Washington and Lee Law Review

Volume 43 | Issue 3 Article 2

Summer 6-1-1986

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Recommended Citation
Lyman P. Q. Johnson, *Corporate Takeovers And Corporations: Who Are They For?*, 43 Wash. & Lee L. Rev. 781 (1986).
Available at: https://scholarlycommons.law.wlu.edu/wlulr/vol43/iss3/2

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WASHINGTON AND LEE LAW REVIEW

Volume 43 Summer 1986 Number 3

CORPORATE TAKEOVERS AND CORPORATIONS: WHO ARE THEY FOR?

LYMAN JOHNSON*

INTRODUCTION

There are very few active participants in corporate takeovers—directors, lawyers, investment bankers, and judges.[1] Yet their collective decisions about the fate of major corporations can greatly alter millions of lives, both near term and far.[2] What guiding vision of the modern corporation and its ultimate purpose informs the actions of these people? Do they believe the corporation's aim is to maximize entity profits, enhance shareholder wealth, behave as a good citizen, or do something else? The high stakes in takeover transactions along with mounting concern over their effects on our corporate system[3] make it fitting for both active participants and others to rethink a

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1. Except for the changing role of target company, the cast of actors in takeovers is fairly stable: until recently, only a handful of active bidders; a realtively small number of prominent law and investment banking firms providing professional advice; and of course, Delaware judges who are often implicated in many takeover attempts.

2. Mergers of large corporations and management responses to the threat of hostile acquisition "affect stockholder profits, employee welfare, consumer choice, technological innovation, the economic base of communities, and the new capital investment plans of the nation." K. DAVIDSON, MEGAMERGERS xiv (1985).

3. Concern about takeover activity extends to the possible harmful effects of threatened as well as actual takeovers. *See, e.g.,* Coffee, *Regulating the Market for Corporate Control: A Critical Assessment of the Tender Offer's Role in Corporate Governance,* 84 COLUM. L. REV. 1145, 1221-50 (1984) (comprehensive explication of diseconomies associated with frequent takeover activity); Williams, *It's Time for a Takeover Moratorium,* FORTUNE, July 22, 1985, at 133-34 (expression of concern about takeover activity by former Securities and Exchange Commission Chairman). *See infra* Section B of Part III.

basic question: "Whose interests, really, do we expect corporations and their managements to serve?"[4]

This question—particularly for those companies actually embroiled in takeovers, but pertinent to others as well—is especially timely in light of three recent developments. First, there is a discernible effort by courts to require greater management allegiance to shareholder interests in takeovers.[5] Second, with increasing frequency management seeks to "pre-empt" takeover threats by leveraging and restructuring corporations for the purpose of making substantial distributions to shareholders.[6] Third, while shareholders clearly benefit from such preemptive efforts and from takeover-generated premiums, there are growing concerns and evidence that other interests vitally dependent on significant corporations, including society's interest in an efficient use of its resources, may not be well served.[7]

How one responds to these developments depends on one's expectations of corporate behavior. For those who have long decried management's lack of meaningful accountability to shareholders, greater attentiveness to investor well being is good news. In fact, by resolving that great bugaboo of corporate governance—how to discipline an autonomous, unresponsive management[8]—takeovers may restore shareholders to a place of central importance in the corporation.[9] For those who are equally concerned that corporations be managed to serve a variety of noninvestor interests, the developments are potentially disturbing.[10] If there is a clear divergence of investor and impor-

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4. The subject of corporate objectives and responsibility, while of ongoing interest, resurfaces with especial intensity at various times. Periodically, as in the 1930's and 1970's, the legitimacy of corporate power is challenged and defended as society at large seeks reassurance that the benefits of corporate social and economic power outweigh resulting problems. *See* Buxbaum, *Corporate Legitimacy, Economic Theory, and Legal Doctrine,* 45 OHIO ST. L. J. 515, 517-20 (1984). The frenzy of takeover activity in the past decade, along with public confusion over whether such activity is generally good, again have raised the subject of corporate purpose.

5. *See infra* Section C of Part II.

6. *See infra* Section B of Part III.

7. *See infra* Section A of Part III.

8. Since Berle and Means, the central issue in corporate law has been the governance ramifications of the separation of ownership and control in public corporations. A. BERLE & G. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY (1932).

9. *See, e.g.,* Gilson, *A Structural Approach to Corporations: The Case Against Defensive Tactics in Tender Offers,* 33 STAN. L. REV. 819, 841 (1981) ("Indeed, . . . the market for corporate control may be the only potentially serious force for limiting management discretion."); Weiss, *Economic Analysis, Corporate Law, and the ALI Corporate Governance Project,* 70 CORNELL L. REV. 1, 27 (1984) ("[T]he market for corporate control in general, and tender offers in particular, are the most important disciplinary factors in the corporate governance system, and should be encouraged.")

10. It is increasingly recognized that there are many groups in society that have a strong interest in the activities of large corporations, and many contend that the claims of at least certain of these groups ought to be expressly considered in models of corporate decisionmaking. *See, e.g.,* M. AOKI, THE CO-OPERATIVE GAME THEORY OF THE FIRM (1984) (proposing cooperative game theory of firm in which both shareholders and employees are members). This being the

tant noninvestor interests,[11] then for these people the basic issue is whether the wealth and governance gains to shareholders are "worth" the perceived costs of takeovers. That evaluation requires a judgment as to exactly which interests corporations facing or expecting a hostile takeover should further—only those of capital providers, or a wider field of claims.

Even more fundamentally, a divergence of interests raises the possibility that current decisionmaking mechanisms do not equip beleaguered corporations to achieve what is best for shareholders while also suitably serving the interests of other claimants. If that apparatus is unable to accommodate investors and a broader base of constituents, then either a hard choice of preferred interests must be made, or new decisionmaking arrangements better able to reconcile various considerations must be sought.

For several reasons much commentary on the governance implications of takeovers has neglected the critical question of corporate objectives. First, courts have been so lenient in examining a target corporation's defensive

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case, there is increasing uneasiness with the following traditional premise:

> the stockholders are the corporation, and undivided loyalty is owed to the stockholders. If the corporation is viewed simply as a collection of capital pooled for the purpose of profits, then the premise is plausible; the sole interest of the corporation is gain for the shareholders. This is the traditional conception of the corporation. There is, however, substantial doubt that this is an adequate conception of the modern business corporation. There is an increasing weight of opinion that the corporation should be viewed as a social and economic institution which has interests other than those of the shareholders that it can and ought to serve.

Summers, *Codetermination in the United States: A Projection of Problems and Potentials*, 4 J. COMP. CORP. L. & SEC. REG. 155, 170 (1982). For another challenge to the traditional view that a corporation is an economic institution existing only to bring gain to its shareholders, see White, *How Should We Talk About Corporations? The Language of Economics and Citizenship*, 94 YALE L. J. 1416 (1985). Professor Eisenberg would classify these views as variations of a "political" model of the corporation. Eisenberg, *Corporate Legitimacy, Conduct, and Governance: Two Models of the Corporation*, 17 CREIGHTON L. REV. 1 (1983) (describing and contrasting Political and Economic Models of business firm). *Cf.* A. BERLE, THE 20TH CENTURY CAPITALIST REVOLUTION 179 (1954) ("American political thought has been frightened, and corporations themselves have been frightened, at any suggestion that they might emerge as political institutions in their own and separate right.").

11. There are, of course, a great variety of concerns about the effects of takeover activity—actual and threatened—on persons and groups other than shareholders. One way to classify many of these misgivings is to separate a concern for the effects on persons whose lives are immediately affected by a particular corporation from concerns that are more national in scope. "Stakeholders" in specific corporations such as employees, suppliers, creditors, customers, and local enterprise-dependent communities fall within the former category. Diversion of credit to unproductive uses, narrow management focus on short run economic performance, inordinate use of debt, and waste of society's resources are oft-cited concerns about takeovers that fall within the latter category. Obviously, the distinction is somewhat artificial since many corporate activities affect both categories. Nonetheless, it serves as a reminder that while there are many persons and groups interested in the fate of individual corporations, there is also a larger societal concern about the cumulative effects of takeover activity. In this article, the term "noninvestor" is used to refer to such nonshareholder interests. The term is not meant to imply, however, that such interests are not "invested" in the entity simply because money capital has not been contributed to the corporation.

measures that commentators understandably have emphasized the need for stricter judicial scrutiny of those actions.[12] The question of exactly which interests management should favor can arise only if courts are willing to provide meaningful review of management's takeover behavior. That has happened only recently. Second, many commentators assume that, at least over the nebulous "long run," shareholder and other important interests generally coincide.[13] They argue that by devotedly seeking to maximize stockholder wealth as measured by share prices, management also furthers the collective welfare of society.[14] In particular, this belief is held by those who consider takeovers to be instrumental in reallocating economic resources to more highly valued uses.[15] Third, for the most part there has been no widely accepted evidence of any divergence of interests, most such claims being conjectural or anecdotal, and heretofore lacking in empirical support. Recent evidence on the adverse efficiency outcomes of many acquisitions,[16]

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12. *See infra* notes 78-80 and accompanying text.

13. The notion that, over the long run, shareholder and societal well being generally coincide is one tenet in what Professor Eisenberg calls the Economic Model of the firm: "[M]anaging the corporation in the interest of the shareholders is socially desirable in that their interest coincides with the social interest in efficiency." Eisenberg, *supra* note 10, at 5. Professor Stone considers the belief that maximization of shareholder wealth also maximizes the collective good to rest on "a crude sort of utilitarianism." Stone, *Corporate Social Responsibility: What it Might Mean If it Were Really to Matter,* 71 IOWA L. REV. 557, 570 (1986).

14. Professor Demsetz has testified that "takeovers and tender offers serve the interests of both shareholders and the nation." *Securities and Exchange Commission Proceedings: Economic Forum on Tender Offers* 16 (February 20, 1985) (statement by Professor Demsetz) (copy on file at the Washington and Lee Law Review office) [hereinafter cited as *SEC Economic Forum]*. The Annual Report of the Council of Economic Advisers for 1985 also concluded that takeovers both increased national wealth and enhanced shareholder well being:

> The available evidence, however, is that mergers and acquisitions increase national wealth. They improve efficiency, transfer scarce resources to higher valued uses, and stimulate effective corporate management. . . . The evidence is overwhelming that successful takeovers substantially increase the wealth of stockholders in target companies.

Economic Report of the President, transmitted to Congress together with the Annual Report of the Council of Economic Advisors, February, 1985, at 196-197 [hereinafter cited as 1985 Economic Report]. These views are excellent examples of a principal tenet of the Economic Model of the firm described by Professor Eisenberg. *See supra,* notes 10, 13.

15. *Id. See also,* Bradley and Rosenzweig, *Defensive Stock Repurchases,* 99 HARV. L. REV. 1378, 1410-11 (1986). Whether takeovers in fact usefully reallocate resources is a critical question. Orthodox economic theory holds that profit maximizing behavior has that allocative effect. Not only does successful profit maximizing behavior redound to the benefit of shareholders in the form of higher stock prices, higher net prices of the acquiror and target shares as a result of a takeover are reasoned to reflect gains in allocative efficiency. *Infra* notes 139-40 and accompanying text. This is a theoretical claim. If, however, takeover-induced stock price movements have causes other than misallocated resources, then the supposed connection between shareholder gain from stock premiums and society's gain in efficiency is broken. That is not to say that profit maximizing behavior does not result in an efficient use of resources, but simply to suggest that seeking to maximize shareholder wealth as an independent end by generating takeover premiums may not lead to the same result.

16. *See infra* Section A of Part III.

however, along with Professor Coffee's suggestion that management preemptive measures may bode badly for noninvestors,[17] should re-open this issue.

Fourth, were any divergence of interests demonstrated, many believe that shareholders alone are the proper constituency of corporate management.[18] Without question there are serious difficulties associated with the oft-advanced view that management should serve as a kind of Platonic guardian for noninvestor interests.[19] Yet, reducing corporate activity to the monistic pursuit of shareholder gain by conceiving the business enterprise as a two-party venture of shareholder and management is not without problems of its own. For example, it is not always made clear exactly why short-term speculators or any investors seeking to liquidate their investment en masse should, as nominal "owners,"[20] have a right to determine the fate of an enterprise they wish to leave.[21] Conceding that management should consci-

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17. *See infra* Section B of Part III.

18. Coffee, *supra* note 3, at 1216-1221. Other commentators believe that shareholder interests and society's desire for efficiency coincide, and that shareholders are the sole constituency of management. Easterbrook and Fischel, *The Proper Role of a Target's Management in Responding to a Tender Offer,* 94 HARV. L. REV. 1161, 1190-92 (1982); Gilson, *supra* note 9, at 862-865.

19. Several commentators have argued that management may consider the interests of nonshareholder constituencies in formulating takeover responses. *See, e.g.,* Lipton, *Takeover Bids in the Target's Boardroom,* 35 BUS. LAW. 101, 105-06, 117, 122 (1979); Steinbrink, *Management's Response to the Takeover Attempt,* 28 CASE W. RES. L. REV. 882, 899-900, 902 (1978); Speech by Harold M. Williams, "Tender Offers and Corporate Directors," *reprinted in* [1979-1980 Transfer Binder] FED. SEC. L. REP. (CCH) 82,445, 82,445; McDaniel, *Bondholders and Corporate Governance,* 41 BUS. LAW. 413 (1986) (arguing that directors should have fiduciary duty to bondholders); Steinberg, *Some Thoughts on Regulation of Tender Offers,* in TENDER OFFERS: DEVELOPMENTS AND COMMENTARIES 273, 283 & n.41, 293-94 & nn.82-85 (M. Steinberg ed. 1985) (arguing that management should be entitled to consider noninvestor interests if it can prove that a tender offer threatens deserving interests). *See also,* Greene & Junewicz, *A Reappraisal of Current Regulation of Mergers and Acquisitions,* 132 U. PA. L. REV. 647, 717-18, 732-739 (1984); Sommer, *Hostile Tender Offers: Time for a Review of Fundamentals,* in TENDER OFFERS: DEVELOPMENTS AND COMMENTARIES 251, 264-68 (M. Steinberg ed. 1985) (suggesting that state corporate statutes envisioned role for directors in acquisitions as voice for entity that would temper tendency of shareholders to vote selfishly).

20. Many commentators no longer view shareholders as "owners" of the corporation in the traditional sense. *See* N. WOLFSON, THE MODERN CORPORATION, 40-41 (1984) (shareholders are risk takers); Baysinger & Butler, *Race for the Bottom v. Climb to the Top: The ALI Project and Uniformity in Corporate Law,* 10 J. CORP. L. 431, 433 n.9 (1985) (same); Easterbrook & Fischel, *Voting in Corporate Law,* 26 J. L. & ECON. 395, 396 (1983) (shareholders are no more "owners of firm than bondholders or employees); Kripke, *The SEC, Corporate Governance, and the Real Issues,* 36 BUS. LAW. 173, 177 (1981) (typical shareholder does not think of himself as owner, but as investor free to invest and disinvest without loyalty to entity). Nonetheless, the "ownership" model of the shareholder's relationship to the corporation still pervades the law. Soderquist & Vecchio, *Reconciling Shareholders' Rights and Corporate Rsponsibility: New Guidelines for Management,* 1978 DUKE L.J. 819, 823-24.

21. If shareholders do not "own" the corporation (only its stock) then their claim on the corporation does not stem from property rights, but from their position as risk bearers. Kripke, *supra* note 20, at 177-78. Yet, in many takeovers, particularly "break-up" acquisitions, others

entiously seek long run profit maximization for the entity, thereby enhancing shareholder wealth, does not logically entitle shareholders as a body to shorten the time frame of their investment and essentially withdraw their capital from the business when a tender offer is presented. While alienability of stock and free movement of capital generally are desirable, allowing shareholders to impose the consequences of an altered liquidity preference on those with less mobile resources, even in the name of "ownership" prerogative, is not without costs.[22] This whole issue of the nature and strength of a shareholder's claim on a corporation in the takeover setting needs reexamination.[23]

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also face risk; specifically, the risk, unrewarded by the prospect of a stock premium, that shareholders will change management-established corporate policy either directly by selling their stock to a bidder or, indirectly, by inducing management to make changes in its policy out of fear of such a sale. *See infra* Section B of Part III.

22. Certain of the costs associated with unlimited nobility of capital may not be economic or quantifiable. For example, diversion of management time and attention from pressing business issues is one cost in a highly competitive international marketplace. Another cost is the lessening of corporate loyalty, an important but intangible factor in business success. As takeovers and efforts to avoid them lead to large employee layoffs, the result is a substantial reduction in employee morale: "We used to be a community—employees, shareholders, lots of groups. We were committed to this company. . . . Now it's clear there is only one important group—the shareholders." Remarks of long-time Exxon Corporation employee, as quoted in *The End of Corporate Loyalty?* Bus. Wk., August 4, 1986, at 42, 44. *See* Baldwin, *The takeover boom: An employee speaks out,* The Christian Science Monitor, July 28, 1986 at 14. *See also* Kelley, *Allowing the Factory Shutdown: Proposed Legislation as Justification,* 2 Notre Dame J. of L. Ethics and Public Policy 329, 332-333 (1985) (describing costs to employees and communities associated with abrupt plant closings).

Another more visible cost is the extraordinary professional fees that are paid in many transactions. For example, it has been estimated that the Safeway takeover fracas will result in the payment of approximately $150 million in lawyer, banking and other fees. Mayer, *Deal Makers Cashing In On Takeover Mania,* Wash. Post, Aug. 10, 1986, at K1.

23. American Law Institute's Principles of Corporate Goverance: Analysis and Recommendations § 2.01 (Tent. Draft No. 2, 1984) (tentatively adopted at the May, 1984 ALI meeting) [hereinafter cited as Principles of Corporate Governance]. Section 2.01 of the *Principles of Corporate Governance* deals with corporate objectives and reads in part,

> "[a] business corporation should have as its objective the conduct of business activities with a view to enhancing corporate profit and shareholder gain."

By describing the "economic objective" of the corporation in this dual manner, the section suggests that corporate profit and shareholder gain are not identical. Yet, the section does not deal with possible "tensions between corporate profit and shareholder gain," leaving those to be "dealt with in Part VI [corporate control transactions] and elsewhere." *Id.,* comment e.

Presumably, in operating decisions maximizing corporate profits also enhances shareholder gain. Moreover, many economists believe that increasing shareholder wealth is desirable because such a focus also results in an efficient use of resources. This position is reflected in the remarks of Professor Oliver Williamson of Yale University who serves as one of two economic advisers to the *Principles of Corporate Goverance* project and who believes that shareholder gain should be the only corporate aim:

> Maximization of shareholder gain has a much sharper edge [than maximizing long-run corporate profit]. Put differently, maximization of long-run corporate profits has embedded in it more degrees of freedom. I think that the integrity of the enterprise mode of organization is better protected by adhering to the stockholder gain criterion,

Finally, many observers contend that any untoward consequences of a corporation's singular focus on shareholder well being are the province of "public policy," not "private" decisionmaking.[24] As long as management's is the only private voice, this position may be understandable. Nonetheless, public policy, coming as it does from wholly outside the enterprise, often deals in aggregates, and can sometimes be a blunt and overinclusive instrument of relief. Unless takeovers are monolithic in origin and outcome, at crucial points in the takeover process each transaction must be assessed individually, a task that may benefit from the airing of multiple perspectives. Thus, those philosophically opposed to intrusive public action in corporate activity might be expected to seek eagerly for novel ways of attaining greater "private" rather than "public" influence on this issue.

In any event, despite Congressional interest in hostile takeovers in 1984-85,[25] federal takeover policy remains narrowly—and apparently unalterably—concerned with investor well being.[26] Moreover, constitutional objections

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> recognizing that such maximization is subject to certain legal, ethical, and social cost constraints.
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> My argument here relies on the underlying proposition that the corporation is preeminently an engine of efficiency. Restriction of the objective of the corporation to stockholder gain preserves this emphasis. . . . I think that if you are interested in an economist's orientation to this subject, that that probably is not uniformly shared but widely shared.

Remarks of Professor Williamson, 59 A.L.I. PROC. 426 (1982). *See also* THE CORPORATE ECONOMY xxii (R. Marris & A. Woods, eds. 1971) ("From a 'classical' viewpoint, 'correct' behavior by managers in general should be aimed at maximizing at all times the aggregate value of all equity shares. . . .").

Whatever the case in operating decisions, what if requiring corporations to maximize shareholder gain in takeovers does not result in a more efficient use of resources? Or what if it does so, but with an abruptness that imposes other costs? What then is the corporate objective? While many interests can be accommodated in the looser goal of long-run profit maximization, the "sharper" aim of shareholder gain once a corporation is, or perceives itself to be, a takeover target may prevent rather than achieve efficiency or other social good. If so, an important underpinning for retaining that corporate objective in takeovers falls away, leaving shareholder gain as its own justification. The question then is whether that alone is a sufficient basis for deciding how corporations should respond to takeovers. While § 2.01 does not address the possibility of such a divergence of interest, it will be a very real issue in Part VI of the *Principles of Corporate Governance*, particularly if shareholder interests continue to find allies in court. *See infra* Section C of Part II.

24. *See, e.g., SEC Economic Forum, supra* note 14, at 16 (statement by Professor Demsetz); Coffee, *supra* note 3, at 1220-21; *see also* Kripke, *supra* note 20, at 184-86.

25. *See* Matheson and Norberg, *Hostile Share Acquisitions and Corporate Governance: A Framework for Evaluating Takeover Activities*, 47 U. PITT. L. REV. 407, 414 n.19 (1986) (description of recently introduced legislation regarding hostile takeovers). Indicative of the complexity of the takeover issue is the remark of Congressman Timothy Wirth, Chairman of the House Subcommittee on Telecommunications, Consumer Protection and Finance, House Committee on Energy and Commerce, who has held extensive hearings on the subject of corporate takeovers: ". . . the more I know about the issue, the less sure I am about what to do." Phillips, *Congress Responds to Hostile Tender Offers*, The Bus. Law. Update, September/October 1985, at 3.

26. The Williams Act, 82 Stat. 454 (1934), (codified at 15 U.S.C. §§ 78(m)(d)-(e) and

have continuted to frustrate state legislation aimed at providing some consideration of noninvestor interests in the post-MITE era.[27] Thus, unavoidably, management, its advisers, and courts are left to fashion piecemeal answers to the question of appropriate corporate behavior and objectives.

That this responsibility has utlimately fallen to judges became very clear when the Delaware Supreme Court held in *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.* that, once a target company is acknowledged to be for sale, the directors' sole duty is to obtain the highest premium for shareholders, regardless of the effect of such action on other constituencies.[28] While the *Revlon* facts involved an inevitable corporate break-up and director conflict of interest, the language of the opinion is broad, and the Court enunciated clear limitations on the place of noninvestor factors in director deliberations.

Given the turmoil that takeovers have caused in corporate life and corporate law, it seems appropriate to reconsider the issue of corporate purpose. Assessing the utility of a phenomenon (takeovers) or the legitimacy of an institution (corporations) is easier if there is a clear sense of what is expected of them. Perhaps takeover activity is a great boon, not only enriching shareholders, but hastening the inevitable process of economic readjustment for the eventual good of society. On the other hand, perhaps the very speed with which such activity causes readjustment is its greatest drawback, a more orderly realignment providing time for thoughtful adaptation to change. The purpose of this Article is not to argue for a particular objective for corporate behavior, say preferring investor over noninvestor considerations, or vice versa. Instead, the aim simply is to argue that the three developments noted earlier coalesce to raise the issue of corporate purpose, and that this issue must be confronted to assess and deal with takeover activity effectively.

Part I briefly surveys an earlier debate, prompted by the Berle-Dodd exchange, on the proper focus of corporate management. Professor Dodd's position, published at a time of widespread disenchantment with the corporate institution, was that managers of the modern public corporation must act as "trustees" for a variety of interests. This view was contrary to a central tenet of economic orthodoxy—that shareholder wealth maximization is the proper aim of management. Yet, for various reasons, corporate law

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78(n)(d)-(f)). The Williams Act clearly has as its aim the protection of investors. *Id. See* Edgar v. MITE Corp., 457 U.S. 624, 633 (1982) (Illinois Business Take-Over Act held to impose impermissible burden on interstate commerce); Bradley and Rosenzweig, *supra* note 15, at 1401-1407.

27. *See* Johnson, *Minnesota's Control Share Acquisition Statute And the Need For New Judicial Analysis Of State Takeover Legislation,* 12 WM. MITCHELL L. REV. 183, 191-92 n.29 (1986) (collecting decisions); *see also* Dynamics Corporation of America v. CTS Corporation, 794 F.2d 250 (7th Cir. 1986) (Indiana Control Share Acquisition statute unconstitutional), *cert. granted,* 55 U.S.L.W. 3233 (1986); Fleet Aero-Space Corp. v. Holderman, 796 F.2d 135 (6th Cir. 1986) (Ohio Control Share Acquisition statute unconstitutional); Terry v. Yamashita, 643 F. Supp. 161 (D. Haw. 1986) (Hawaii Control Share Acquisition statute unconstitutional).

28. Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1986).

has provided managers with the necessary antecedent to the role Dodd envisioned for them—considerable discretion. Discussions of corporate governance have centered largely on how best to limit this discretion and assure that it is not used to the detriment of shareholders. As takeovers came to be touted for this function, however, target management often responded by contending with Dodd that indeed it was a trustee for a corporation's many constituencies and, accordingly, must resist on their behalf.[29]

Part II reviews several decisions in which management asserted that its defensive measures were designed to protect noninvestor constituencies. Until *Revlon*, and other recent decisions, courts generally upheld various defensive actions because of a failure to distinguish duty to "corporation" and duty to shareholder. *Revlon* indicates that decisional law at last may be joining economic orthodoxy and public policy in regarding shareholders as the proper constituency of management in takeovers.

While shareholders clearly win from such a judicial trend and the related development of management preemptive measures, Part III describes emerging concerns that other interests in society may lose. While evidence on how various interests fare in takeovers is still developing, there is some question of a possible divergence of interests, thereby returning us to the question of corporate purpose earlier raised by Berle and Dodd.

Part IV sketches three perspectives for dealing with a potential divergence of interests and suggests that arguing in terms of whether target management should favor one or another set of interests when making takeover-related decisions is problematic. Unless takeover activity is to be dealt with entirely at the aggregate policy level, such management-centered perspectives might fruitfully yield to an approach whereby management is not the sole decision-making body on the outcome of attempted takeovers. Again, however, the aim of this Article is largely to draw attention, not to prescribe.

I. Expectations of Corporate Behavior

A. Whose Interests Should Autonomous Management Serve?

As corporations grew larger and their business affairs more complicated in the late nineteenth and early twentieth centuries, they increasingly needed skilled managers as well as reliable sources of capital. Since Berle and Means' classic work[30] it is "conventional wisdom"[31] that those possessing manage-

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29. *See, e.g., SEC Economic Forum, supra* note 14, at 135-49, 156-58 (statement by Philip O'Connell, Senior Vice President of Champion International, testifying on behalf of The Business Roundtable); Blade, *A Takeover Debate: Jacobs v. Pentair Chief,* Minneapolis Star & Trib., June 1, 1985, at 9B (Chairman of Pentair, Inc. challenged view of Irwin Jacobs that shareholder interests should come first and asserted that companies should be managed for benefit of "stakeholders" such as employees, communities, customers, suppliers, and society as well).

30. A. Berle & G. Means, The Modern Corporation and Private Property (1932).

31. E. Herman, Corporate Control, Corporate Power 9 (1981).

ment expertise have come to play the critical role in formulating and implementing corporate policy—and in selecting their colleagues and replacements—while widely dispersed capital providers, unable to coordinate efforts to monitor management, play a largely passive role. Although separation of the ownership and management functions undoubtedly is necessary for the effective operation of a complex business, it clearly reduces the voice of the corporation's "owners."[32]

Beyond the exigencies of business practice, another reason shareholders have little say in corporate affairs is that modern corporate statutes assign them a very limited function. While shareholders formally possess the power to elect and remove directors,[33] amend the organic documents,[34] and approve fundamental changes in corporate structure,[35] often these actions also require express board involvement[36] or are effectively controlled by the board. Taken together, the separation of functions and the statutory norm, along with generally deferential judicial review of management activities, have led to a "substantial erosion of shareholder participation" in corporate decisionmaking.[37] The resulting inability of shareholders to hold management accountable for its behavior continues to trouble legal scholars.[38]

Interestingly, Berle and Means' description of the allocation of power within the corporation coincided with the assertion that such an important institution ought not be managed solely to serve shareholders anyway. Instead, Professor Dodd argued that management of public corporations must be sensitive to its new position as "trustee" for a wide array of interests, including employees, customers, and society at large.[39] In this view of management, its essential function is not merely to act as "attorneys for stockholders,"[40] but to mediate and strike a balance among the various constituencies of a corporation.[41] Professor Berle, on the other hand, insisted

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32. Certain scholars who believe that the market effectively disciplines management on behalf of shareholders might dispute the assertion that investors have little control over corporate affairs. *See, e.g.,* Wolfson, *supra* note 20, at 18 ("None of the Berle and Means' discussion, with the literal exception of one or two isolated anecdotal examples, ever proves that free-market forces do not discipline management or that control systematically uses its power to *harm* shareholders or the public."); Hetherington, *Redefining the Task of Corporation Law,* 19 U.S.F. L. REV. 229 (1985). *See infra* notes 63-73 and accompanying text.

33. *See, e.g.,* DEL. CODE ANN. tit. 8 §§ 211(b), 141(k) (1983).

34. *See, e.g.,* DEL. CODE ANN. tit. 8 §§ 109, 242 (1983).

35. *See, e.g.,* DEL. CODE ANN. tit. 8 §§ 251, 271, 275 (1983).

36. *See, e.g.,* DEL. CODE ANN. tit. 8 § 242(b)(1) (charter amendment), §§ 252-62 (merger), §§ 271-84 (sale of substantially all assets) (1983). While Delaware's corporate laws are often singled out as particularly pro-management, many other states have also provided management with considerable flexibility and discretion.

37. Buxbaum, *The Internal Division of Powers in Corporate Governance,* 73 CALIF. L. REV. 1671, 1683 (1985).

38. *Id;* Brudney, *Corporate Governance, Agency Costs, and the Rhetoric of Contract,* 85 COLUM. L. REV. 1403, 1410 n.19 (1985).

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

40. *Id.* at 1160.

41. *See, e.g.,* AOKI, *supra* note 10, at 172-73.

that all corporate powers are "necessarily and at all times exercisable only for the ratable benefit of all the stockholders as their interests appear."[42]

Thus, while it was generally undisputed that management had become largely autonomous, there was serious disagreement as to whether this autonomy was a problem lest management stray from its duties to shareholders, or an opportunity for management to better serve important non-investor interests. Whatever the proper touchstone of management behavior, one obvious danger of a management that is neither responsive to shareholders nor somehow controlled by other private or public groups is that it is free to pursue its own self-serving vision of the enterprise.[43] This concern prompted some, who both welcomed the loosened grip of shareholders on management and doubted that management itself could be dependably relied on as the instrument for socially responsible behavior, to seek new decision-making arrangements "within" the firm. Professor Chayes articulated this need as follows:

> A more spacious conception of [corporate]'membership', and one closer to the facts of corporate life, would include all those having a relation of sufficient intimacy with the corporation or subject to its power in a sufficiently specified way. Their rightful share in decisions on the exercise of corporate power would be exercised through an institutional arrangement appropriately designed to represent the interests of a constituency of members having a significant common relation to the corporation and its power.
>
> It is not always easy to identify such constituencies nor is it always clear what institutional forms are appropriate for recognizing their interests. The effort to answer those questions is among the most meaningful tasks of the American legal system.[44]

Exciting and laudable as that task may have been, it is fair to conclude that little has been done to formalize the relationship of various constituen-

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42. Berle, *Corporate Powers as Powers In Trust*, 44 HARV. L. REV. 1049 (1931). The exchange between Professors Berle and Dodd continued. *See* Berle, *For Whom Corporate Manager are Trustees*, 45 HARV. L. REV. 1365 (1932); Dodd, *Is Effective Enforcement of the Fiduciary Duties of Corporate Managers Practicable*, 2 U. CHI. L. REV. 194, 205-07 (1935). Later, Professor Dodd somewhat backed away from his initial view, stating that the concept of trusteeship was a "misnomer" and a "misleading metaphor." Dodd, Book Review, 9 U. CHI. L. REV. 538, 547 (1942). On the other hand, in 1954 Professor Berle stated that their exchange had "been settled (at least for the time being) in favor of Professor Dodd's contention." A. BERLE, THE 20TH CENTURY CAPITALIST REVOLUTION, 169 (1954). That is not to say, however, that Professor Berle considered Dodd's initial position to be the proper outcome, only that the initial position is "how social fact and judicial decisions turned out." A. Berle, *Forward*, to E. MASON, THE CORPORATION IN MODERN SOCIETY (1959) at xii. *See* Weiner, *The Berle-Dodd Dialogue on the Concept of the Corporation*, 64 COLUM. L. REV. 1458 (1964).

43. Rostow, *To Whom and for What Ends is Corporate Management Responsible?* in MASON, *supra* note 42, at 46, 62.

44. Chayes, *The Modern Corporation and the Rule of Law*, in MASON, *supra* note 42, at 25. For a critique of Professor Chayes' views, see Rostow, *supra* note 43.

cies to the internal governance of the American corporation.[45] Generally, any protection from the effects of corporate behavior provided to noninvestor constituencies has been imposed from "outside" the enterprise.[46] Thus, those who regarded the slack in management-shareholder relations as an occasion for more corporation-initiated responsible action foundered on the difficult task of translating that noble goal into organizational reality.[47]

There was an even more fundamental obstacle to the design of new arrangements to better serve noninvestor interests. Many people—notably economists—simply rejected the idea that corporations, now that management had supposedly been "freed" of its obligation to capital providers, ought expressly to serve a broader set of interests.[48] Instead, the orthodox view held that management was obliged to concentrate solely on serving the economic interests of shareholders.[49] Many believed that in so orienting itself, management ultimately advances the public welfare as well.[50] Oftentimes, however, the case for this position was made less by a convincing argument that it is socially expedient or morally "just" for corporations to maximize shareholder wealth than by contending that the goal of wealth maximization constrains management by providing clear guidance for its behavior. Friedrich Hayek expressed this viewpoint in arguing that public intervention into corporate activities would surely follow from a "trust" conception of management:

> So long as the management has the one overriding duty of administering the resources under its control as trustees for the shareholders

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45. The American corporate structure is in contrast, for example, to employee participation in corporate decisionmaking in certain European countries. *See, e.g.,* AOKI, *supra* note 10, Ch. 10. *See also* Wedderburn, *The Legal Development of Corporate Responsibility,* in CORPORATE GOVERNANCE AND DIRECTORS' LIABILITIES 3 (K. Hopt and G. Teubner eds. 1985).

46. Particular groups and interests are the intended beneficiaries of specific legislation designed to protect from the effects of corporate behavior. For example, there is anti-trust and product safety legislation to protect consumers; legislation to protect the health and safety, right to collectively bargain, and pension benefits of employees; fraudulent conveyance laws and federal bankruptcy laws to protect creditors; and state and federal legislation to protect the environment. Greater levels of such governmental action partially explain why Professor Dodd appeared to pull back somewhat from his earlier trust conception of management. Dodd, Book Review, *supra* note 42.

47. Stone, *supra* note 13, at 558-59. Professor Stone believes that the failure to propose concrete methods of achieving institutional reform is the major weakness of much of the literature on corporate responsibility. *Id.*

48. *See, e.g.,* M. FRIEDMAN, CAPITALISM AND FREEDOM, 133 (1962) (for corporate managers to do anything other than maximize profits for shareholders is "fundamentally subversive doctrine" that could "thoroughly undermine the very foundations of our free society").

49. AOKI, *supra* note 10, at 3. The dominant assumption in corporate finance is that management will concentrate solely on serving shareholder interest. *See, e.g.,* BRUDNEY & CHIRELSTEIN, CORPORATE FINANCE, 3 (2d ed. 1979) ("Many financial writers . . . [say] that the aim of the firm should be to *maximize the market price per share of its stock*—that is, to achieve the highest sustainable market value for the company's common shares."); Remarks of Professor Williamson, *supra* note 23.

50. *See supra* note 13 and accompanying text.

> and for their benefit, its hands are largely tied; and it will have no arbitrary power to benefit this or that particular interest. But once the management of a big enterprise is regarded as not only entitled but even obliged to consider in its decision whatever is regarded as the public or social interest, or to support good causes and generally to act for the public benefit, it gains indeed an uncontrollable power—a power which could not long be left in the hands of private managers but would inevitably be made the subject of increasing public control.[51]

Whatever the rationales for regarding shareholder welfare as the proper end of corporate behavior, that clearly is the predominant view of the firm. The result is that while "corporate responsibility" to a wider range of interests is a continuing concern,[52] it has stayed on the fringes of corporate law, never being worked into mainstream corporate governance discussions of the manager-investor relationship.

B. Attaining Management Loyalty to Shareholders

While conventional economic theory rejected Dodd's trust conception of management in favor of shareholder wealth maximization, that *prescription* for corporate behavior left unchanged Berle and Means' *description* of the modern corporation as providing management with considerable discretion. Thus, the major "problem" for those who accepted shareholder well being as the proper end of corporate behavior was ensuring that management diligently pursued that goal. There were two dimensions to this problem. The first concerned the question of whether it was proper at all, given the goal of profit maximization, for management to engage in such socially responsible behavior as, for example, making charitable donations of corporate funds. Since American corporations rarely have been accused of engaging in too much socially responsible behavior and, since modest amounts of such behavior are easily defended as being in the "long run" interests of shareholders, few objected to such expenditures. Consequently, the law did little to inhibit management in this area.[53]

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51. 3 F. HAYEK, LAW, LEGISLATION AND LIBERTY. A NEW STATEMENT OF THE LIBERAL PRINCIPLES OF JUSTICE AND POLITICAL ECONOMY 82 (1982). *See also* Rostow, *supra* note 43, at 67, 71; FRIEDMAN, *supra* note 48, at 133-34.

52. *See, e.g.*, Schwartz, *Defining the Corporate Objective: Section 2.01 of the ALI's Principles*, 52 GEO. WASH. L. REV. 511, 521-22 (1984); Schwartz, *Federalism and Corporate Governance*, 45 OHIO ST. L. J. 545, 545-51 (1984).

53. Engel, *An Approach to Corporate Social Responsibility*, 32 STAN. L. REV. 1, 63 (1979); Wedderburn, *supra* note 45, at 10-11. *See* A.P. Smith Manufacturing Co. v. Barlow, 13 N.J. 145, 147, 98 A.2d 581, 583, *appeal dismissed*, 346 U.S. 861 (1953). In *A.P. Smith Manufacturing Co. v. Barlow*, a charitable contribution was upheld by the New Jersey Supreme Court because present "conditions require that corporations acknowledge and discharge social as well as private responsibilities." *Id.* That decision served as a modern judicial response to the earlier pro-shareholder decision in *Dodge v. Ford Motor Co.*, 204 Mich. 459, 506-07, 170

The second aspect focused on how to prevent management from utilizing its discretion, not to act in a socially responsible manner, but to shirk or favor its own rather than investor interests. This concern arose because, economic theory aside, neither the law nor institutional reality has ever regarded management as the simple "agent" of shareholders.[54] Rather, the law has accorded management considerable discretion and flexibility in operating the corporation[55] and, in conjunction with institutional reality, also made it very difficult for investors to challenge the exercise of managerial prerogatives. Thus, there is sufficient "slack" for management both to act socially responsible—at the expense of shareholders—and to shirk and favor itself—at the expense of shareholders. Unobjectionable as limited socially responsible action might be, at least when not patently and consistently contrary to shareholder interests, shirking and self-serving behavior by management are universally rejected.[56] Such behavior is particularly offensive if engaged in more frequently than investors reasonably expect and if those who engage in such behavior are not easily held to account.

Commentators have given considerable thought to ways in which the law might better ensure management allegiance to investor ends rather than to its own. These include, among more traditional solutions, revitalized "shareholder democracy,"[57] perhaps a more likely prospect with the increased holdings of institutional investors;[58] more meaningful intra-corporate litiga-

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N.W. 668, 684 (1919) and led Professor Berle to concede that Dodd's trust concept of corporate management had prevailed. *See infra* note 42.

One practical concern raised by takeovers is whether, as a defensive measure, corporate management will reduce or forego altogether charitable and humanitarian efforts. Such efforts, if significant, might be regarded by shareholders and bidders as "fat" to be cut out at a profit. If so, the market for corporate control may make such behavior, though legally permissible under § 2.01 of the *Principles of Corporate Governance*, less likely. *See* PRINCIPLES OF CORPORATE GOVERNANCE, *supra* note 23, at § 2.01(a).

54. M. EISENBERG, THE STRUCTURE OF THE CORPORATION 2-3 (1976); Brudney, *supra* note 38, at 1428.

55. "Flexibility" for management in the operation of the corporation is the hallmark of many modern corporate statutes, including the recently revised Model Business Corporation Act. *See* Hamilton, *Reflections of a Reporter*, 63 TEX. L. REV. 1455,1455 (1986). For a critique of the *Model Business Corporation Act's* "flexibility" rationale, *see* Branson, *Countertrends in Corporation Law: Model Business Corporation Act Revision, British Company Law Reform, And Principles of Corporate Governance and Structure*, 68 MINN. L. REV. 53 (1983).

56. Brudney, *supra* note 38, at 1416, n.33 ("Although managerial literature sometimes speaks in terms of business statesmen reconciling interests of the many constituencies of the corporation, there is no suggestion that management's powers exist to permit it to favor itself;. . .").

57. A belief in shareholder democracy motivates the federal securities laws, particularly the proxy rules of the Securities Exchange Act of 1934. At the state level certain substantive provisions of corporate statutes such as cumulative voting, preemptive rights, shareholder approval of certain transactions, and prohibiting classification of directors are sometimes advocated as ways of "protecting" shareholders if not also providing them with an effective "voice." Many consider such efforts to be futile and misdirected. *See, e.g.*, Kripke, *supra* note 20, at 176 n.13.

58. While the concentration of stock in institutional hands has led some to regard

tion;[59] a federal law of corporations or of fiduciary standards to prevent states from competing for the corporate chartering business by offering lax corporate laws;[60] and closer judicial review of particular kinds of management behavior to reverse a perceived erosion of fiduciary strictures.[61] In spite of extensive discussions of governance reform, however, many still regard the modern shareholder as unfairly vulnerable to management abuse.[62]

Certain economists and legal scholars provide an altogether different view of the interplay between investor and management interests. Rejecting the search for better "rules" to eradicate management discretion, these commentators believe that shareholder and management interests are adequately aligned by various contractual and market mechanisms.[63] A complete statement of the "neo-classical" theory of the firm is unnecessary for this Article, but a brief summary of key concepts will tie this discussion of corporate purpose and corporate governance back to the takeover issue.[64]

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institutions as an effective counterpoise to management, it is not clear that they vote contrary to management interests. For example, James E. Heard, Deputy Director of the Investors Responsibility Research Center (IRRC), recently testified on the results of an IRRC study which found that many fiduciaries are voting to approve management-sponsored defensive measures. FED. SEC. L. REPORTS (CCH), No. 1173, April 16, 1986, p. 7 (testimony of James E. Heard before Energy and Commerce Subcommittee on Consumer Protection and Finance). Recently, however, the Council of Institutional Investors, a coalition of pension funds, adopted a shareholder "bill of rights" for the purpose of reasserting the role of investors in corporate decisionmaking and making corporate management more accountable to shareholders, especially in takeovers. Vise, *"Bill of Rights" Seeks to Boost Power of Shareholders,* Wash. Post, April 13, 1986, at F1. Also, T. Boone Pickens, Jr., a frequent bidder for corporations, has proposed the establishment of a non-profit organization to advocate shareholder interests. Victor, *Pickens' Plan Gets Mixed Reviews From Bar,* The Nat'l L. J., Aug. 11, 1986, at 9.

59. The ability of a corporation's board of directors to terminate derivative litigation greatly limits its present effectiveness as a constraint on managerial behavior. *See, e.g.,* Edwards, *Compelled Termination and Corporate Governance: The Big Picture,* 10 J. CORP. L. 373 (1985); Coffee & Schwartz, *The Survival of the Derivative Suit: Evaluation and a Proposal for Legislative Reform,* 81 COLUM. L. REV. 261 (1981).

60. Cary, *Federalism and Corporate Law: Reflections Upon Delaware,* 83 YALE L. J. 663 (1974). For thoughts about federal influence on corporate goverance of an earlier advocate of federal chartering *see* Schwartz, *Federalism and Corporate Governance,* 45 OHIO ST. L. J. 545 (1984).

61. Brudney, *supra* note 38, at 1434 n.80; Buxbaum, *supra* note 37.

62. Brudney, *supra* note 38, at 1434 n.80; Buxbaum, *supra* note 37.

63. Professor Hetherington, for example, considers Berle and Means' view of the corporation to be obsolete: "A new theory has arisen to challenge the orthodoxy of the Berle and Means view of the structure and goals of corporation law. This new theory . . . asserts that existing corporate arrangements should be viewed as a network of exchange transactions by which participants—managers, shareholders, and others—seek to enhance their various interests and that a theory of corporation law should be predicated on an empirically based understanding of those relationships." Hetherington, *supra* note 32, at 248. Professor Hetherington finds it "incredible that Berle and Means assigned so little importance to the role of the market in disciplining management." *Id.* at 236. For a contrasting "institutionalist" view of the relationship between the corporate system and society, drawn from Alfred Chandler's work, *see* Buxbaum, *supra* note 4, at 520-25.

64. This model of the firm is put forward by various financial economists. *See* Jensen &

The separation of ownership and management described by Berle and Means is not disputed in this theory. Such separation, however, means that shareholders—who are regarded as "principals"—must incur "agency costs" to monitor their "agents" (management) and assure fidelity to shareholder interests.[65] Since these costs diminish the value of their investment, shareholders seek to reduce them. The essential governance issue, then, is how to lower these costs most economically. These theorists assert that a variety of monitoring techniques[66] (e.g., independent directors or audit committees) and a variety of contractual devices may be utilized to align management and investor interests.[67]

Furthermore, various markets, such as the markets for capital and management services,[68] but especially the market for corporate control, play a vital role in reducing agency costs and assuring management loyalty. Many now believe that the "market for corporate control," first fully described by Dean Manne in 1965,[69] is the chief means for providing management accountability.[70] Since Manne believed that the price of a corporation's stock reflects managerial efficiency, a low price means that investors consider management to be inefficient in some manner.[71] While this controversial analysis has been stated in various ways, the following excerpt captures the gist of the purported relationship among supposedly efficient capital markets, stock price movements, and the governance implications of takeovers:

> . . . corporate takeovers are beneficial exchanges of corporate control that generally result in more efficient management of target resources. . . . If incumbent managements perform poorly, share prices will reflect this performance by falling below their highest potential value. A profit opportunity then exists for a shrewd entrepreneur to purchase the undervalued shares, replace the poor managers with more competent ones, and reap the rewards. . . .[72]

Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305 (1976); Fama, *Agency Problems and the Theory of the Firm*, 88 J. POL. ECON. 288 (1980); Fama & Jensen, Separation *of Ownership and Control*, 26 J. L. & ECON. 301 (1983); Fama & Jensen, *Agency Problems and Residual Claims*, 26 J. L. & ECON. 327 (1983). For a useful summary and evaluation of the essential elements of the theory, *see* Davis, *Judicial Review of Fiduciary Decisionmaking—Some Theoretical Perspectives*, 80 NW. U.L. REV. 1, 4-19 (1985).

65. *See, e.g.*, Jensen & Meckling, *supra* note 64, at 308-09, 312-13.

