they were first written 57 years ago.
Eighth Circuit Issue

The Court of Appeals for the Eighth Circuit

Top Row (left to right): Judge Frank J. Magill, Judge Pasco M. Bowman, Judge George G. Fagg, Judge Roger L. Wollman, and Judge C. Arlen Beam.

Bottom Row: Judge Richard S. Arnold, Judge Gerald W. Heaney, Chief Judge Donald P. Lay, Judge Theodore McMillian, and Judge John R. Gibson.

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THE HONORABLE GERALD W. HEANEY
JUDGE, UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT