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STATE TAKEOVER LAWS: A REBIRTH OF CORPORATION LAW?

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INTRODUCTION

Seventy or eighty years have passed since corporation law has had anything much to say about the relationship between business corporations and the rest of American society. By corporation law, I mean the body of state statutory and common law rules that govern United States corporations. For much of this century, this body of law has focused almost exclusively on the relationship between those who manage a firm—directors and officers—and those who own it—the shareholders. Because shareholders of a large corporation have no direct involvement in its control, shareholders require assurance that management effectively is pursuing the shareholders' financial interests. This accountability problem engenders a basic question that lies at the heart of corporation law: How can shareholders prevent management from hindering the shareholders' financial objective by, for example, failing to conduct the business efficiently or perhaps even pursuing conflicting goals at the shareholders' expense?

The doctrinal preoccupation with accountability takes for granted an underlying principle, a principle that provides the fundamental postulate of modern corporation law. A corporation exists for the financial benefit of its shareholders; management must devote itself to this single purpose with relentless fidelity. In response to this basic norm, therefore, corporation law offers a body of doctrine designed to address the accountability problem. Rules specifying management's fiduciary duties of care and loyalty identify more particularly the contours of the norm's prescriptions. In addition, corporation law offers procedural mechanisms, in the form of the shareholders' power annually to elect the board of directors and the shareholder's derivative suit, for enforcement of the particular obligations imposed upon management. Like any other body of legal doctrine, of course, corporation law is very complex. But its basic thrust is quite simple.

In nineteenth-century America, however, corporation law had a far broader focus than its present preoccupation with ensuring accountability

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and maximizing shareholder wealth indicates. Various legal doctrines revealed serious concerns about the economic and political power of corporations. States sought to control the threat to society that such power presented and used corporation law as a tool for that purpose. The difference between nineteenth-century corporation law and recent corporation law, therefore, is that between a societal or regulatory perspective and the present internal or governance perspective.[1] It is also the difference between making corporations responsive to various nonshareholder interests and requiring corporations to dedicate themselves single-mindedly to shareholder welfare.

The explosion of hostile takeover activity in recent years has raised an important policy controversy. Because takeovers include a bidder's offer of a premium over market value to a target company's shareholders, takeovers present an opportunity for shareholders to realize impressive financial gains. In addition, because a successful hostile takeover typically results in the members of the target company's management losing their positions, the heightened threat of hostile takeovers may create powerful incentives for corporate management diligently to pursue shareholder welfare so as to minimize the likelihood of a successful hostile bid. Those that advocate a robust "market for corporate control" thus base their claims primarily on the enhancement of shareholder wealth. Additionally, some argue that society as a whole will benefit from the reallocation of resources to higher valued uses that takeovers are said to generate. According to this view, shareholders' financial interests in the takeover context are congruent with society's interest in efficiency.

State legislatures, however, have taken a different view of the takeover phenomenon. They have intervened in order to impede or at least to regulate the current wave of takeover activity. Although apparently dealt a crippling blow by the United States Supreme Court in 1982,[2] state legislatures have rebounded and continue their efforts to exert some kind of control over takeovers. One typical state takeover statute recently survived constitutional attack in *CTS Corp. v. Dynamics Corp. of America,*[3] and several states have adopted even more potent statutory approachs to the perceived problem. While state takeover legislation often pays lip service to shareholder welfare, such legislation actually has a different purpose, a purpose fundamentally antithetical to the shareholder primacy norm of present corporation law. These statutes instead represent efforts to curb takeover activity on the ground that takeovers are harmful to various nonshareholder constituencies that feel their impact. Because the objective of hostile takeovers in recent years typically has been to gain control and then to realize the full value of the target company by dismantling or liquidating its assets,[4]

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1. One might also say that present law is merely "enabling" rather than "regulatory."
2. Edgar v. MITE Corp., 457 U.S. 624 (1982).
3. CTS Corp. v. Dynamics Corp. of Am., 481 U.S. 69 (1987).
4. *See* Coffee, *Shareholders Versus Managers: The Strain in the Corporate Web,* 85 Mich. L. Rev. 1, 2-7 (1986).

the impact on the communities in which these target companies do business has been perceived to be extremely disruptive. Not only have management and lower level employees lost their jobs, but ripple effects on the company's established network of suppliers, creditors, and consumers, who are dependent on the firm for their livelihood, have been tremendous. State and local governments have lost tax revenues, and communities have lost charitable contributions. These perceived effects on local economies, rather than concern for shareholders, have prompted state action.

State takeover legislation has taken the form of revisions or amendments to state corporation statutes. These laws redefine or revise certain elements of the corporate structure created by both the corporation statutes and state common law. Generally, takeover statutes address various aspects of the attributes of share ownership and of the board's fiduciary duty. While focusing on such "internal" questions, however, the actual goal of state takeover legislation is the achievement of broader societal objectives. These laws attempt to regulate certain kinds of corporate activity for the benefit of parties external to the corporation's management/shareholder relationship. As a result, takeover laws reject the purely internal perspective of present corporation law in favor of an approach that seeks to use corporation law to address important questions about the relationship between corporations and society.

This embrace of objectives that parallel earlier, broader goals of corporation law has implications that extend beyond the takeover problem. It reaches deeper, to the question of corporation law's social and political function. As states wrestle with the takeover phenomenon, they may be in the process of revising basic ideas about the relationship between corporations and society and what role corporation law should play in structuring that relationship. Their efforts recall an earlier vision that once dominated thinking about these issues. It is this apparent congruence that may cause us to ask whether we are witnessing a rebirth of corporation law.

I. Corporations and Society in Nineteenth-Century America

A. *Regulation of Economic Power*

Nineteenth-century corporation law addressed policy concerns that differed fundamentally from those of modern doctrine. State laws reflected deep doubts about the potentially harmful effects of business corporations on the general public. Two basic concerns underlay this preoccupation. First, corporate status tended in the nineteenth century to be associated with special privilege. Americans feared that incorporation to pursue a particular line of business represented denial of opportunity to others who might also have sought to enter that line. Thus, incorporation, in the view of many, threatened to foreclose entrepreneurial activity. Actually, because corporate charters rarely granted monopoly privileges, these fears were misplaced.[5] Nevertheless, in the public's opinion, corporate status seemed inevitably to threaten equality of opportunity.[6]

Second, and of more importance to contemporaries, grants of corporate status threatened the balance of economic power in American society.[7] Incorporation appeared to present opportunities for accumulation and entrenchment of wealth that otherwise would be unavailable. Economic power of such magnitude was potentially harmful to consumers, workers, and anyone else forced to deal with the corporation. Even more ominous, economic power would bring with it political power. Because corporate organization concentrated managerial power over potentially vast economic resources in the hands of a few, the likelihood that the managers would wield that power in a self-serving manner threatened the public's general welfare. Again, although it was not necessarily true that corporate status would confer economic power which otherwise would be unattainable, that reality did not blunt criticism of the corporate device on balance of power grounds.[8]

For much of the nineteenth century, each instance of incorporation required a special act of the state legislature. These special charters were tailor-made to the needs of the particular incorporators and included whatever regulations and restrictions the legislature deemed to be peculiarly suited to the firm being incorporated. Special chartering raised concerns about favoritism and political corruption. Critics argued repeatedly that entrepreneurs bribed legislators to obtain the advantages of incorporation.[9] This reason alone led some to advocate the abolition of corporations,[10] but other reforms were chosen instead.

Some states sought to ensure the equality of opportunity through constitutional provisions requiring a two-thirds legislative majority in favor of granting each corporate charter.[11] This requirement diminished promoters' ability to use their influence in ways that threatened public welfare. The more generally favored solution to the inequality of opportunity problem, however, took a different form. Most state legislatures responded by enacting general incorporation laws, the ancestors of present corporation statutes. By dispensing with the need for a special legislative act and instead

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5. Courts construed corporate charters strictly, refusing to find rights to monopoly by implication. *See* Charles River Bridge v. Proprietors of Warren Bridge, 36 U.S. (11 Pet.) 420 (1837).

6. *See* J. Hurst, The Legitimacy of the Business Corporation in the Law of the United States *1780-1970* 30-34 (1970).

7. For a discussion of the importance of the theory of balanced power in nineteenth-century law and political economy, see Millon, *The Sherman Act and the Balance of Power,* 61 S. Cal. L. Rev. 1219 (1988).

8. *See* J. Hurst, *supra* note 6, at 36-45.

9. *See id.* at 136.

10. *Id.* at 33-36; M. Meyers, The Jacksonian Persuasion: Politics and Belief 201 (1957).

11. *See, e.g.,* Del. Const. of 1831, art. 2, § 17; N.Y. Const. of 1822, art. 7, § IX, 1 N.Y. Rev. Stat. (1929).

ordaining simple procedures that could be followed by anyone seeking to incorporate, these laws made the benefits of incorporation generally available. General incorporation laws thus attempted to guarantee equality of opportunity by eliminating legislative discretion entirely and offering incorporation to those willing to comply with certain statutory requirements applicable to all corporations formed under their aegis. Some states enacted such statutes before the Civil War, and the rest followed suit during the latter part of the nineteenth century.

Free availability of corporate status also addressed the balance of power concerns by ensuring that more than just a few corporations would dominate the economic landscape. Nevertheless, the increasing resort to incorporation for the conduct of ordinary manufacturing, processing, and distribution functions[12] continued to raise concerns about concentrated, imbalanced wealth and economic power. Rather than relying solely on market competition to maintain balance, general incorporation laws therefore imposed several sorts of restrictions on chartered corporations that were directly related to these concerns. These restrictions all were designed to control the creation of economic power, along with its concomitant harmful effects on workers, consumers, and society as a whole.

Special charters typically had defined the business purposes that a corporation could pursue and the powers that it could exercise in furtherance of those goals. Such provisions were intended to ensure that a corporation would remain within the boundaries contemplated by the legislature. Courts called upon to construe such provisions generally read them strictly, refusing to find implied or incidental purposes or powers beyond those specified in the charter.[13] Even after general incorporation laws became the norm, states still insisted that corporate charters include specific limitations on corporate purposes. Some states were willing only to allow incorporation for a single purpose,[14] and courts continued to construe limitations on corporate purposes and powers strictly.[15] Although some other states began to allow incorporation "for any lawful purpose" as early as the 1870s,[16] most corporate charters continued to specify particular purposes long after it was no longer necessary.[17] Accordingly, if a charter contained reference to a

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12. *See generally* A. CHANDLER, THE VISIBLE HAND: THE MANAGERIAL REVOLUTION IN AMERICAN BUSINESS (1977).

13. *See* The Binghamton Bridge, 70 U.S. (3 Wall.) 51, 74-75 (1865); Minturn v. Larue, 64 U.S. (23 How.) 435, 436 (1859); Commonwealth v. Central Passenger Railway, 52 Pa. 506, 516-17 (1866).

14. A. BERLE & G. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY 131 n.5 (1948).

15. *See, e.g.*, Chewacla Lime Works v. Dismukes Frierson & Co., 87 Ala. 344, 6 So. 122 (1888); Day v. Spiral Springs Buggy Co., 57 Mich. 146, 23 N.W. 628 (1885); Powell v. Murray, 157 N.Y. 717, 53 N.E. 1130 (1899); People *ex rel.* Tiffany & Co. v. Campbell, 144 N.Y. 166, 38 N.E. 990 (1894).

16. Act of Feb. 3, 1876, ch. 65, 1876 Me. Laws 51; Act of Apr. 14, 1874, ch. 165, 1874 Mass. Acts 109; Act of June 21, 1875, ch. 611, 2875 N.Y. Laws 755.

17. *See* H. BALLANTINE, PRIVATE CORPORATIONS 198 (1927).

particular purpose, a general provision authorizing "the transaction of any lawful business" would be construed to refer only to those matters that were related to the company's stated purpose.[18] Thus, the corporate purpose doctrine served to restrict the range of activity open to a particular firm, thus constraining its ability to accumulate economic power.

During the nineteenth century, an extensive body of common law developed in response to the question of what remedies were appropriate if corporate acts exceeded the purposes and powers conferred in the corporate charter. The so-called ultra vires doctrine was especially important in cases in which corporations sought to avoid liability for agreements that exceeded the corporation's lawful powers. Under the strict view applied by the United States Supreme Court, any transaction that exceeded the corporation's lawful powers was void.[19] State courts, however, tended to distinguish between partly executed and wholly executory contracts, and held that only the latter were void.[20] Because an elaborate jurisprudence grew up around these questions, corporation law treatises addressed them extensively and entire volumes were devoted to the subject.[21] The great attention this topic once received reveals the importance of the conviction that corporations should be strictly limited in their powers to those granted by the state. This concept persisted despite the solicitude for those who legitimately had relied on a belief that a corporation was empowered to enter into a transaction that it later sought to avoid. Not until the 1920s and 1930s did the ultra vires doctrine lose its significance, as people began to accept a vision of the corporation as an entity that possessed all of the powers of any natural person.[22]

In addition to the ultra vires doctrine, the desire to impose constraints on corporate activity also was apparent in the various statutory limitations on corporate powers that were a typical feature of general incorporation laws. Of particular importance was the prohibition on ownership of stock in other corporations. Through this mechanism the states addressed directly their concerns about consolidation and concentration. As a result, no holding companies or parent-subsidiary acquisitions were possible, and several states initiated quo warranto prosecutions against corporations that sought to evade this prohibition.[23]

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18. *See, e.g.,* International Lumber Co. v. American Suburbs Co., 119 Minn. 77, 137 N.W. 395 (1912).

19. *See, e.g.,* Thomas v. Railroad Co., 101 U.S. 71 (1879); Pearce v. Madison & Indianapolis R.R., 62 U.S. (21 How.) 441 (1858). *See generally* Colson, *The Doctrine of* Ultra Vires *in United States Supreme Court Decisions,* 42 W. VA. L.Q. 179, 297 (1936).

20. *See, e.g.,* Whitney Arms Co. v. Barlow, 63 N.Y. 62 (1875).

21. *See* S. BRICE, A TREATISE ON THE DOCTRINE OF ULTRA VIRES (A. Green 2d ed. 1880); H. STREET, A TREATISE ON THE DOCTRINE OF ULTRA VIRES (1930).

22. *See* Horwitz, Santa Clara *Revisited: The Development of Corporate Theory,* 88 W. VA. L. REV. 178, 187-88 (1985).

23. *See* California v. American Sugar Ref. Co., 7 Ry. & Corp. L.J. 83 (Cal. Super. Ct. 1890); People v. Chicago Gas Trust Co., 130 Ill. 268, 22 N.E. 798 (1887); State v. Nebraska

Throughout most of the nineteenth century, states also imposed dollar limits on capitalization or on asset value. Such limitations appeared in special acts and continued to be included in general statutes as well. For example, Massachusetts, in its first general incorporation act, allowed incorporation for "any kind of manufacturing, mechanical, mining or quarrying business," but limited capitalization first to $200,000 and later to $500,000.[24] The 1870 Massachusetts statute repealed earlier versions and set particular limits for various kinds of enterprises. For certain businesses, a $100,000 limit was in effect until 1903.[25] Special acts in New Jersey typically imposed limits on the amount of real estate that a corporation could own.[26] Even after the general statute of 1846 eliminated such restrictions,[27] they continued to appear in statutes governing other types of enterprises.[28]

Finally, states imposed durational limits on corporate existence. These limits varied from twenty to fifty years. Nearly half the states still retained these limitations as late as 1903.[29] Once again, the states' goal was to prevent entrenched concentration of economic power.

As use of the corporate device became increasingly common and general incorporation laws replaced special chartering as the method for ensuring equality of opportunity, the states took pains to guarantee that corporations would not attain enough size or accumulate enough wealth to threaten the public's interest in a balance of economic power. Thus, corporation law sought to ensure that corporate purposes and powers were limited, and that statutory restrictions prevented the creation of large holding companies and regulated the size and durational existence of corporations. These features of corporation law were designed to prevent large firms from achieving arbitrary, uncontrollable power over workers, consumers, and others who dealt with corporations. Additionally, they responded to concerns that concentrated economic power might bring with it political power that would be exercised selfishly. In these ways, the states fashioned a body of corporation law that addressed important social and political concerns resulting

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Distilling Co., 29 Neb. 700, 46 N.W. 155 (1890); People v. North River Sugar Ref. Co., 121 N.Y. 582, 24 N.E. 834 (1890); Mallory v. Hanaur Oil Works, 86 Tenn. 598, 8 S.W. 396 (1888).

24. Act of March 19, 1855, ch. 68, 1855 Mass. Acts 534; Act of May 15, 1851, ch. 133, 1851 Mass. Acts 633.

25. Act of June 17, 1903, ch. 437, 1903 Mass. Acts 418. For other states that retained dollar limits into the twentieth century, see, e.g., Act of April 26, 1921, No. 84, 1921 Mich. Pub. Acts 125 (eliminating maximum limit); Act of Mar. 28, 1919, ch. 92, 1919 N.Y. Laws 113 (same); Act of Apr. 1, 1915, No. 141, 1915 Vt. Laws 222 (same).

26. J. CADMAN, THE CORPORATION IN NEW JERSEY: BUSINESS AND POLITICS *1791-1875* 232-34 (1949).

27. Act of February 25, 1846, 1846 N.J. Laws 64.

28. *See* Act of Apr. 2, 1873, ch. 413, 1873 N.J. Laws 88 (general railroad incorporation statute); *see also* Bagby's Code (Maryland), Art. 23, § 245 (limiting land holdings of mining corporations).

29. *See* Louis K. Liggett Co. v. Lee, 288 U.S. 517, 555 n.29 (1933) (Brandeis, J., dissenting).

from the special characteristics of business conducted in the corporate form.

B. *Protection of Vulnerable Constituencies*

In addition to responding to the potentially destructive effects of corporate economic power on the welfare of the general public, corporation law also included more particular protection for those perceived to be especially vulnerable in their dealings with corporations.

General incorporation statutes addressed concerns about fraud and financial irresponsibility. Most notably, state laws actively regulated the relationship between the corporation and its creditors by denying to shareholders the full benefits of limited liability. The so-called "trust fund" doctrine imposed personal liability on shareholders of an insolvent corporation to the extent they had failed to pay full par value for their stock.[30] Statutes also provided safeguards designed to ensure that, if stock was paid for by property rather than by cash, the corporation received full value from the shareholder.[31] Most states held shareholders potentially liable even beyond the value of their investments. The New York general incorporation law of 1848, for example, imposed "double liability" on shareholders until all capital was paid in,[32] and most of the other states followed this model.[33] Additional state constitutional or statutory provisions required even greater potential liability.[34] In the words of one historian, "the distinction between the liability of the 'members' of a corporation and a partnership, so clear to modern eyes, was still regarded rather as a matter of degree than of kind throughout the nineteenth century."[35] All such provisions responded to the fear that incorporators, operating through the vehicle of a thinly capitalized shell, might shift the risk of insolvency entirely onto the shoulders of its creditors. Rather than leaving creditors to protect themselves through investigation and contract, the states instead took steps to prevent what they perceived as abuses of the privilege of limited liability.

Not only were shareholders potentially responsible in cases of corporate insolvency. In addition, the states imposed liability on directors and officers for various kinds of conduct that could jeopardize creditors' interests. For example, Massachusetts imposed personal liability for dividend payments that rendered the corporation insolvent, for debts contracted while loans were outstanding to shareholders, for permitting debts to exceed capital, and for allowing stock to be issued in return for overvalued property.[36]

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30. For the origin of this principle, see Wood v. Dummer, 3 Mason 308 (Mass. 1824); *see also* Sawyer v. Hoag, 84 U.S. (17 Wall.) 610 (1873).

31. *See, e.g.*, Act of Mar. 22, 1882, ch. 106, 1882 Mass. Acts 78.

32. Act of Feb. 17, 1848, ch. 40, 1848 N.Y. Laws 54.

33. *See* 1 W. COOK, TREATISE ON STOCK AND STOCKHOLDERS, BONDS, MORTGAGES, AND GENERAL CORPORATION LAW 203-06 (3d ed. 1894).

34. *See* 3 S. THOMPSON, COMMENTARIES ON THE LAW OF PRIVATE CORPORATIONS chs. 46, 50 (1st ed. 1895).

35. Horwitz, *supra* note 22, at 208.

36. *See* Act of March 22, 1882, ch. 106, 1882 Mass. Acts 78.

This concern for creditors extended not just to banks and other lenders or to trade creditors. Many states also provided particular protection to employees, a class of persons deemed particularly vulnerable to financial manipulation or irresponsibility. For example, a provision of a Pennsylvania statute qualified shareholder limited liability by excepting claims for "salaries and wages due and owing to the corporation."[37]

Thus, corporation law not only addressed the more general concerns of workers, consumers, and the public that economic power presented; important features of corporation law also offered statutory protection for those thought to be particularly vulnerable in their dealings with corporations, primarily corporate creditors and employees. Shareholder property rights vis-a-vis other constituencies were thus subject to important qualifications, as the restrictions on limited liability make clear. Thus, as with its more general concerns about economic power, corporation law again reflected a vision of the broad purposes that it might serve, a vision that recognized much more than merely the shareholders' desire to maximize their wealth. Not until corporations had increased in size and number and individual participation in the stock market had risen did corporation law begin to change its focus.[38]

II. Corporation Law's Internal Focus

A. *Deregulation*

The gradual rejection of the various regulations designed to control corporate power began during the last years of the nineteenth century, as, one by one, the states began to "liberalize" their general incorporation statutes. Because incorporation generated substantial revenue, competition for corporate charters drove this phenomenon. Initially, states focused their reforms on the traditional prohibition on corporate ownership of stock in other corporations, as well as on the limits on size and duration of corporate existence. Because of recent dramatic increases in the scale of business enterprises, corporations seeking to expand were eager to escape from these restraints. The leader of these reforms was New Jersey, which in 1888 became the first state to allow corporations to buy and sell stock, at least under certain circumstances.[39] Fearful that New York corporations might be tempted to reincorporate in New Jersey to take advantage of these provisions, New York also revised its corporation law in 1890, eliminating the upper limit on authorized capital and granting limited permission to corporations to own stock in other corporations.[40] Still fearful of New

37. *See* Pa. Business Corp. Law § 514; *see also* Act of March 22, 1882, ch. 106, 1882 Mass Acts 78; N.Y. Stock Corp. Law § 71.

38. *See* Dodd, *Statutory Developments in Business Corporation Law, 1886-1936*, 50 Harv. L. Rev. 27, 30-31 (1936).

39. Act of April 4, 1888, ch. 269, 1888 N.J. Laws 385; Act of April 7, 1888, ch. 295, 1888 N.J. Laws 445.

40. Act of June 7, 1890, ch. 567, 1890 N.Y. Laws 1167.

Jersey's competition, in 1892 New York again revised its statute, expanding the power to hold stock.[41] New Jersey responded in 1893, declaring expressly that any New Jersey corporation could buy, hold, and sell stock or bonds of any other corporation in the same manner as any natural person, and that corporations could be formed in New Jersey to conduct all their business elsewhere.[42] A leading treatise described the aftermath of these developments in these terms:

> New Jersey is a favorite state for incorporations. Her laws seem to be framed with a special view to attracting incorporation fees and business fees from her sister states and especially from New York, across the river. She has largely succeeded in doing so, and now runs the state government very largely on revenues derived from New York enterprises.[43]

The immediate impact of New Jersey's revisions was the facilitation of great business combinations. Previously existing trusts or unincorporated associations now were reorganized as holding companies incorporated in New Jersey for the purpose of acquiring the stock of firms incorporated elsewhere. Thus, New Jersey offered a harbor for such enterprises as the Whiskey Trust, which owned virtually every distillery in the United States and previously had been attacked by several states, and for the Federal Steel Corporation, a consolidation of the United States steel and iron industries that constituted the largest steel company in the world.[44] By 1904, New Jersey was home to all seven of the largest consolidations, which had an aggregate capitalization of over two and a half billion dollars.[45] New Jersey's receptive attitude thus allowed big business to escape the traditional constraints on growth and accumulation that other states continued to impose. An observer of these developments noted that New Jersey had succeeded in permitting results "regarded by the courts and legislatures of many states as a serious menace to the social and political welfare of the people."[46] Other states soon felt compelled to adopt similar provisions.

New Jersey's thorough revision of 1896 was "the first of the modern liberal corporation statutes."[47] Liberalization of corporation law involved more than just the removal of obstacles to corporate growth and consolidation. Following New Jersey's lead, other states not only removed barriers to size and consolidation but also repealed the various regulations that previously had imposed significant constraints on corporate activity. Thus, the states abandoned the many regulatory provisions designed to protect

41. Act of Mar. 4, 1882, ch. 188, 1892 N.Y. Laws 422.
42. Act of Mar. 14, 1893, ch. 196, 1893 N.J. Laws 301.
43. 2 W. COOK, *supra* note 33, at 1604.
44. Keasbey, *New Jersey and the Great Corporations,* 13 HARV. L. REV. 198, 201 (1899).
45. *See* Louis K. Liggett Co. v. Lee, 288 U.S. 517, 563 (1933) (Brandeis, J., dissenting).
46. Keasbey, *supra* note 44, at 202.
47. Cary, *Federalism and Corporate Law: Reflections Upon Delaware,* 83 YALE L. J. 663, 664 (1974).

those who dealt with corporations from those aspects of the corporate form that were deemed particularly threatening. Various provisions that assigned liability to directors in cases of insolvency were discarded.[48] The development of no-par stock allowed shareholders to escape personal liability for failure to pay fully for their subscriptions.[49] The personal liability of shareholders no longer guaranteed employees their unpaid wages.

Competition for corporate charters thus spurred the states to adopt increasingly lenient incorporation laws. For example, Massachusetts in 1902 established a commission to " 'consider and determine whether the corporation laws of other states or countries are more favorable than those of this Commonwealth to the growth of trade, commerce, and manufactures.' "[50] The result was "a vehicle of thoroughly up-to-date model."[51] When, at Governor Woodrow Wilson's urging, New Jersey reversed course and adopted a series of statutory revisions unfavorable to big business, Delaware sought to step into the breach by adopting a new, "liberal" statute designed to attract out-of-state corporations.[52] Delaware soon succeeded in taking the lead in the "race to the bottom," which it has not relinquished.

The new vision of the corporation that coincided with the deregulation movement was "the modern . . . theory that, in the absence of fraud in its organization or government, an ordinary business corporation should be allowed to do anything that an individual may do."[53] Thus, the states no longer imposed regulations on corporations for the benefit of the general public or those thought to be particularly vulnerable to corporate activity. Instead, general incorporation statutes became nothing more than "enabling acts,"[54] designed to confer maximal freedom on incorporators and management "to create whatever arrangements they found most serviceable" to promotion of business success.[55] In Justice Brandeis' famous words, the deregulation movement of the early decades of this century was a race "not of diligence but of laxity."[56]

B. *Reorientation*

1. The Internal Balance of Power

As state legislatures competed with each other to free corporations from the bondage of nineteenth-century regulatory premises, corporation law

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48. *See, e.g.,* Mass. Acts & Resolves of 1903, ch. 437, §§ 34, 35. A 1904 amendment to New Jersey's corporation statute abolished directors' liability to the corporation for dividends declared out of capital, substituting a less threatening personal right of action for shareholders injured as a result of such conduct. *See* Act of March 28, 1904, ch. 143, 1904 N.J. Laws 275; Fleisher v. West Jersey Securities Co., 84 N.J. Eq. 55, 92 A. 575 (Ch. 1914).

49. *See, e.g.,* Mass. Acts & Resolves of 1920, ch. 349, § 3; N.Y. Laws of 1912, ch. 351.

50. Dodd, *supra* note 38, at 34.

51. *Id.* at 37-38.

52. *See id.* at 43 n.67; Del. Rev. Code ch. 65 (1915).

53. Report of the Committee on Corporation Laws [Massachusetts] 20 (1903).

54. Dodd, *supra* note 38, at 43.

55. J. HURST, *supra* note 6, at 70.

56. Louis K. Liggett Co. v. Lee, 288 U.S. 517, 559 (1933) (Brandeis, J., dissenting).

gradually reoriented itself and came increasingly to focus on the corporation's internal affairs, principally the relationship between management and shareholders. The balance of power between management and shareholders was one of the arenas in which states competed for corporate charters. Because management generally decided where to incorporate, states attracted corporations by offering corporation law that created a comfortable working environment for management. Typically this meant that states facilitated managerial discretion and limited managerial liability. During the early decades of the nineteenth century, therefore, states redefined the relationship between management and shareholders in ways that conferred important new powers on management. Commentators have argued that an important reason for Delaware's persistent preeminence has been its continuing ability to create favorable conditions for corporate management vis-a-vis shareholders.[57]

As corporations expanded greatly in number and in size and a public market for industrial securities developed,[58] share ownership became increasingly widespread. The number of Americans that owned stock increased by a factor of twenty during the first three decades of the twentieth century.[59] Widely dispersed stock ownership replaced family control and partnership organization among manufacturing, processing, and distribution firms.[60] Among the larger corporations, majority or even controlling minority stock holdings became rare.[61]

Some important consequences followed from these developments. Share ownership increasingly lost any sort of meaningful participatory aspect as shareholders became passive investors who expected others to assume full responsibility for maximization of the value of their investments. Management naturally stepped into this power vacuum. In the words of a leading treatise,

> The enlargement of facilities for the purchase and sale of corporate securities, the tendency toward combination of corporations, and the consequent desirability of diversification of individual investments have joined to create a class of stockholders who regard themselves as investors rather than co-entrepreneurs. . . . Accordingly, modern decisions tend toward an emphasis of the directors' absolutism in the management of the affairs of large corporations;

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57. *See* Cary, *supra* note 47. Alternatively, others argue that competition among the states for corporate charters promotes creation of corporation law that is optimal from the shareholders' point of view. *See* Winter, *State Law, Shareholder Protection, and the Theory of the Corporation,* 6 J. LEGAL STUD. 251 (1977). The proliferation of antitakeover laws, with their attendant adverse impact on shareholders' welfare, *see infra* part III, is an embarrassment to adherents of this explanation for the content of state corporation law.

58. *See* Navin & Sears, *The Rise of a Market for Industrial Securities, 1887-1902,* 24 BUS. HIST. REV. 105 (1955).

59. T. MCCRAW, PROPHETS OF REGULATION 163 (1984).

60. *See* Navin & Sears, *supra* note 58, at 109-10.

61. A. BERLE & G. MEANS, *supra* note 14, ch. 4.

> the board of directors has achieved a super-control of corporate management and of the corporation's legal relations.[62]

It was this "separation of ownership and control," and the consequent accountability problems that it raised, that formed the subject of Berle and Means' classic work.[63]

As the states shifted their attention to the relationship between management and shareholders, state law gave management important new powers at the shareholders' expense. For most shareholders, the only realistically possible influence over the conduct of corporate affairs was through the election of directors. Yet shareholders lost one potentially important disciplinary tool as states eliminated older statutory provisions that allowed shareholders to remove directors without cause before the expiration of their terms.[64] Shareholders lost this power under the common law as well.[65] In addition, the general adoption of voting by proxy diluted the significance of shareholders' voting rights. Under proxy voting, shareholders typically delegated voting power to management or to some controlling shareholder, who inevitably voted in a self-serving manner. In Berle and Means' words, "The proxy machinery has thus become one of the principal instruments not by which a stockholder exercises power over the management of the enterprise, but by which his power is separated from him."[66] Similarly, statutory elimination of traditional unanimity requirements for certain fundamental corporate changes such as mergers or sales of substantial assets[67] meant that, if management could persuade a majority to agree with its position, management could force dissenting shareholders to go along.

Perhaps the most fundamental shift in the balance of power between management and shareholders, however, was the removal of various constraints on managerial discretion. As we have seen, special charters as well as nineteenth-century charters issued pursuant to general incorporation laws typically included specifically defined corporate purposes and powers. No departure from these purposes and powers was legal without unanimous shareholder consent. A primary objective of these restrictions was to grant to shareholders enforceable expectations as to how management would use the assets entrusted to it. Because of the move to elaborate all-encompassing purpose clauses, however, management gained virtually absolute freedom to make decisions regarding the direction of the firm's business. The only

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62. H. SPELLMAN, A TREATISE ON THE PRINCIPLES OF LAW GOVERNING CORPORATE DIRECTORS 4-5 (1931).

63. A. BERLE & G. MEANS, *supra* note 14.

64. *Id.* at 139.

65. *See, e.g.*, Taylor v. Hutton, 43 Barb. 195 (N.Y. App. Div. 1864); 3 W. COOK, TREATISE ON CORPORATIONS § 624 (5th ed. 1903).

66. A. BERLE & G. MEANS, *supra* note 14, at 139.

67. For the traditional unanimity rule, see, e.g., Mason v. Pewable Mining Co., 133 U.S. 50 (1890); State *ex rel.* Brown v. Bailey, 16 Ind. 46 (1861); Stevens v. Rutland & Burlington R.R., 29 Vt. 545 (1851). For its statutory rejection with respect to mergers, see W. NOYES, A TREATISE ON THE LAW OF INTERCORPORATE RELATIONS 36 n.1, 84 n.2 (1902).

limit on management's discretion was "the imagination of its organizing attorneys and their ability to embrace the world within the limits of the English language."[68] Even if the charter did define some specific purpose, the new statutes allowed charter amendments that were authorized by a less than unanimous shareholder vote.[69] State statutes also abandoned traditional restrictions on the board's ability to declare dividends, as well as other provisions designed to ensure a corporation's solvency.[70] The broad discretion management enjoyed was reconceived as a mandatory statutory norm, rather than as a result of express or implicit delegation of authority from the shareholders.[71] As statutes granted management broad discretion in running the business, courts developed the remarkable doctrinal presumption that management exercised these powers in good faith.[72]

While economic conditions and corporation law were redefining the role of shareholders in the corporation, at a more general level new ideas about the nature of the corporation also raised important questions about managerial discretion and accountability to shareholders. Professor Horwitz has traced the reconceptualization of the corporation as a "natural entity."[73] Analyzing doctrinal developments during the early decades of this century in several areas of corporation law, he argues that the corporation came to be viewed as a "natural" legal person, as opposed to an "artificial" creation of the state, and as a distinct "entity," as opposed to a mere aggregation of individuals that had no separate identity of its own. The new theory Horwitz identifies justified liberation of the corporation and its managers from traditional state regulations on the scope of corporate activities and the extent of corporate economic power. If a corporation was a natural legal person, no basis existed for imposing restrictions based solely on corporate status and thus not applicable to other persons. In addition, because the conceptual separation of the corporate entity from its constituent shareholders distinguished corporations from partnerships, in which by definition all owners were entitled to participatory control of the firm, the separation legitimated release of the new class of professional managers from shareholder control.

The natural entity theory also had another tendency, however, one that Horwitz did not recognize. The concept of the corporation as a distinct entity that enjoyed all of the freedoms enjoyed by other persons could be used to support the claim that managerial discretion ought to extend to the

68. A. BERLE & G. MEANS, *supra* note 14, at 140.

69. *See, e.g.,* Act of Mar. 17, 1902, ch. 229, 1902 Me. Laws 337; Act of June 17, 1903, 1903 Mass. Laws 437; N.Y. Stock Corporation Law of 1923, §§ 36, 37 (1923).

70. *See, e.g.,* DEL. REV. CODE, ch. 65, § 31, as amended by Act of March 22, 1929, 1929 Del. Laws 366 (allowing dividend payments out of capital).

71. *See* Manson v. Curtis, 223 N.Y. 313, 322, 119 N.E. 559, 562 (1918) (board's powers are "original and undelegated").

72. *See, e.g.,* Allaun v. Consolidated Oil Co., 147 A. 257 (Del. Ch. 1929); Robinson v. Pittsburgh Oil Ref. Corp., 126 A. 46 (Del. Ch. 1924).

73. Horwitz, *supra* note 22.

use of corporate resources for the benefit of various nonshareholder interests, even at the expense of shareholders. In a famous article, Professor Dodd made just this argument.[74] The vision of the corporation that Dodd advocated was one of the corporation as a citizen engaged in a broad range of activities and responsive to a broad range of concerns, including the welfare of its employees, consumers of its products, and members of communities in which it operates. Applied to natural persons, the concept of citizenship denotes the individual's willingness to engage in activities that sacrifice personal financial gain for public benefit. In other words, the corporation, in addition to maximizing wealth, should enjoy the freedom to engage in various socially productive activities like any other citizen. The natural entity theory offered a potential justification for rejecting shareholders' rights to management's exclusive attention. By suggesting a theoretical basis for extremely broad discretion, corporate theory therefore presented additional accountability concerns.

2. The Shareholder Primacy Principle

The developments discussed above all shared a common tendency. Because they raised concerns about the scope of managerial discretion and about accountability, they all implicated shareholders' financial welfare. In light of the recent explosion of corporate accumulation (which meant that large amounts of money were at stake), increasingly broad participation in the stock market, and big business's growing reliance on the stock market for capital, this was no small concern. To rein in the potentially troubling scope of managerial discretion, states formulated a new principle: management's broad discretion with respect to conduct of corporate affairs must be exercised solely for the benefit of the shareholders. This principle therefore offered a benchmark against which to evaluate management's conduct, a benchmark which became the fundamental postulate of corporation law. Only recently has state takeover legislation called this principle into serious doubt.

During the early decades of this century, the expansion of managerial discretion was especially troubling to shareholders because no clear doctrinal principle required management to exercise its powers solely for the benefit of shareholders. The issue rarely was presented in those terms; instead, shareholders' complaints about the propriety of managerial conduct typically were framed as challenges to ultra vires acts. Thus, questions regarding charitable gifts of corporate funds, political contributions, or expenditures for the benefit of employees were resolved by reference to the corporate purposes and powers expressed in the charter, or, less frequently, by reference to specific statutory prohibitions. The broader question of corporate purpose arose only in cases in which the charter imposed no meaningful restrictions and there was no question of a statutory violation. Unless

74. Dodd, *For Whom are Corporate Managers Trustees?*, 45 HARV. L. REV. 1145 (1932).

a legal rule restricted management to maximizing shareholders' wealth, management would enjoy the freedom to use corporate resources in ways that benefitted nonshareholders' interests at the expense of shareholders.

The courts promptly resolved these doubts about the proper objective of corporate activity and management's role. In a famous case decided in 1919, the Michigan Supreme Court offered the classic statement of the shareholder primacy principle:

> A business corporation is organized and carried on primarily for the profit of the stockholders. The powers of the directors are to be employed for that end. The discretion of directors is to be exercised in the choice of means to attain that end, and does not extend to a change in the end itself, to the reduction of profits, or to the nondistribution of profits among stockholders in order to devote them to other purposes.[75]

The court cited no precedent in support of this principle. Since then, however, the Michigan Supreme Court's formulation has been cited countless times in support of challenges to management conduct that threatens to subordinate shareholders' financial interests to competing values, such as concern for workers, the environment, or the community.[76]

As corporation law abandoned its nineteenth-century regulatory premises, firms found themselves in possession of broad legal powers essentially coextensive with those of natural persons. The absence of externally imposed limits on corporate power, the widespread separation of ownership and control, and generous managerial discretion raised new and troubling accountability concerns. The states responded by developing a new body of law and a new principle, the requirement that management diligently devote itself to maximizing shareholder wealth rather than other possibly conflicting objectives. In so doing, corporation law quietly rejected its former concerns about the dangers that corporate power presented to society and the need to impose regulations for the benefit of those constituencies most directly vulnerable to corporate activity.

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75. Dodge v. Ford Motor Co., 204 Mich. 459, 170 N.W. 668, 684 (1919).

76. Since establishment of this basic principle, there have been occasional efforts to expand the concept of corporate purpose to accommodate conduct that interferes with maximization of shareholder wealth. The issue has arisen in cases in which shareholders challenge management policies as inconsistent with maximizing profits. *See, e.g.*, Kelly v. Bell, 266 A.2d 878 (Del. 1970); Shlensky v. Wrigley, 95 Ill. App. 2d 173, 237 N.E.2d 776 (1968); Union Pacific R.R. v. Trustees, Inc., 8 Utah 2d 101, 329 P.2d 398 (1958). Courts reject such challenges if management's conduct can be construed as likely to result in long-run benefits to the corporation, even if only indirectly. In other cases, shareholders have used various strategies to attempt to exert pressure on management to pursue political objectives that conflict with maximizing profits. *See, e.g.*, Medical Comm. for Human Rights v. SEC, 432 F.2d 659 (D.C. Cir. 1970); State *ex rel.* Pillsbury v. Honeywell, Inc., 291 Minn. 322, 191 N.W.2d 406 (1971).

III. State Responses to Hostile Takeovers

As hostile takeovers by means of tender offers increased in frequency during the 1970s, several states enacted statutes to regulate this phenomenon. In 1982 the United States Supreme Court determined in *Edgar v. MITE Corp.*[77] that the particular takeover statute at issue was an unconstitutional burden on interstate commerce.[78] A plurality of the Court also concluded that the statute was preempted by the Williams Act.[79] Although *MITE* appeared to deal a crippling blow to efforts to regulate takeovers, state legislatures responded with renewed vigor and continued their efforts to impose meaningful restraints on the harsh effects of the takeover boom.

The primary impetus for state efforts to regulate takeovers has been the desire to protect those dependent on the continued presence of corporate activity from the disruptive effects that hostile takeovers are perceived to generate. Many believe that the so-called "bust-up" takeover, in which the successful bidder seeks to liquidate target company assets or otherwise restructure the company to pay off acquisition indebtedness and realize a quick profit, has replaced the hostile bid designed to continue operations under more efficient management. Such transactions are perceived to result in layoffs or plant closings. Besides causing employees to lose their jobs, hostile takeovers also threaten established relationships with local suppliers of goods, services, and credit, and may cause loss of tax revenues and charitable contributions and other less readily identifiable "ripple effects" on the communities in which target companies operate. Indeed, it has been persuasively argued that the source of shareholders' gains in hostile takeovers depends upon the destruction of established relationships between certain nonshareholders and the corporation.[80] Even successful efforts to defend against hostile takeovers often result in significant job losses as a result of radical corporate restructuring.[81] By responding to such concerns, takeover legislation defines as its intended beneficiaries local nonshareholder (or stakeholder) constituencies rather than typically nonresident shareholders. To the extent that state legislation succeeds in deterring hostile takeovers, it is at the shareholders' expense, because the shareholders lose the opportunity to realize substantial premiums over market price for their shares as well as the accountability incentives for management that the threat of hostile takeovers ensures.

In the aftermath of *MITE*, states seeking to limit takeovers addressed constitutionality concerns with a new strategy. In place of administrative review mechanisms and rules designed to supplement the Williams Act's

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77. 457 U.S. 624 (1982).

78. Edgar v. MITE Corp., 457 U.S. 624, 646 (1982).

79. *Id.* at 639-40; *see* 15 U.S.C. §§ 78m(d)-(e), 78n(d)-(f) (1982).

80. Shleifer & Summers, Breach of Trust in Hostile Takeovers (National Bureau of Economic Research Working Paper No. 2342, 1987).

81. *See* Lipton, *Corporate Governance in the Age of Finance Corporatism*, 136 U. Pa. L. Rev. 1, 26 (1987).

procedural guidelines, several states instead presented takeover legislation in the guise of traditional regulation of corporate internal affairs. The states placed these provisions in that quintessentially state-governed body of law, the general incorporation statute. As such, they could be seen to be examples of state corporation law's traditional exercise of jurisdiction over such purely "internal" matters as definition of the attributes of share ownership, and therefore would be more likely to survive constitutional scrutiny for that reason.[82]

One such statute is the control share acquisition statute, which has been adopted in one form or another by several states.[83] Control share acquisition statutes deny voting rights to successful tender offerors absent approval by target company shareholders. Rather than directly regulating a bidder's ability to launch or to consummate a tender offer, these statutes, by redefining voting rights in this manner, instead impose restrictions on acquirers' ability to exercise postacquisition control of the acquired company. Indiana's control share acquisition statute, which survived constitutional attack in *CTS Corp. v. Dynamics Corp. of America*,[84] conditions voting rights on majority approval by all preacquisition disinterested shareholders, that is, excluding shares owned or controlled by the bidder or by the target's inside directors or officers. Unless the bidder is willing to wait for the next shareholders' annual meeting, the necessary plebiscite can be held at the bidder's expense but only after a delay of up to fifty days. Moreover, even if the bidder wins the voting rights contest, all dissenting shareholders have a statutory right to cash out their shares for fair value.

On its face the Indiana statute does not purport to restrict or otherwise to regulate the frequency with which hostile takeovers occur. Nor does it say anything about protection of nonshareholders' interests. The United States Supreme Court in *CTS* assumed that the statute's purpose was simply to protect shareholders from coercive two-tier offers, in which a bidder's willingness to buy only a majority interest forces the remaining target shareholders to cash out later at a lower price.[85] By assigning to shareholders the power to decide a bid's fate collectively, the statute neatly addressed the coercion problem.[86] However, a good deal more was going on beneath the surface of the Indiana law's apparent policy to protect shareholders. First, the problem of shareholder coercion, though theoretically compelling, is simply not very important from a practical standpoint because two-tier

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82. For a discussion of this "corporatization" strategy, see Johnson & Millon, *Misreading the Williams Act*, 87 MICH. L. REV. ____, (June 1989).

83. *See generally* Note, *"May We Have the Last Dance?" States Take Aim at Corporate Raiders and Crash the Predator's Ball*, 45 WASH. & LEE L. REV. 1059 (1988).

84. 481 U.S. 69 (1987).

85. CTS Corp. v. Dynamics Corp. of Am., 481 U.S. 69, 82-83 (1987).

86. For a discussion of the utility of control share acquisition statutes with respect to coercive offers, see Booth, *The Promise of State Takeover Laws*, 86 MICH. L. REV. 1635, 1679-99 (1988).

offers currently are extremely rare and have been so in recent years.[87] Thus, one should view the shareholder protection rationale with some skepticism. Second, as Justice White argued in dissent in *CTS,* the Indiana statute's legislative history and the state's brief to the Supreme Court revealed that the state's real concern was to prevent liquidation or removal out of state of Indiana corporations.[88] Third, the statute imposed significant costs on hostile bidders. The requirement that shareholders approve voting rights necessarily involves expense and uncertainty. Further, the delay of up to fifty days, which is itself costly, also gives target company management opportunities to seek out rival bidders or at least to urge shareholders to deny voting rights. Finally, the cash-out provision for dissenters also would raise acquisition costs. For all of these reasons, control share acquisition statutes—despite their *ex post* benefits for a target company's shareholders who actually are confronted with a two-tier bid—surely have an *ex ante* deterrence effect on hostile bids for companies under the statutory coverage. It was evidently this "chilling effect" that led Judge Posner to describe the Indiana statute as "a lethal dose" for tender offers.[89] The actual purpose of the statute thus was not to benefit shareholders of Indiana corporations but instead to restrict the level of takeover activity and thereby protect those local constituencies thought to be vulnerable should hostile bids succeed—a goal that could be achieved only at the shareholders' expense. Since *CTS,* commentators generally have recognized that this was the real purpose and likely effect of the Indiana statute.[90]

In upholding the Indiana statute against preemption and commerce clause challenges, the Supreme Court in *CTS* avoided any serious analysis of the true purpose or likely effect of the law. As noted above, the Court accepted the argument that the statute was intended to neutralize the coercive effects of two-tier offers; the Court also summarily equated shareholders' possession of decisionmaking power with a proshareholder purpose. It therefore slighted the legislation's likely *ex ante* deterrent effect, seeing "little evidence" that the statute would harm shareholders by decreasing the number of successful tender offers. While the Court suggested that deterrence would have no effect on its commerce clause analysis, it said nothing about whether deterrence might be a basis for preemption. Thus,

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87. *See* Mendelsohn & Berg, *Anti-Takeover Bill Would Shift Balance of Power,* NAT'L L. J., Feb. 8, 1988, at 38, 40, col. 1.

88. *CTS,* 481 U.S. at 100-01 (White, J., dissenting).

89. Dynamics Corp. of Am. v. CTS Corp., 794 F.2d 250, 262-63 (7th Cir. 1986), *rev'd in part,* CTS Corp. v. Dynamics Corp. of Am., 481 U.S. 69 (1987).

90. *See, e.g.,* Langevoort, *The Supreme Court and the Politics of Corporate Takeovers: A Comment on* CTS Corp. v. Dynamics Corp. of America, 101 HARV. L. REV. 96 (1987); Steinberg, *Federal Preemption of State Antitakeover Statutes: The Time for Congressional Action is Now,* 16 SEC. REG. L.J. 80, 83 (1988); Comment, *State Antitakeover Legislation: Unconstitutional Economic Folly,* 20 ARIZ. ST. L.J. 475 (1988); Coll, *Rules are Changing in Wall Street's Takeover Game,* Wash. Post, April 3, 1988, at H1, col. 1; Miller & Cohen, *Corporate Raiders Predict Hard Times for Hostile Bids, High Court Decision May Have "Killed" Their Game,* Wall St. J., Apr. 23, 1987, at 6, col. 1.

the Court has yet to address directly the fundamental question of whether the Constitution allows the states to use corporation law to limit hostile takeovers in order to benefit local nonshareholders at the shareholders' expense.

A more potent form of takeover law presents that question more directly and therefore probably will require the Court to resolve the issue. Several states have enacted a different sort of takeover law, termed business combination statutes.[91] Like the control share acquisition statutes, these statutes respond to *MITE* by seeking refuge in state corporation law's traditional jurisdiction to define the attributes of stock ownership. Business combination statutes prohibit a successful tender offeror from using its controlling position to effectuate a merger, sale of assets, liquidation, or other specified business combination for a period of time, typically three to five years. These laws generally contain exceptions for cases in which management is willing to bless the combination. Unlike the control share acquisition statutes, however, the business combination statutes generally do not include any provisions allowing shareholders, acting despite management's opposition, to authorize a business combination and therefore determine whether a hostile bid contingent on a post-tender offer business combination will succeed.[92]

If there was any doubt about the objective of the control share acquisition statutes, the purpose of the business combination statutes is unmistakably clear—to deter hostile takeovers that threaten local nonshareholder interests. Several statutes expressly identify their intended beneficiaries. For example, a recent amendment to North Carolina's business combination statute opens with this preamble:

> Whereas, takeovers and takeover attempts of corporations in North Carolina are occurring with increasing frequency; and
>
> Whereas, such activity can be highly disruptive to communities within North Carolina by causing, among other things, high unemployment and erosion of the State and local economy and tax base; and
>
> Whereas, many of these corporations are not presently subject to the North Carolina Shareholder Protection Act since while substantially present in North Carolina they are chartered elsewhere; and

91. *See* ARIZ. REV. STAT. ANN. §§ 10-1221 to -1223 (West Supp. 1987); 1988 Conn. Legis. Serv. P.A. No. 88-350 (West); DEL. CODE ANN. tit. 8, § 203 (1988); IND. CODE ANN. § 23-1-43 (Burns Supp. 1988); KY. REV. STAT. ANN. §§ 271A.396 to .399 (Michie/Bobbs-Merrill Supp. 1988); MINN. STAT. ANN. § 302A.673 (West Supp. 1988); MO. ANN. STAT. §§ 351.450 to .459 (Vernon Supp. 1988); N.J. STAT. ANN. §§ 14A:10A-1 to 10A-6 (West Supp. 1988); N.Y. BUS. CORP. LAW § 912 (McKinney 1986 & Supp. 1988); WIS. STAT. ANN. § 180.726 (West Supp. 1988).

92. Delaware's statute is exceptional in providing that tender offers resulting in acceptance by at least 85% of outstanding stock are not subject to the statutory moratorium. DEL. CODE ANN. tit. 8, § 203(a)(2).

> Whereas, these corporations offer employment to a large number of North Carolina citizens who pay income taxes, property and other taxes in this State; and
>
> Whereas, these corporations pay significant amounts of income taxes to North Carolina; and
>
> Whereas, these corporations pay substantial State and local property taxes; and
>
> Whereas, these corporations pay substantial sales and use taxes in North Carolina; and
>
> Whereas, these corporations provide their North Carolina employees with health, retirement and other benefits; and
>
> Whereas, these corporations and their employees contribute greatly to community projects in North Carolina; and
>
> Whereas, many unrelated businesses rely on these corporations to purchase goods and services; and
>
> Whereas, North Carolina has a vital interest in providing to these corporations the benefits of the provisions of the North Carolina Shareholder Protection Act. . . .[93]

Similarly, Wisconsin's statute declares that Wisconsin corporations "encompass, represent and affect, through their ongoing business operations, a variety of constituencies including shareholders, employees, customers, suppliers and local communities and their economies," and states further that it is intended "to promote the welfare of these constituencies" and to "allow for the stable, long-term growth of resident domestic corporations."[94]

The legislative history of New York's business combination statute—which has served as a model for similar laws passed by other states—clearly reveals the statute's intent to protect nonshareholders. The official memorandum that accompanied the bill refers to New York's desire to avoid the disruptive effects of takeovers on target company employees and on local communities in which target companies operate. Thus, the memorandum anticipates that the new law will encourage commitment to the welfare of New York corporations and their employees and refers to promotion of "long-term growth."[95] In other words, the statute will discourage hostile bidders from taking actions that threaten the continuity of target company operations. This rationale explains the AFL-CIO's public support for the measure; a "Support Memorandum" stated that "[n]o matter which side wins control in a takeover battle, workers, customers, and the community

93. 1987 N.C. Sess. Laws ch. 124.

94. WIS. STAT. ANN. § 180.726 (West Supp. 1988).

95. Governor's Program Bill, 1985 Extraordinary Session, Memorandum (C. 915) at 1, 6, 9 (copy on file with author).

in which the company is located are the likely ultimate losers."[96]

Although some business combination laws pay lip service to the rhetoric of shareholder welfare,[97] the policy preference for nonshareholders over shareholders is clear from the design of all such statutes. These statutes do not deprive a successful bidder of the power of control as such but instead impose a lengthy moratorium on the types of transactions that motivate "bust-up" takeovers. The likely effect of such laws is surely to deter these bids, because those transactions generally cannot be undertaken unless target company management consents. A bidder willing to use its control in a manner that allows existing operations to continue more or less intact, however, is less likely to be deterred by such a statute. Thus, the statutes' design strongly implies a desire to protect nonshareholders from disruptive takeovers.

Additionally, other reasons make it impossible to read the business combination statutes as laws enacted to protect shareholders. One might argue that shareholders confronted by two-tier offers face unfair coercion and therefore need management to intervene. Actually, two-tier bids largely have disappeared from the takeover scene,[98] and, in any event, because they apply equally to coercive and noncoercive bids, business combination statutes are not limited to situations in which management intervention might be justified on shareholder protection grounds.[99] More generally, by conferring power to make decisions on management rather than on shareholders, and by apparently allowing the board broad discretion in the exercise of that power, it seems safe to assume that at least some hostile bids will fail even though they might otherwise have attracted a favorable shareholder response. Again, statutory design belies any persuasive argument that ensuring shareholders' welfare is the statutory objective.

Perhaps the most significant examples of recent takeover legislation are the statutes that redefine the board of directors' duty to the corporation and its shareholders by providing expressly that the board, in exercising its managerial authority, may take into account the interests of nonshareholders as well as shareholders. Minnesota's statute expresses this notion most fully:

> 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 pos-

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96. Memorandum dated Dec. 10, 1985 (copy on file with author).

97. North Carolina has titled its antitakeover statute the Shareholder Protection Act. N.C. GEN. STAT. §§ 55-75 (Supp. 1988). *Cf.* text accompanying *supra* note 93 (Preamble, in listing all justifications for statute, does not mention interests of shareholders).

98. *See supra* note 87 and accompanying text.

99. So-called "fair price" and "dissenters' rights" statutes are more appropriately tailored to the shareholder coercion problem. *See generally* Note, *supra* note 83.

> sibility that these interests may be best served by the continued independence of the corporation.[100]

Several other states have passed similar legislation.[101] These provisions, however, are not restricted to the takeover context. Instead, they redefine the board's fiduciary obligation in general terms, allowing it to consider nonshareholders' interests in the discharge of any and all of its various responsibilities.[102] Presumably, therefore, management might find refuge in these laws from shareholder derivative suits alleging, for example, that the board chose to confer a gratuitous benefit on employees in a manner that was costly to the corporation. Faced with a hostile takeover bid that threatens stakeholder relationships, the board under these statutes expressly may take steps necessary to preserve those relationships, even though shareholders may lose a profitable tender offer opportunity. Although signs of common law recognition of such a power do exist,[103] such express statutory mandates obviate any need for management to depend upon the common law. Of course, it remains to be seen what—if any—effect these changes will have on management's behavior, but their striking departure from strict shareholder primacy should not be ignored for that reason.

In all of its various forms, recent state takeover legislation represents a first step toward reshaping corporation law in a manner that will protect various interests of nonshareholders. Believing that takeover activity threatens these interests, legislators are attempting to address an important feature of corporate structure, the susceptibility of the corporation to hostile takeover by means of a tender offer. The redefinition of certain aspects of share ownership attempts to regulate the incidence of takeovers—at least of "bust-up" takeovers—to protect those perceived to suffer from their effects. The new fiduciary duty provisions give the board express power to protect stakeholders. By seeking to regulate the relationship between the corporation and various affected constituencies, therefore, the states are rejecting the purely internal perspective—the focus on management-shareholder relations—that has characterized corporation law for much of this century. In effect, we may be witnessing a reemergence of a regulatory conception of the uses of corporation law.

The effort to make corporation law responsive to the interests of nonshareholders represents a dramatic departure from the equally venerable principle that identifies shareholders' welfare as the fundamental postulate of corporation law. If the control share acquisition and business combination

100. MINN. STAT. ANN. § 302A.251(5) (West Supp. 1988).

101. *See* ARIZ. REV. STAT. ANN. § 10-1202 (Supp. 1987); ILL. ANN. STAT. ch. 32, para. 8.85 (Smith-Hurd Supp. 1988); IND. CODE ANN. § 23-1-35-1(d) (Burns Supp. 1988); ME. REV. STAT. ANN. tit. 13-A, § 716 (1981 & Supp. 1988); OHIO REV. CODE ANN. § 1701.59 (D) (1986); PA. STAT. ANN. tit. 42, § 8363 (1988).

102. Arizona's statute thus far contains the only mandatory provision. ARIZ. REV. STAT. ANN. § 10-1202 (Supp. 1987).

103. *See infra* note 116.

statutes challenge that principle only indirectly, by *ex ante* deterrence of hostile bids that promise gains to shareholders, the newly expanded fiduciary duty laws do so head on. Thus, the states once again are acknowledging the broad social significance of corporate governance and corporate purpose, as well as the consequences of corporate activity, and, in the takeover area at least, are seeking to adjust corporation law accordingly.

Not surprisingly, state legislators have chosen mechanisms different from those employed by their nineteenth-century forbears for implementation of their policy objectives. Instead of express prohibitions on certain troublesome transactions or restrictions on corporate structure, recent antitakeover laws operate in one of two ways. First, the control share acquisition and business combination laws seek to decrease the frequency of takeover activity by redefining the postacquisition powers of the successful bidder in a manner that will deter hostile bids. Through this method the states are attempting to package their policy goals as traditional corporation law, purportedly addressing internal governance concerns through adjustment of the incidents of share ownership. Second, by expressly mandating consideration of nonshareholder interests, some states have candidly empowered the board to resist hostile bids—and other states perhaps impliedly have done the same by passing business combination statutes and failing to redefine the duty of care provisions. With this mechanism, the states have turned to the board's traditional state law responsibility to look after the welfare of "the corporation and its shareholders."[104] What is remarkable in this context, however, is a newly found willingness to consider the corporation's best interests in terms broader than merely the interests of its shareholders. While the particular concerns of today are no longer those of the nineteenth century, and the particular statutory provisions that address those concerns are different, by using corporation law to protect local nonshareholders from the consequences of incorporation, recent takeover legislation resembles the older approach of corporation law that was abandoned during the early decades of this century. It is this development that suggests a rebirth of corporation law.

IV. Some Unanswered Questions

Although the Supreme Court upheld the Indiana control share acquisition statute in *CTS*, substantial questions remain regarding the constitutionality of state takeover laws. Because these questions have been discussed elsewhere, that analysis need not be rehearsed here.[105] Instead, the interpretation of the significance of state takeover legislation advanced above—that

104. *See* Aronson v. Lewis, 473 A.2d 805, 811 (Del. 1984); Guth v. Loft, 5 A.2d 503, 510 (Del. Ch. 1939), *aff'd*, 19 A.2d 721 (Del. 1941).

105. *See, e.g.*, Hazen, *State Anti-Takeover Legislation: The Second and Third Generations*, 23 Wake Forest L. Rev. 77 (1988); Comment, *State Antitakeover Legislation: Unconstitutional Economic Folly*, 20 Ariz. St. L.J. 475 (1988); Note, *The Constitutionality of Second Generation Takeover Statutes*, 73 Va. L. Rev. 203 (1987).

it coincides with an earlier conception of the uses and content of corporation law—raises some additional questions, to which I now turn.

A. Motivation

Some commentators have questioned the motivation behind state takeover laws. They suggest that takeover laws respond to the desires of management of large, locally resident corporations to protect themselves from the threat of hostile takeovers, rather than to broader social and political objectives. According to Professor Romano's recent study, Aetna Life and Casualty Insurance Company, based in Hartford, Connecticut, and the Connecticut Business and Industry Association, "essentially a state chamber of commerce," were the primary proponents of Connecticut's recent takeover statute.[106] She finds no evidence that other constituencies, such as as organized labor or community groups, played a role in the legislative process.[107] Nor were shareholders as a class represented. While conceding that legislators may have been implicitly motivated by concerns for such constituencies, Romano concludes that the Connecticut statute was primarily a reaction to pressure from business interests.[108] She also suggests that a similar explanation lies behind recent takeover legislation passed in other states.[109] If she is correct, takeover legislation's apparent focus on protecting a broad range of constituencies that stand to lose from takeovers is a sham, a smoke screen that compliant legislatures approved at the behest of corporate managers seeking to entrench themselves.

Romano's explanation for takeover legislation, however, is unconvincing. First, in at least some states, including Missouri, New York, and Ohio, there is explicit evidence of labor's support for takeover legislation, evidence that Romano acknowledges.[110] Indeed, in Connecticut itself organized labor was on record as supporting plant-closing legislation introduced in the previous legislative session;[111] to the extent legislators associated hostile takeovers with the threat of plant closings, therefore, they may well have assumed that labor, despite taking no specific position on the takeover bill, supported such legislation. Second, Professor Romano makes no effort to explain provisions in other state statutes that refer specifically to a broad range of nonmanagement interests. Again, Connecticut itself recently has passed a law that makes clear the legislature's solicitude for nonshareholders.[112] Romano offers no reason to doubt that such pronouncements

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106. Romano, *The Political Economy of Takeover Statutes,* 73 VA. L. REV. 111, 124 (1987).

107. *Id.* at 134-35.

108. *Id.* at 135.

109. *Id.* at 136-37.

110. *Id.* at 137-38.

111. *Id.* at 134 n.58.

112. Connecticut's new law empowers "the Connecticut Partnership Compact," which is to include representatives of labor and citizen groups as well as business and the legislature, to impose conditions on certain post-takeover transactions for the benefit of various noninvestors. *See Connecticut Takeover Statute Barring Raiders Signed Into Law,* 20 Sec. Reg. & L. Rep. (BNA) 925 (June 17, 1988).

reflect genuine concerns, regardless of whether active lobbying efforts can be identified. Groups such as unorganized labor, suppliers of goods and services, and local communities in which production facilities operate generally do not engage actively in organized efforts to influence legislation, or at least they are unable to do so on a systematic basis. Although such groups therefore may play no visible role in the legislative process, it is a mistake to assume that legislators are ignorant or unresponsive to their concerns. Finally, the equation of management's support for takeover legislation with a management objective of selfishly motivated entrenchment is questionable. Surely corporate managers are aware that takeovers threaten their jobs, and they are willing to take steps to defend themselves through legislative lobbying, charter amendment, or defensive measures after takeovers have been launched. It is incorrect, however, to assume that narrow self-interest is necessarily management's sole motivation in such situations. Rather, it seems more accurate to recognize that management often believes itself responsible for the welfare of a broad range of constituencies that depend on the continued viability of corporate operations. In other words, management's participation in the legislative process may signal the vicarious presence of a broad range of interests that happen to agree with management's desire to fend off irresponsible and socially destructive takeover activity.

Another version of the argument that takeover legislation responds to the narrow interest of some particular group posits that, in several states, legislators have reacted hastily to a particular threat to a single company.[113] While the resulting legislation in these cases may address the needs of a broad range of interests associated with the company in question, however, this argument fails to consider the impact of takeover activity on the broad spectrum of corporations and constituencies that might be affected. Again, the legislation is portrayed as the product of concern for some particular interest rather than as an effort to craft a general solution to a general problem.

In at least some cases in which this claim has been made, however, investigation has revealed that the legislation enjoyed the support of a broadly based coalition.[114] Further, like Romano's thesis, this criticism oversimplifies the motivations of both the corporate sponsors of the legislation and the legislators themselves. It presumes that the affected corporation seeks takeover legislation solely for the benefit of those who depend on that specific corporation, without any regard for other similarly situated corporations and constituencies that also will benefit from the legislation. This argument also presumes that legislators rush blindly to do the bidding of a powerful resident corporation, heedless of the broader public policy

113. *See, e.g.,* Butler, *Corporation-Specific Anti-Takeover Statutes and the Market for Corporate Charters,* 1988 WIS. L. REV. 365.

114. *See* Davis, *Epilogue: The Role of the Hostile Takeover and the Role of the States,* 1988 WIS. L. REV. 491, 493-500.

considerations at stake. The impetus for *any* legislation, however, is often a particular event involving a limited cast of characters that nevertheless reveals the need for a broadly applicable legislative response. Such origins may lead to undue haste and various attendant shortcomings of policy or drafting, but such origins should not lead one to conclude that the legislation disserves the public interest for that reason alone. Indeed, the magnitude of a particular takeover threat may dramatize the extent of a general problem previously only dimly perceived. Legislators are aware that a statutory reaction to a particular set of circumstances will have effects well beyond the situation at hand. It is more sensible, therefore, to presume that such effects are an important component of the legislative strategy.

Questions about motivation will continue to attend takeover enactments. Those opposed to such laws no doubt will continue to depict them as mere entrenchment devices passed solely for the benefit of locally powerful corporations and those who manage them. Such characterizations deserve skepticism. To the extent they are accurate, however, they should not be allowed to obscure the broader issue of the significance of what these laws represent. Regardless of whether takeover legislation responds to parochial, short-sighted concerns, its impact is potentially much broader. Moreover, whatever state legislators have actually been up to, the fact remains that these laws represent a significant departure from long-standing assumptions about the proper objectives and beneficiaries of corporation law.

B. *Efficacy*

In addition to concerns about motivation, some question whether takeover statutes represent serious efforts to achieve their objective of protecting nonshareholders. That objective may be clear, but whether the statutes include effective mechanisms for its realization is not. Most statutes seek to protect nonshareholders simply by discouraging certain kinds of hostile takeovers or takeovers in general. Thus, the control share acquisition statutes increase the time necessary to complete a takeover and raise uncertainty about whether the bidder can exercise its controlling position once achieved. Business combination statutes impose a moratorium on transactions that motivate "bust-up" takeovers. Under either type of statute, however, a hostile bidder may be able to circumvent statutory obstacles by making a sufficiently attractive offer to target shareholders. If a control share acquisition statute applies, a bidder may condition its offer on shareholder approval of its voting rights. Similarly, business combination laws typically empower management to waive the statutory restriction; management might be persuaded to do so—indeed might be required to do so by fiduciary principles—if a bidder offers a high enough price per share. In Delaware, the prohibition will not apply if the bidder succeeds in obtaining eighty-five percent of outstanding stock. The effect of control share acquisition and business combination statutes, therefore, is not to prevent hostile takeovers entirely. Rather, the states probably will deter at least certain kinds of takeovers *ex ante*. As a result, the incidence of hostile bids may decline, but by some as yet unknown amount.

Because these statutes will not necessarily prevent all harmful takeovers, they will have an unpredictable, hit-or-miss effect. And, in those harmful takeovers that occur despite statutory obstacles, the bidder's higher costs will take the form of higher stock premiums and transaction costs. Thus, target shareholders, investment bankers, and legal counsel will benefit from the increased costs, but stakeholders and other nonshareholders affected adversely will not. Accordingly, control share acquisition and business combination statutes are an imperfect route to the objective of protecting nonshareholders.