66. Jensen & Meckling, *supra* note 64, at 308, 323-24; *see* Davis, *supra* note 64, at 5-6.

67. Jensen & Meckling, *supra* note 64, at 323-38.

68. *See* Fama, *supra* note 64, at 288 (discussing market for managers); Fischel, *The Corporate Governance Movement*, 35 VAND. L. REV. 1259, 1287-90 (1982).

69. Manne, *Mergers and the Market for Corporate Control*, 73 J. POL. ECON. 110 (1965). British economist Robin Marris had advanced a similar theory shortly before Manne, but did not believe with Manne that it effectively constrained management. DAVIDSON, *supra* note 2, at 304-05.

70. *See supra* note 9 and accompanying text.

71. *See* Manne, *supra* note 69, at 113.

72. Jarrell & Bradley, *The Economic Effects of Federal and State Regulations of Cash Tender Offers*, 23 J. L. & ECON. 371, 380-81 (1980).

The threat that a "shrewd entrepreneur"—i.e., the bidder in a takeover attempt—will purchase a company's stock allegedly serves to discipline management and curb actions unfavorable to investors. The result is a "solution" to the governance problem described by Berle and Means that requires no great legal reforms *except* prohibition of management resistance to takeovers.[73]

Professor Brudney has harshly criticized reliance on the contract-market analysis of corporate governance as both an inaccurate description of the investor-management relationship and as legitimizing the very insularity of management that Berle and Means deplored.[74] Quite apart from the merits of this criticism, however, what is notable about both the contract-market approach and a more interventionary "rules" approach to better corporate governance is that each undertakes to seek (or describe) solutions to the problem of slackness in the management-investor relationship. Certainly, improving management loyalty to shareholder interests rather than to its own is an important, perhaps the most important, component of effective corporate governance. This concern is, nonetheless, considerably narrower in scope than the lively mid-century discussion of whether management *ought* to advance (only) shareholder interests.

The remainder of this Article deals with the question of whether that broader issue should be revisited in light of developments in the takeover field. Courts for the most part clearly have not closely scrutinized management's takeover behavior. As a result, target companies have successfully implemented a wide variety of takeover defenses to thwart the workings of the market for corporate control and the desire of shareholders for stock premiums. It is now equally clear, however, that recent cases appear to be rejecting deference to management in favor of greater protection for shareholders.

The *Revlon* decision is of particular interest because it is the first time the Delaware Supreme Court has directly addressed the issue of whether, in formulating takeover strategy, directors may consider noninvestor interests. In doing so the Court has, albeit in the takeover rather than in the day to day operational setting, unknowingly revived the broader question of management orientation so vigorously debated by Professors Berle and Dodd and others, but then largely slighted in governance discussions of the narrower management-investor relationship. That and other recent decisions may represent a judicial movement toward requiring greater affirmative allegiance to shareholder interests. Evaluated in the restricted context of management-investor relations, such a trend might be viewed as commendable, and overdue, and finally laying to rest the legacy of Berle and Means.

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73. *See, e.g.*, Easterbrook & Fischel, *supra* note 18, at 1201-03. Professor Brudney believes that the call for intervention to prohibit management resistance or to prohibit application of the business judgment rule to defensive measures reveals the "schizophrenia" of an otherwise non-interventionary theory. Brudney, *supra* note 38, at 1432 n.74.

74. Brudney, *supra* note 38. *See also* Buxbaum, *supra* note 4, at 525-37.

Nonetheless, growing concerns and evidence that takeovers and the management responses they engender are not also favorable for other important interests raise, as in mid-century, the issue of whether corporations should be managed exclusively for shareholders, or whether corporations must somehow behave to take account of other interests and, if so, how.

II. Judicial Notions Of Management Duty

A. Problems With the Business Judgment Rule; the Incompleteness of its Judicial Reassessment

Although a central principle of economic orthodoxy is that management should faithfully serve the interests of shareholders, there is a strong, though obscured, strain of managerialism in corporate law. Management is not simply the "agent" of shareholders; it has an independent obligation to manage the company.[75] This notion is seen clearly in the traditionally lenient judicial review of management decisions, including those involving takeover measures.

Courts have not required directors to acquiesce in a takeover simply because it may have offered a large premium to shareholders.[76] In fact, far from acquiescing, management has been allowed to employ a variety of potent measures to resist and defeat a takeover attempt.[77] On what basis do courts allow such behavior if management's task is to serve shareholder interests loyally, particularly when the available stock price evidence indicates that takeovers benefit shareholders? One answer of course is that courts generally have applied the business judgment rule in assessing management behavior in takeovers, thereby greatly reducing the scope of judicial review of the merits of management actions.[78] While formulated in various ways,

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75. A corporation's business and affairs are managed under the "direction" of its board of directors. The board, not the shareholders, elects officers to carry out the actual managing functions. *See, e.g.*, Model Business Corp. Act §§ 8.01, 8.40-.41 (1984). Thus, corporations are managed by persons who, while supposedly acting on behalf of shareholders, have a great deal of freedom because they are not directly controlled by shareholders or, many would argue, effectively controlled by the board itself. Obviously, management needs a certain latitude of action and thus, as the Delaware Supreme Court has recognized, the difficulty lies in "structuring the modern corporation in order to satisfy the twin objectives of managerial freedom of action and responsibility to shareholders. . . ." Aronson v. Lewis, 473 A.2d 805, 811 n.4 (Del. 1984).

76. Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 955 n.10 (Del. 1985).

77. *See infra* note 78.

78. *See, e.g.*, Treco, Inc. v. Land of Lincoln Sav. & Loan, 749 F.2d 374 (7th Cir. 1984); Buffalo Forge Co. v. Ogden Corp., 717 F.2d 757 (2d Cir.), *cert. denied*, 464 U.S. 1018 (1983); Panter v. Marshall Field & Co., 646 F.2d 271 (7th cir.), *cert. denied*, 454 U.S. 1092 (1981); Treadway Cos. v. Care Corp., 638 F.2d 357 (2d Cir. 1980); Crouse-Hinds Co. v. Internorth, Inc., 634 F.2d 690 (2d Cir. 1980); Johnson v. Trueblood, 629 F.2d 287 (3d Cir. 1980), *cert. denied*, 450 U.S. 999 (1981); Martin-Marietta Corp. v. Bendix Corp., 549 F. Supp. 623 (D. Md. 1982); Whittaker Corp. v. Edgar, 535 F. Supp. 933 (N.D. Ill. 1982); Moran v. Household Int'l, Inc., 500 A.2d 1346 (Del. 1985); Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946

the business judgment rule under Delaware law is a "presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company."[79] Applied in the takeover setting, the business judgment rule will prevent a court from interfering with defensive measures as long as they were implemented without the primary purpose of retaining control of the corporation in incumbent management.[80]

Assuming courts are presented with evidence on the beneficial impact of takeovers on shareholder wealth and fully appreciate their governance implications,[81] continued application of the business judgment rule can only reflect a judicial belief that potential losses to shareholders do not outweigh the rationale for the rule. One important reason for the business judgment rule is that management, not shareholders or judges, manage corporations. That rationale, however, does not deal with the critical questions of who are the proper constituents of managerial efforts, and what exactly is the content of management's duty to them at various stages before and during a takeover. Application of the business judgment rule to the point of allowing management to consistently thwart high premium takeover attempts must mean, in effect, that courts do not identify the best interests of the "corporation" with the interest of shareholders in obtaining tender offer premiums. That does not stem, however, from a strongly held conviction that management is the steward of many interests, but from a failure to ask the right question: Beyond vague references to the "corporation," whose interest exactly is management supposed to serve in a takeover?

Judicial dissatisfaction with the business judgment rule in takeover settings first appeared in dissenting opinions.[82] It was only in 1984, however,

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(Del. 1985); Pogostin v. Rice, 480 A.2d 619, 626-27 (Del. 1984).

Application of the business judgment rule to defensive measures has been widely criticized. *See, e.g.*, Easterbrook & Fischel, *supra* note 18; Gilson, *supra* note 9; Gelfond & Sebastian, *Re-Evaluating the Duties of Target Management in a Hostile Tender Offer*, 60 B.U.L. Rev. 403 (1980); Comment, *The Misapplication of the Business Judgment Rule in Contests for Corporate Control*, 76 Nw. U. L. Rev. 980 (1982).

79. Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984).

80. In *Unocal*, the Delaware Supreme Court appeared to incorporate the "primary purpose" test into the business judgment rule. Historically, however, that was a separate test. *See* Cheff v. Mathes, 41 Del. Ch. 494, 199 A.2d 548 (1964). Unlike the business judgment rule's presumption of propriety, however, the "primary purpose" test requires directors to prove that they acted to serve some "corporate" purpose other than retention of control. Concerned about the inherent conflict of interest faced by directors in formulating takeover responses, the court in *Unocal* did not simply presume the propriety of the defensive measure, but required the directors to prove the existence of reasonable grounds for believing that a takeover endangered corporate policy or effectiveness. 493 A.2d at 955. That burden is satisfied by showing "good faith and reasonable investigation. . . ." *Id.*

81. The Chancery Court was presented with such evidence in *Moran v. Household International Inc.*, 490 A.2d 1059, 1067-68 (Del. Ch. 1985). Judge Posner was also well aware of the literature on the shareholder wealth effects of takeover activity in *Dynamics Corp. of America v. CTS Corp.*, 794 F.2d 250 (7th Cir. 1986), *cert. granted*, 55 U.S.L.W. 3233 (1986).

82. Johnson v. Trueblood, 629 F.2d 287 (3d Cir. 1980) (Judge Rosenn, dissenting); Panter v. Marshall Field & Co., 646 F.2d 271 (7th Cir. 1981) (Judge Cudahy, dissenting).

that court opinions began to show an appreciation of the full governance implications of takeovers, seeing them not simply as another "corporate" problem for management to contend with but as an opportunity for shareholders to assert their influence and to impose their preferences on management.

In *Norlin Corp. v. Rooney Pace, Inc.,*[83] target management issued sufficient common and preferred stock to its wholly owned Panamanian subsidiary and to a newly created Employee Stock Ownership Plan (ESOP) to enable management to retain voting control of the corporation. In an action seeking a preliminary injunction against voting the newly issued shares, the Second Circuit found that the circumstances of the defensive measures raised a "strong inference" that the purpose of the transaction was "not to benefit the employees [as claimed by management] but rather to solidify management's control of the company."[84] The court was especially concerned that defensive actions not change the fundamental governance structure of a corporation:

> Our most important duty is to protect the fundamental structure of corporate governance. While the day-to-day affairs of a company are to be managed by its officers under the supervision of directors, decisions affecting a corporation's ultimate destiny are for the shareholders to make in accordance with democratic procedures.[85]

The court resolved the propriety of issuing stock to a wholly owned subsidiary by looking to applicable statutory law, but turned to common law fiduciary principles to decide the legality of issuing stock to the ESOP. Since the board's action appeared to be motivated largely by self-interest rather than by other "corporate" purposes, the court declined to apply the business judgment rule and stated that "the duty of loyalty requires the board to demonstrate that any actions it does take are fair and reasonable."[86] The board having failed in that showing, the court upheld the granting of an injunction.

Minstar Acquiring Corp. v. AMF, Inc.[87] involved the validity under New Jersey law of various "scorched earth" tactics and a "poison pill" stock rights plan implemented immediately before a hostile tender offer. Being troubled, as was the court in *Norlin,* by the governance implications of management's defensive maneuvers, the Court questioned whether the business judgment rule should even be applied in takeovers.[88] The court expressed

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83. 744 F.2d 255 (2d Cir. 1984).

84. *Id.* at 265.

85. *Id.* at 258.

86. *Id.* at 266. *Compare* Danaher Corporation v. Chicago Pneumatic Tool Co., [1985-86 Transfer Binder] FED. SEC. L. RPTR. (CCH) 92,556 (S.D.N.Y. 1986) (management met burden of proving that establishment and funding of ESOP was not motivated by desire to maintain control).

87. 621 F. Supp. 1252 (S.N.Y. 1985).

88. *Id.* at 1259.

the view that the decision to sell stock is a "private transaction" and an "independent right of alienation" in which the board's effort to act as a "surrogate" for the shareholders was "troublesome."[89] The *Minstar* court's holding did not require it to confront squarely the issue of judicial deference to management action having such significant governance overtones. Nonetheless, its concern about delineating the respective provinces of shareholders and directors clearly underlay the court's decision to strike down the "poison pill" rights plan under state law because, in several ways, the plan improperly infringed on stockholder rights.[90] Furthermore, relying on *Norlin* as authority for requiring the target board to prove the fairness of defensive measures apparently motivated by management self-interest rather than by other "corporate" purposes, the court in *Minstar* also held that management had failed to meet that burden with respect to the "scorched earth" tactics.

While these decisions clearly show a more critical judicial attitude toward management's defensive measures, the problem with them, and with much criticism of the business judgment rule in the takeover context, is that they do not address the underlying issue of whether management has an affirmative and overriding duty to shareholders to procure a premium for their stock—i.e., to maximize shareholder wealth as measured by stock prices to use the economists' phrase. Instead, these courts have sought only to remove from defensive actions the taint of management self-interest. When management can plausibly advance some "corporate" rather than selfish reason for its behavior, courts will uphold the measures. That, however, is quite a different matter than affirmatively requiring management to advance only the interests of investors. If investors truly are the chief constituency of corporate management, justifying defensive measures as free of self-interest and as being in the best interests of the "corporation"—rather than the shareholders—seems irrelevant. Advocates of shareholder interests might insist that, as primary beneficiaries of corporate behavior, shareholders are entitled to more from management than the absence of self-interest. They might argue that shareholders are entitled to that conduct which best assures them of the reasonably expected benefits of a tender offer or competing offer—that is, behavior which maximizes value, but does not altogether defeat the opportunity to sell. Even further, shareholder advocates might contend that management has a duty to solicit bids or otherwise distribute value to investors whenever it knows that for any extended period corporate assets are significantly higher in value than corporate stock.

In short, such advocates might argue that management should at all times pursue shareholder well-being, not simply by seeking long term profit

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89. *Id.* at 1260 n.6.

90. *See also* Asarco Inc. v. M.R.H. Holmes A Court, 611 F. Supp. 468 (D. N.J. 1985) (poison pill issuance protected by business judgment rule, but violative of New Jersey prohibition against different voting right within same class of stock unless approved by shareholders); Amalgamated Sugar Co. v. NL Industries, F. Supp. (S.D.N.Y. 1986) (poison pill that became nonredeemable for ten years once triggered was violative of New Jersey law).

maximization, but also by heeding short term preferences.[91] Prior to a takeover attempt this focus would require management to dispose of assets and to restructure the corporation voluntarily whenever doing so would place more value in shareholder hands than the prevailing market value of their stock.[92] Once a takeover attempt begins, such an orientation essentially transforms management into a "bargaining agent" for shareholders whereby it seeks that resolution—eventual capitulation, escape to a competing bidder, or management buyout—that results in shareholders receiving the largest possible premium.

Regrettably then, even courts critical of the business judgment rule have failed to articulate the exact nature of the shareholders' claim on a corporation in or expecting a hostile takeover, contenting themselves with the requirement that management not act out of self-interest. Specifically, courts have failed to resolve whether, in addition to conscientious devotion to profit maximization, shareholders may rightfully expect and insist that management provide short term liquidity from the enterprise at top dollar. They have also failed to precisely sort out the relative claims of investors and other "corporate" interests in a takeover, interests which may conflict rather than coincide with those of investors.[93] Until *Revlon* this failure continued notwithstanding a line of decisions stating that noninvestor considerations are a legitimate basis for management resistance to takeovers.

B. Noninvestor Interests in Pre-Revlon Decisions

While several Delaware decisions have held that it is improper for directors to use corporate funds for the purpose of preserving control in

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91. This is an example of the possible "tension" between long term profit maximization and shareholder gain that § 2.01 of the ALI Principles of Corporate Governance does not resolve. *See supra* note 23. Most economists apparently prefer a focus on shareholder gain. *Id.* The law, however, is currently not that precise in its requirements.

92. A corporation's failure to correct a perceived imbalance between the value of its assets and its stock may make the corporation vulnerable to bidders who essentially "arbitrage" the discrepancy by buying companies in the stock market and selling them in the asset market. Moreover, recent efforts by corporate management to "decompose" their entities may reflect an effort to satisfy their shareholders while beating potential bidders to the punch. *See infra* Section B of Part III.

93. Courts have not adequately dealt with the differing investment objectives of various investors. Roughly speaking, there are "short-term" investors—epitomized by arbitrageurs—and "long-term" investors. *See* W. BAUMOL, THE STOCK MARKET AND ECONOMIC EFFICIENCY 84-85 (1965) ("[T]he body of stockholders constitutes no homogeneous group and if one attempts to determine what promotes the welfare of 'the stockholder' one runs into just the same sort of difficulties as when one undertakes to measure the welfare of society."). Shorter term investors acting collectively can always impose their assessment of the firm and its policies on longer term investors simply by selling their stock to a bidder who will change corporate policy in a manner that longer term investors may dislike. To this concern it might be responded that "the standard assumption in corporate finance theory is that management should seek to maximize the value of the corporation shares, since this will necessarily involve the appropriate tradeoff that shareholders desire between long and short-term profit maximization." Coffee, *supra* note 3, at 1154 n.18. Whether such value maximizing behavior in operating decisions can and should be so easily carried over to the takeover setting is, however, the very question that takeovers are raising.

themselves,[94] later decisions make it clear that share repurchases undertaken to prevent takeovers that threaten the corporate entity or its business policy are proper.[95] Thus, in *Kors v. Carey* the "corporate" interest to be protected was the preservation of established relationships with customers which the directors believed would be damaged, to the detriment of the enterprise, if the dissident gained control. In *Cheff v. Mathes,* a dissident's likely change in sales policies and employee unrest constituted sufficient threat to the "corporate" interest to meet the directors' burden. More recently, in *Unocal Corp. v. Mesa Petroleum Co.,* the Delaware Supreme Court continued to refrain from identifying "corporate" and "shareholder" interests when it stated that the board had a "fundamental duty and obligation to protect the corporate enterprise, which includes stockholders,. . ."[96] The court further stated that in analyzing the effect of a takeover bid on the "corporate" enterprise directors may consider, among other matters, the impact on "creditors, customers, employees, and perhaps even the community generally."[97]

Other decisions have cited possible harm to various noninvestor interests in either providing injunctive relief from takeover attempts or upholding defensive measures. Among such interests were employee morale[98] and even the public interest.[99] One of the most direct statements on the place of noninvestors in corporate decisionmaking was made by the Tenth Circuit in holding that the directors of the corporation owning the Denver Post had acted properly in taking certain challenged actions:

> We are fully cognizant of the well established corporate rule of law which places corporate officers and directors in the position of

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94. Bennett v. Propp, 187 A.2d 405 (Del. 1962); Yasik v. Wachtel, 25 Del. Ch. 247, 17 A.2d 309 (Del. 1941); Macht v. Merchants Mortgage and Credit Co., 22 Del. Ch. 70, 194 A.23 (Del. Ch. 1937).

95. Cheff v. Mathes, 41 Del. Ch. 494, 199 A.2d 548 (1964); Kors v. Carey, 39 Del. Ch. 47, 158 A.2d 136 (1960); Kaplan v. Goldsamt, 380 A.2d 556 (Del. 1977). Directors have the burden of proving that the repurchases were in the "corporate" interest. See infra note 80. Share repurchases at a price that gives the bidder a substantial profit on the transaction are now referred to as "greenmail." For discussions of greenmail see Macey & McChesney, *A Theoretical Analysis of Corporate Greenmail,* 95 YALE L. J. 13 (1985); Note, *Greenmail: Targeted Stock Repurchases and the Management-Entrenchment Hypothesis,* 98 HARV. L. REV. 1045 (1985).

96. Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 954 (Del. 1985) (upholding discriminatory self-tender). Effective July, 1986, amended SEC Rule 13e-4(f) requires that an issuer's offer to repurchase its stock must be open to all holders of the class of securities subject to the offer. FED. SEC. L. RPTR. (CCH), No. 1186, July 16, 1986, Pt. II. The effect is to change the *Unocal* outcome for issuers subject to the rule.

97. *Unocal,* 492 A.2d at 955.

98. F. & M. Schaefer Corp. v. C. Schmidt & Sons, Inc. 597 F.2d 814 (2d Cir. 1979); Boyes Form Burial Casket Co. v. Amedco, Inc., 407 F. Supp. 811 (E.D. Pa. 1976); Abramson v. Nytronics, Inc., 312 F. Supp. 519 (S.D.N.Y. 1970). *See* Enterra Corp. v. SGS Associates, 600 F. Supp. 678, 689 (E.D. Pa. 1985) (refusal to enjoin stands still agreement because of stability it provided to corporation in its relations with employees and other noninvestors).

99. Grummon Corp. v. LTV Corp., 665 F.2d 10 (2d Cir. 1981).

fiduciaries for the stockholders. Basic in that rule of law is the profit motive of the corporate entity. In this case we have a corporation engaged chiefly in the publication of a large metropolitan newspaper, whose obligation and duty is something more than the making of corporate profits. Its obligation is threefold: to the stockholders, to the employees, and to the public.[100]

More recently, a federal district court made much the same kind of statement in an almost classic expression of the view that directors are equipped to, and should, mediate the interests of various constituencies:

> The exercise of independent, honest business judgment of an enlightened and disinterested Board is the traditional and appropriate way to deal fairly and evenhandedly with both the protection of investors, on the one hand, and the legitimate concerns and interests of employees and management of a corporation who service the interests of investors, on the other.[101]

However apparently clear the language in these opinions, there is a danger of making too much of these decisions as authority for the proposition that management either owes a duty to or may on other grounds consider noninvestor interests in takeovers. Most statements about noninvestor interests are dicta and unnecessary for resolving the issues presented. Furthermore, given the posture of the cases, it is not at all clear that shareholders were denied an opportunity to tender or were otherwise damaged. Moreover, the statements were made less to highlight the claim of various noninvestors on the corporation than to emphasize the variety of factors that management, in its wide discretion, may consider in formulating takeover responses.[102]

Thus, at one level these decisions might be viewed as simply respecting management's judgment that the takeover attempt should be resisted because it was not in the "long run" interests of shareholders. As such, management's concerns for "corporate policy" and various noninvestor interests are but intermediate concerns, important only for their contribution to the eventual well being of shareholders.[103] Yet, by implicitly seeking to reconcile interests in this manner, the courts fail to answer why shareholders should not be entitled to elect an immediate stock premium over longer run profit for the

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100. Harold Co. v. Seawell, 472 F.2d 1081, 1091 (10th Cir. 1972).

101. GAF Corp. v. Union Carbide Corp., 624 F. Supp. 1016, 1020 (S.D.N.Y. 1985).

102. While corporate management "may" consider noninvestor interests, it is certainly not obligated to do so. *See* Local 1330 United Steel Workers v. United States Steel Corp., 631 F.2d 1264, 1279-82 (6th Cir. 1980) (corporation has no duty to consider effects on employees or communities in plant closing decision).

103. The court in *Union Carbide* stated that the Union Carbide board's duty was "solely to the welfare of Carbide's investors and to deal with the interests of Carbide's employees and management fairly, in furtherance of those interests of investors." *Union Carbide*, 624 F. Supp. at 1019. This statement seems to imply that the interests of management and employees are of significance only in that they further investor interests.

entity. Nor do they deal with takeovers as perhaps the only viable means for shareholders to express displeasure with management's long-term operating decisions. Instead, while these decisions might be woven into the orthodox view that corporations are to be operated for the ultimate good of shareholders, they permit the time frame for realizing benefits to be determined not by shareholders but by management in the exercise of its broad discretion. The result is that preservation of management prerogative rather than any particular protection for investor or noninvestor interests is the striking outcome of these decisions.