As noted above, some statutes make the relevance of nonshareholders' interests explicit and attempt to provide a mechanism by which those interests will be considered. While such laws address nonshareholders' interests more directly, they too are defective. Control share acquisition statutes vest shareholders with the ultimate power to decide whether a particular hostile bid will succeed. Because there is no reason to expect that shareholders faced with an attractive premium will vote to deny voting rights because they are concerned about possible loss of jobs or other effects, provisions instructing the board to consider such matters probably are ineffective. Even if business combination statutes vest decisionmaking power in the board and another statute instructs the board to consider nonshareholders' interests in reacting to a hostile bid, the lack of direction with respect to evaluation of effects on shareholders and nonshareholders is a crucial defect. If the interests of shareholders and nonshareholders conflict, which will be the case whenever an attractive premium is offered and plant closings or other disruptive events appear likely, the absence of any guidance as to how various interests of nonshareholders and shareholders are to be evaluated renders the success of the legislature's objective of protecting nonshareholders wholly speculative. Especially if consideration of nonshareholders' interests is merely permissive, it is not possible to predict whether or how nonshareholders' interests will be valued in particular cases. Moreover, even if the provision is mandatory, the lack of any clear guidance remains a basic defect.

Statutes that empower the board to take nonshareholders' interests into account in responding to hostile takeovers present a further difficulty. Such a statutory mandate threatens to clash with the board's traditional, common law fiduciary duty to maximize shareholders' wealth.[115] If the statute requires consideration of nonshareholders' interests, as Arizona's statute does, the legislature has resolved that conflict. In the other states, however, the statutory mandate is merely permissive. As to these laws, one might argue that, if a statute permits directors to sacrifice shareholders' welfare in favor of nonshareholders' concerns, the statute abrogates the common law to that extent. However, little evidence suggests that the state legislatures have given any thought to this question. In other words, because the legislators appear

115. This argument is fully developed in Johnson, *The Eventual Clash Between Judicial and Legislative Notions of Target Management Conduct*, 14 J. CORP. L. 35 (1988).

to have been unaware that they had enacted statutes that conflicted with preexisting law, one should be reluctant to infer an intent to abrogate basic common law principles. Under these circumstances, therefore, it is far from clear which norm—traditional shareholder primacy or the broader protection of nonshareholders' interests—should guide target company directors confronted with "bust-up" takeovers and the like.[116]

The pressures on the board to look after shareholders may well be irresistible. That is, confronted with a situation in which a statute and perhaps even common law allow the board to resist a takeover because of its harmful impact on nonshareholders, the board will be reluctant to resist on that ground. Ultimately, of course, existing corporation law leaves management accountable solely to shareholders. To defeat an offer that would generate high stock premiums certainly would jeopardize management's position at the next board election. Furthermore, even if applicability of the traditional shareholder primacy norm is questionable, the possibility of liability may well be sufficient to generate a shareholders' derivative action. In contrast, nonshareholders do not vote for directors and—presumably—lack standing to challenge board actions under recent statutes that recognize nonshareholders' concerns, just as they lack standing under traditional corporation law. Doubts about the constitutionality of the statutory

116. Even if takeover statutes do not abrogate the common law principle of shareholder primacy, there may be another reason why the conflict between statutory and common law is not as stark as I have presented it. At least in some jurisdictions, inklings exist of a common-law principle that would allow or even require the board to take nonshareholders' interests into account in the takeover setting. For example, in *Unocal v. Mesa Petroleum Co.*, the Delaware Supreme Court referred to the board's duty to evaluate the threat "to the corporate enterprise" that a takeover presents. Unocal v. Mesa Petroleum Co., 493 A.2d 946, 955-56 (Del. 1985). Besides considering such factors as adequacy of the tender offer price and other issues of concern to shareholders, the court stated that the board also may weigh "the impact on 'constituencies' other than shareholders (i.e., creditors, customers, employees, and perhaps even the community generally)." *Id.* The court recently noted its adherence to this principle in another decision, Ivanhoe Partners v. Newmont Mining Corp., 535 A.2d 1334, 1341-42 (Del. 1985), and other jurisdictions follow this approach. *See* Gearhart Indus. v. Smith Int'l, 741 F.2d 707 (5th Cir. 1984) (applying Texas law); Course-Hinds Co. v. InterNorth, Inc., 634 F.2d 690 (2d Cir. 1980) (applying New York law); Treadway Cos. v. Care Corp., 638 F.2d 357 (2d Cir. 1980) (applying New Jersey law); Berman v. Gerber Prods., 454 F. Supp. 1310 (W.D. Mich. 1978) (applying Michigan law).

Yet, what the *Unocal* principle means in a concrete situation is far from clear. The Delaware Supreme Court said little about how the board should weigh the respective interests of shareholders and nonshareholders if they conflict. In a more recent case, the only case in which the issue actually has been presented, the court determined that the circumstances of the takeover bid required the board to look solely to the shareholders' interests and subordinate the competing interests of a class of nonshareholders; once sale of the company appears inevitable, the board's duty is to auction the company to the highest bidder. Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1986). This rule, recently reiterated in Ivanhoe Partners v. Newmont Mining Corp., 535 A.2d 1334, 1345 (Del. 1985), significantly limits the applicability of the *Unocal* principle, denying the board any authority to consider nonshareholders' interests in these auction situations. Because some statutes arguably authorize defensive measures for the sake of nonshareholders even after Revlon's auction rule, such statutes conflict with the common law to that extent.

mandate also may discourage management's reliance on it. If confronted with a "bust-up" bid, management will take into account the likelihood that it will lose its position if the bid succeeds. While these concerns might prompt the board to seek refuge in state law authorizing defensive measures for the benefit of nonshareholders, "golden parachutes" or other similar financial incentives often will mitigate concerns about loss of jobs.[117] Thus, although good reasons exist why management might choose not to deploy defensive powers granted by takeover statutes, few compelling reasons favor such action. Accordingly, present state efforts to protect nonshareholders through empowerment of the board of directors may prove to be futile.

Like the question of motivation, doubts about whether takeover laws will achieve their objectives have no bearing on the significance of these legislative developments in light of existing assumptions about the purpose and scope of corporation law. By challenging the shareholder primacy principle in order to protect nonshareholders, the states depart from orthodox assumptions. This departure parallels nineteenth-century thinking about corporation law's responsibility to address questions of broad social and political concern.

CONCLUSION

Corporation law of the later nineteenth century differed in fundamental ways from the body of law that we are accustomed to today. Most notably, it sought to regulate particular features of corporate activity that contemporaries viewed with distrust. For nineteenth-century Americans, these concerns centered on the perceived ability of corporations to accumulate threatening economic and political power and the possibility that the privileges of corporate status might be exercised irresponsibly, to the detriment of employees and other creditors. No one believed that shareholders' desire to maximize the value of their investments ought to provide the central postulate from which the various rules and principles of corporation law should follow. Recent state statutory developments in the hostile takeover area parallel this older way of thinking about corporation law. While the particular policy concerns and statutory solutions are different, the assumptions about the scope and purposes of corporation law are similar. Although there is no reason to believe that the legislators are aware of the implications of what they are doing, they are in effect challenging reigning assumptions about the shareholders' central position in corporation law and policy. Once again, state legislators are using corporation law to impose restrictions on corporate activity and are redefining certain attributes of corporate status in a manner designed to accomplish important social and political objectives.

If courts were to strike down current legislation on constitutional grounds, they would require state legislators to decide whether to start from

117. A survey published in 1982 concluded that over 60% of the top executives of the 1,000 largest corporations had golden parachutes in place. *Loose Ends*, FORBES, Nov. 22, 1982, at 238. Since then that figure no doubt has increased.

scratch in attempting to protect nonshareholders from the disruptive effects of hostile takeovers. The extent of state legislators' commitment to those concerns would be put to the test. Even aside from the question of constitutionality, should present laws prove ineffective, legislators would confront the same test. To replace a control share acquisition or business combination statute with a new form would require careful consideration of policy questions and a creative approach to formulation of new solutions. How strong a commitment to nonshareholders would emerge from such efforts is by no means clear. And whether corporation law—rather than some regulatory approach external to the corporate statute—would continue to provide the vehicle for these protectionist goals is also unclear. Accordingly, it remains to be seen whether, if recent developments do represent a broader view of the purposes and scope of corporation law, the states are serious about challenging settled assumptions. And, if the challenge is real, it also remains to be seen whether that challenge will extend beyond the particular subject of hostile takeovers to other areas of corporation law.

Ultimately, whether we are witnessing a rebirth of a broader conception of corporation law as a tool for regulating the impact of corporate activity on society will depend on a deeper question. Competing visions of what corporations are and who the beneficiaries of corporate activity should be underlie the debate about the desirability of takeovers and the appropriate role for state legislation.[118] In effect, the states may be in the process of reviving an older conception of the corporation as an entity created by the state for the benefit of the public. That notion legitimates the imposition of regulations on the relationship between the corporation and society, or on the relationship between the corporation and certain constituencies whose welfare is threatened by particular features of corporate activity. The idea of the corporation as a public institution contrasts sharply with the now conventional view of the corporation as a private entity entitled—indeed required—to regard as paramount the welfare of its shareholders, as the corporation's owners, and no one else.

The states also may be unwitting participants in the creation of a new theory of what corporations are. Older debates focused on whether the corporation was an entity separate and distinct from its shareholders or, instead, merely an aggregation of owners no different from a partnership.[119] The emerging theory also may perceive the corporation as an aggregation rather than as a separate entity—but an aggregation that includes not only shareholders but various nonshareholders involved in the corporate enterprise. This concept thus legitimates efforts to confer protections on nonshareholders through corporation law.

As the states continue to wrestle with the difficult questions of law and policy that takeover legislation engenders, commentators will continue to

118. *See generally* Johnson, *Corporate Takeovers and Corporations: Who Are They For?,* 43 WASH. & LEE L. REV. 781 (1986).

119. *See* Horwitz, *supra* note 22.

criticize departures from pure shareholder primacy. For many, these developments appear almost heretical—a radical rejection of basic, canonical ideas about the proper—and necessary—structure of corporation law. Such critics are correct in seeing these developments as a serious threat to established assumptions about the basic objectives of corporation law. Yet, potentially far-reaching and destabilizing as this change in perspective may be, it is not unprecedented. Whether state legislators know it or not, the assumptions underlying recent legislation represent the rebirth of an older tradition that the present shareholder-centered regime itself displaced during the early decades of this century. Thus, the basic assumptions regarding the purpose and scope of corporation law that recent takeover legislation appears to challenge are themselves neither inevitable nor necessary.