These pre-*Revlon* decisions then suffer from the same fundamental flaw as *Norlin* and *Minstar.* They fail to resolve the issue of whether a majority of shareholders should have the right to elect an immediate substantial premium—whatever the implications of that preference for other shareholders, the entity itself, and entity-dependent noninvestors—rather than receive value from the corporation over the longer term. Using the language of § 2.01 of the Principles of Corporate Governance, these decisions fail to distinguish a corporation's objective to enhance "corporate profit" from its objective to increase "shareholder gain." Nor do any of these decisions shed light on the even harder issue of whether directors, far from simply not interfering with unsolicited offers out of self interest, ought affirmatively to seek higher immediate returns for shareholders either through "auctioning" the company, distributing value via stock repurchases, or other corporate restructuring. While difficult questions of value-maximizing tactics and how to judicially review such tactics open once the board of directors is narrowly conceived as essentially a "bargaining agent" for shareholders,[104] those questions can be confronted only when courts squarely acknowledge that it is shareholder wealth maximization over their chosen time horizon—and no other interests—that directors are to serve. Prior to *Revlon* that had not happened.

C. Solicitude for Shareholders in Revlon and Other Recent Decisions

In *Revlon* the Supreme Court of Delaware stated that it was addressing for the first time the "extent to which a corporation may consider the impact

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104. Professors Easterbrook and Fischel contend that management of the target company should take no action to resist a takeover attempt. *See* Easterbrook and Fischel, *supra* note 18. Others, however, argue that management should elicit competing bids and, in effect, "auction" the corporation on behalf of the shareholders at the highest price. *See, e.g.,* Gilson, *Seeking Competitive Bids versus Pure Passivity in Tender Offer Defense,* 35 STAN. L. REV. 51 (1982); Weiss, *supra* note 9, at 26-32; Lowenstein, *Pruning Deadwood in Hostile Takeovers: A Proposal for Legislation,* 83 COLUM. L. REV. 249, 322-23 (1983); Oesterle, *Target Managers as Negotiating Agents for Target Shareholders in Tender Offers: A Reply to the Passivity Thesis,* 71 CORNELL L. REV. 53, 83-94 (1985). *See also* Matheson and Norberg, *supra* note 25. Notwithstanding such commentary, pre-*Revlon* courts in effect allowed management to select entity survival and profit rather than shareholder gain as its focus.

of a takeover threat on constituencies other than shareholders."[105] While complex, the essential facts are as follows: MacAndrews and Forbes ("M and F") made an offer to purchase Revlon that the Revlon Board rejected. The Board then adopted a "poison pill" rights plan somewhat similar to that upheld in *Moran v. Household International, Inc.*[106] M and F then offered $47.50 per share for all of Revlon's shares, subject to procuring financing and redemption of the rights. Revlon responded with an offer to exchange notes and preferred stock for 26% of its outstanding stock. The notes contained covenants limiting the amount of additional debt that could be incurred by the company, thereby aiming to thwart M and F's proposed financing plan.

M and F responded to the exchange offer by first reducing its offer to $42 per share, but then increasing it to $50 and then $53, conditioned again on redemption of the rights. The Revlon board then entered a leveraged buy-out agreement, with Forstmann, Little & Co. and certain members of management, for $56 per share. M and F then raised its bid to $56.25 and announced that it would engage in "fractional bidding" to defeat any other offer for Revlon. Forstmann then offered $57.25 for Revlon, conditioned on obtaining a lock-up option on two substantial divisions of Revlon, a no-shop provision, and a $25 million "break-up" fee. In addition, Forstmann agreed to support the market value of the notes that Revlon had issued in its exchange offer and which had declined in value. The Revlon Board accepted this offer.

M and F then raised its offer to $58 and sued to enjoin the lock-up option and break-up fee. The Chancery Court issued an injunction and the Supreme Court affirmed. In invalidating the lock-up option, the court stated that since the Revlon Board had acknowledged the company was for sale, its duty had changed from preserving Revlon as a corporate entity to the more limited function of serving as "auctioneer" of the company at the best price for shareholders.[107] As such, it was improper to enter the arrangement with Forstmann out of concern for the noteholders.

The court began its analysis by stating that the business judgment rule protects those decisions by directors as are in the best interests of the "company."[108] The court also stated the common, but fuzzy, notion that directors owe fiduciary duties to the "corporation and its shareholders,"[109] a phrase that appears throughout Delaware decisions.[110] The court considered

105. Revlon, Inc. v. MacAndrews & Forbes Holdings, 506 A.2d 173, 176 (Del. 1986).

106. 500 A.2d 1346 (Del. 1985).

107. *Id.* at 182.

108. *Id.* at 180.

109. *Id.* at 179.

110. *See, e.g.*, Guth v. Loft, Inc., 23 Del. Super. 255, 5 A.2d 503, 510 (1939); Aronson v. Lewis, 473 A.2d 805, 811 (Del. 1984). The reason for stating that a director is a fiduciary for the "corporation and its shareholders" is that in director loyalty cases—e.g., self-dealing—where the phrase originates the interests of the corporate entity and of shareholders were aligned. If directors favored themselves in such a transaction, that damaged both the corporate

implementation of the rights plan to be valid since it was in the best "corporate" interests and, because it "spurred the bidding to new heights," in the best interests of shareholders as well.[111]

Only as the court addressed the lock-up option did it recognize the need to clarify and distinguish the duty to "shareholders" from the duty to "corporation." In doing so, the court spoke of a "change" in the duty so that obtaining the maximum price for shareholders is the directors' sole concern when the company is for sale.[112] As such, solicitude for noninvestor interests or preserving the "corporate" enterprise is no longer appropriate. The remainder of the opinion goes on to discuss defensive measures solely in terms of how they affect shareholder well being, concluding that the lock-up option was invalid since it ended the auction of the company to the detriment of shareholders.[113]

The important question is whether courts will confine the idea of a "change" in directors' duties to the *Revlon* facts or whether *Revlon* marks the beginning of an effort to articulate more clearly director takeover duties generally by distinguishing shareholder from "corporate" interests and requiring greater fidelity to the former. In short, are there reasons to believe that courts will require directors to advance shareholder rather than "corporate" well being in all facets of takeovers?[114]

There are several reasons for believing that courts increasingly will review defensive measures for their distinct impact on shareholders. First, the nature of the duty to shareholders in takeovers needs clarification rather than leaving it buried in the phrase "corporation and its shareholders." This clarification requires an evaluation of the shareholders' claim on the corporation, assessing its status in relation to other demands on corporate activity

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entity and, derivatively, the shareholders. Certainly, as in classic self-dealing cases, the law must be vigilant that management not simply favor its own interests in takeovers. Beyond that, however, the line-up of other interests in takeovers may be different. "Corporate" interests, unless wholly identified with those of investors, may be aligned with rather than opposed to those of directors who seek the preservation of the entity and its constituent relationships. Thus, to continue using the phrase "corporation and its shareholders" to describe management's fiduciary duty is of little use in takeovers. This is the same "tension" in decisional law between entity well being and shareholder gain as exists in § 2.01 of the *Principles of Corporate Governance*. *See infra* note 23. Codifications of director duty such as § 4.01 of the *Principles of Corporate Governance* and § 8.30 of the *Revised Model Business Corporation Act*, by simply stating that a director is to act in the best interests of the "corporation," also provide no guidance in takeovers.

111. 506 A.2d at 181. The court's opinion in *Revlon* is an example of the imprecision and equivocation about whose interests directors are to protect in takeovers that was just noted. *See infra* note 110 and accompanying text.

112. *Revlon*, 506 A.2d at 182.

113. *Id.* at 184-185.

114. Already the Sixth Circuit has adopted *Revlon's* auctioning concept in holding that a target board of directors breached its fiduciary duty to shareholders in approving a management buy-out that effectively ended the bidding process. Edelman v. Fruehauf Corp., [Current] FED. SEC. L. RPTR. (CCH) 92,863 (6th Cir. 1986). As in *Revlon*, however, directors had conceded that the corporation would be sold. *Id.*

at various stages of a takeover. Are shareholders entitled to more than management devotion to long term profit maximization, deserving opportunities at premiums as well? If so, why limit this to instances where directors acknowledge the break-up of the company instead of requiring value maximizing behavior, if not at all times, at least from the point an unsolicited offer is made? If directors are to serve as the faithful "agents" of shareholders there is no logical reason to assign them that role only when they subjectively concede break-up. As this line of reasoning is pushed, it is readily apparent that envisioning management as shareholder "agent" may be narrowing and troubling.[115] Nonetheless, since courts have shown an inclination to scrutinize management behavior, these hard issues should not be ducked.

Second, the court in *Revlon* stated a principle that it may have intended for general application: "A board may have regard for various constituencies in discharging its responsibilities, *provided* there are rationally related benefits accruing to the stockholders."[116] This element of the business judgment rule, originating in *Unocal,* may require directors to demonstrate, even prior to the inevitability of a "break-up," that defensive measures lead to specific benefits for shareholders rather than simply being in the best interests of the "corporation." Whether "benefits" will be interpreted to mean an opportunity to realize immediate takeover-generated premiums as maximized by management efforts or as simply meaning the opportunity to remain an investor in the company as presently operated and over the "long run" is not clear.

Support for the interpretation that "benefits" means an opportunity for a premium is found in the court's discussion of the rights plan, a discussion that sheds light on the earlier *Moran* decision.[117] The *Revlon* court considered the rights plan to be valid since it "protected the shareholders" from a takeover attempt at a price below the company's "intrinsic value."[118] The plan did so by encouraging bidding that drove the offered price to new heights, an outcome the court considered "a proper result of its implementation. See *Moran,* 500 A.2d at 1354, 1356-67."[119] The intent may have been to strictly limit *Moran* to a holding on the validity, not the later utilization of the poison pill, a reading consistent with the last few sentences of that opinion.[120] That measure is thus defensible as reasonably related to share-

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115. The troubling notion of management as "agent" is a different kind of concern about the agency model of management than that expressed by Professor Brudney. *See supra* note 38. The concern here is not the descriptive deficiencies of such a model, but the ramifications for the corporate institution if indeed courts come to view target management as essentially a bargaining agent for shareholders in takeovers.

116. 506 A.2d at 182 (emphasis added).

117. Moran v. Household International, Inc., 500 A.2d 1346 (Del. 1985).

118. *Revlon,* 506 A.2d at 181.

119. *Id.*

120. *Moran,* 500 A.2d at 1357. In what may have been an attempt to blunt the expected adverse reaction to its opinion, the court in *Moran* emphasized that it was sanctioning only the

holder "benefit" because it can be expected to result in higher bids for shareholders' stock. Should directors utilize the plan for some other end—for example, the protection of noninvestor interests—by absolutely refusing to redeem the rights in the face of a high premium offer, they undoubtedly will be called on to justify that action as "reasonably related" to shareholder rather than simply "corporate" well being.[121] Thus, while the *Revlon* court did not expressly define "benefit" in terms of a shareholder's right to receive bids, striking down the lock-up option and upholding the rights plan because of their impact on the bidding process may carry that meaning.

Third, reviewing defensive measures for their impact on the bidding process provides a kind of standard of propriety, a standard that is absent when judges review operating decisions. Simply put, since "[m]arket forces must be allowed to operate freely to bring the target's shareholders the best price available,"[122] actions which inhibit this, as the lock-up option did in *Revlon,* are improper, while actions that enhance this, as the redeemable poison pill did in *Revlon,* are proper. Such a judicial perspective would defer less readily to management's defense of such actions as in the best interests of the "company" and would require proof that the actions benefited shareholders. Shareholder benefit, however, would not be confined to "long-run" interests, but if market forces are to operate fully, must include the interest in obtaining all available benefits of the market, including a market for corporate control that offers stock premiums and presents shareholders with the opportunity to make basic decisions on the corporation's fate. Evaluating defensive measures in terms of their effect on the bidding process will not always be easy, but it may be an appealing benchmark for courts struggling to reconcile management duty and shareholder rights.[123]

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initial implementation of a "poison pill" rights plan, not the manner in which it was ultimately employed: "While we conclude for present purposes that the Household Directors are protected by the business judgment rule, that does not end the matter. The ultimate response to an actual takeover bid must be judged by the Directors' actions at the time, and nothing we say here relieves them of their basic fundamental duties to the corporation and its stockholders. . . . Their use of the Plan will be evaluated when and if the issue arises." *Id.*

121. *Moran,* 500 A.2d at 1354. In *Moran,* the court emphasized that a board of directors "faced with a tender offer and a request to redeem the Rights, . . . will not be able to arbitrarily reject the offer." *Id. See Unocal,* 493 A.2d at 955 ("A corporation does not have unbridled discretion to defeat any perceived threat by any Draconican means available."). The *Revlon* court imposes a stricter test for defensive measures than these "arbitrary" and "unbridled discretion" standards. *Revlon,* 506 A.2d at 182.

122. *Revlon,* 506 A.2d at 184. The court in *Revlon* once again, as in *Unocal,* rejected the "passivity" thesis of Easterbrook and Fischel, *supra* note 18, and stated that the "directors role remains an active one, changed only in the respect that they are charged with the duty of selling the company at the highest price attainable for the stockholders' benefit." *Revlon,* 506 A.2d at 184 n.16.

123. The difficulty of evaluating defensive measures in terms of their effect on the bidding process is made clear by Judge Guy's dissenting opinion in *Edelman v. Fruehauf Corp.,* [Current] FED. SEC. L. RPTR. (CCH) 92,863 (6th Cir. 1986). Judge Guy pointed out that no shareholders objected to the resistance and that continued resistance required "an evaluation of the upside benefit of getting perhaps a dollar more per share versus the downside benefit

Finally, emphasis on director duty to shareholders rather than to "company" is increasingly prominent in decisions. The last portion of the *Revlon* opinion abandons the customary "corporation and its shareholders" phrase and refers only to the duty to shareholders.[124] Shareholder participation in corporate governance clearly was of concern to the *Norlin* and *Minstar* courts, however incomplete the courts' analyses.[125] Recently, the Sixth, Second and Seventh Circuits, in striking down a management buy-out,[126] a lock-up option[127] and a poison pill rights plan,[128] respectively, expressed concern for the effect of these defensive measures on shareholder well being. The Sixth Circuit made it clear that in reviewing the propriety of a management buy-out which sought to end a takeover attempt, the court's function was to determine whether the target corporation's directors had fulfilled their fiduciary duty to shareholders to obtain the highest premium for their stock.[129] The Second Circuit considered the challenged lock-up option to affect shareholders adversely by both dampening the bidding process and impinging on governance rights.[130] The court stated that a director's obligation is "to protect the financial interests of the corporation, and thereby the shareholders. . . . When engaging in defensive maneuvers, . . . a director's obligation is to ensure the overall fairness . . . to the shareholders."[131]

Judge Posner, in striking down a target company's poison pill, was even clearer in expressing the duty of directors as running to the shareholders:

> It is supposed to be the shareholders' company, for it is they who are entitled to all the income that the company generates after paying off all contractually or otherwise obligated expenses. The officers and directors are the agents and fiduciaries of the shareholders and owe a duty of complete loyalty which is inconsistent with erecting insuperable barriers to hostile takeovers.[132]

Judge Posner's opinion refers only to director duty to shareholders, and avoids altogether the confusing "corporation and its shareholders" language. He summarizes the various arguments for and against defensive measures in terms of their effect on shareholder wealth, citing Jarrell's study that some resistance is wealth maximizing provided the bidder is not ultimately driven

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of possibly losing the white night in the process." *Id.* at 94,216. If courts require premium-maximizing behavior they may have to refine their analysis to respond to Judge Guy's legitimate concern.

124. *See infra* note 112 and accompanying text.

125. *See infra* notes 83-90 and accompanying text.

126. Edelman v. Fruehauf Corp., [Current] FED. SEC. L. RPTR. (CCH) 92,863 (6TH CIR. 1986).

127. Hanson Trust PLC v. ML SECM Acquisition, Inc., 781 F.2d 264 (2d Cir. 1986).

128. Dynamics Corp. of America v. CTS Corp., 794 F.2d 250 (7th Cir. 1986).

129. *Edelman*, CCH 92,863 at 94,212, 94,214.

130. *Hanson Trust*, 781 F.2d at 281.

131. *Id.* at 277-78.

132. *Dynamics Corp.*, 794 F.2d at 254.

away.[133] In the end, however, Judge Posner appears unwilling to evaluate defensive measures solely by the standard of shareholder wealth. Instead, given the present lack of conclusive evidence on the wealth effects of defensive measures, Judge Posner's chief concern is that defensive measures render shareholders vulnerable to their own management, thereby nullifying the important governance protection provided to shareholders by the market for corporate control.[134]

It is too early to know whether, after years of deference, courts truly will move toward requiring management at all stages of a takeover to respond in a manner that better serves shareholder interests.[135] If they do, the market for corporate control may indeed be the engine of enhanced managerial accountability to shareholders, thereby apparently rectifying a longstanding problem of corporate governance. Yet, should the law finally join economic orthodoxy in placing investors at the center of the corporate stage, it seems proper to ask whether this triumph bodes well for other interests.

III. The Results of Takeover Activity

There is considerable evidence that shareholders of target companies profit from corporate takeovers.[136] If stricter judicial review of defensive

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133. *Id.* at 255.

134. *Id.* at 255-58. *See* R. Posner, Economic Analysis of Law 303-05 (2d ed. 1977).

135. Many takeover participants see a clear indication of heightened judicial solicitude for target shareholders. Stewart and Hertzberg, *Life Becomes Easier for Corporate Raiders,* Wall St. J., Aug. 22, 1986 at 6. It is possible, however, that the Delaware Supreme Court will pull back from *Revlon* and veer off in a more management-oriented direction, a pattern in recent years. *Compare* Zapata Corp. v. Maldanado, 430 A.2d 779 (Del. 1981) *and* Singer v. Magnavox Co., 380 A.2d 969 (Del. 1977) *with* Aronson v. Lewis, 473 A.2d 805 (Del. 1984) *and* Weinberger v. UOP, Inc., 457 A.2d 701 (Del. 1983).

If courts do scrutinize defensive measures more closely, one practical consequence will be that directors will fashion takeover responses that minimize their legal exposure to disgruntled shareholders. Currently, many companies cannot obtain directors' and officers' liability coverage at affordable rates. *Ailing D&O Insurance Market Looks for Cure,* 6 The Bus. Law. Update, (March-April, 1986) 1. Those that can purchase insurance encounter limits on the amount of coverage and discover that protection from takeover activity is excluded altogether in many policies. *Id.* Unless and until this problem is resolved, there may be little incentive for directors—particularly outside directors—to do anything but respond to a hostile takeover attempt in a way that appeases shareholders while providing management a relatively advantageous outcome.

136. *See generally* Jensen & Ruback, *The Market for Corporate Control: The Scientific Evidence,* 11 J. of Fin. Econ. 5 (1983); Jensen, *Takeovers: Folklore and Science,* 62 Harv. Bus. Rev. 109 (Nov.-Dec. 1984); Jarrell, *The Wealth Effects of Litigation by Targets: Do Interests Diverge in a Merge?,* 28 J. L. & Econ. 151 (1985). While shareholders of target companies experience dramatic wealth gains from takeovers, it is less clear that shareholders of acquiring corporations also benefit. A study of 78 mergers and takeovers in the period 1976 through 1981 found that, three years after consummation, the price of the acquiror's stock was much lower than if it had simply continued its preacquisition performance. Magenheim & Mueller, *On Measuring the Effect of Acquisitions on Acquiring Firm Shareholders* (Nov., 1985) (unpublished manuscript) (copy on file at Washington & Lee Law Review office). Furthermore, the studies of target stock performance tend to observe a period fairly close in time to the tender offer. There appears to be "no authoritative study . . . as to whether, in the long run,

measures and management-initiated responses aimed at "preempting" takeovers continue, shareholders will realize even greater benefits.

Notwithstanding these gains, since corporations are important social and economic institutions,[137] many in society expect them to serve interests other than just those of capital providers. One of the major issues in the takeover debate is whether high levels of such activity serve or damage noninvestor interests. There simply is no authoritative evidence that enables this assessment to be made. As a result, it is not conclusively known whether the wealth and governance benefits to shareholders "offset" by some calculus any costs to other interests, or even whether takeover gains to certain noninvestors are greater than losses to others.

If, however, one believes that corporations should be managed to promote shareholder interests, then the salutary effects of widespread takeover activity on shareholder well being are sufficient warrant for requiring premium-maximizing behavior by management. Additional information on how noninvestors fare, however important for public policy, is, in this view, simply irrelevant to the issue of how management should behave toward takeovers. Moreover, if stock prices are a "reliable barometer" of whether takeovers are beneficial for society,[138] then premium-producing takeovers both enhance shareholder wealth and are good for society. As such, the argument goes, we do know that takeovers serve, or at least are not inconsistent with, the public good.

While the state of knowledge about the effects of takeovers on various interests is still developing, currently there are two concerns that can be set against the benefits to shareholders as one seeks some overall evaluation. The first deals with the outcome of completed takeovers. Is the result of takeover activity generally the ousting of inefficient management or other "synergistic" gain, to the good of society's desire for an efficient use of economic resources? Or is there credible evidence that, whatever may motivate takeover activity, the end result is not the singular attainment of more efficient enterprises? The second concern relates to the potential costs to noninvestor interests as prospective target companies seek to "pre-empt"

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tender offers have contributed to corporate viability or profitability or have benefited shareholders." Goldberg, *Regulation of Hostile Tender Offers: A Dissenting View and Recommended Reforms*, 43 MD. L. REV. 225, 228 (1984). *See also*, ADVISORY COMM. ON TENDER OFFERS, U.S. SEC. & EXCHANGE COMM'N., REPORT AND RECOMMENDATIONS xvii (July 8, 1983) ("insufficient basis for concluding that takeovers are either per se beneficial or detrimental to the economy or the securities markets in general, or to issuers or their shareholders, specifically").

137. *See infra* note 10.

138. The 1985 Economic Report, *supra* note 14, at 197 states: "Stock market prices thereby provide a reliable barometer of the likely consequences of takeover transactions. If the aggregate net change in the value of an acquirors' and targets' shares is positive as a result of a takeover, then the transaction creates wealth and is beneficial." It bears remembering, however, that an acquisition which increases the wealth of both acquiring and target shareholders does not necessarily improve society's welfare. There are costs that simply are not captured by the stock price evidence. These result not only from such economic factors as an increase in monopoly power, but also from less quantifiable social costs. *See infra* note 22.

takeovers by placating shareholders with corporate restructurings and the substitution of debt for equity.

A. Theory and Evidence on the Outcome of Completed Takeovers

In the absence of direct evidence on how various interests fare in takeovers, the ability to reconcile shareholder interests with the collective good depends on the contention that stock price increases in takeovers reflect positive changes in societal as well as in shareholder welfare, societal welfare being equated with enhanced efficiency in the use of economic resources. The first step in this argument is to explain the theoretical relationship among efficient capital markets, the considerable evidence on stock price movements in takeovers, and the efficiency implications of takeovers:

> In fact, the stock price change is the best measure of the takeover's future impact on the organization. The vast scientific evidence on the theory of efficient markets indicates that, in the absence of inside information, a security's market price represents the best available estimate of its true value. The evidence shows that market prices incorporate all current public information about future cash flows and the value of individual assets in an unbiased way. Stock prices change, of course, in response to new information about individual assets. Because market prices are efficient, however, the new information is equally likely to cause them to decrease or increase, after allowing for normal returns. Positive stock price changes then indicate a rise in the total profitability of the merged companies. Furthermore, because evidence indicates it does not come from the acquisition of market power, this increased profitability must be from the company's improved productivity.[139]

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139. Jensen, *Takeovers: Folklore and Science*, HARV. BUS. REV. 109, 113 (Nov.-Dec. 1984). Elsewhere, Professor Jensen has acknowledged some problems with the available stock price evidence:

> Several studies show indications of systematic reductions in the stock prices of bidding firms in the year following the event. These post-outcome negative abnormal returns are unsettling because they are inconsistent with market efficiency and suggest that changes in stock price during takeovers overestimate the future efficiency gains from mergers. . . . Explanation of these post-event negative abnormal returns is currently an unsettled issue.

Jensen & Ruback, *supra* note 136, at 20-22. Magenheim and Mueller also found post-acquisition declines in the bidders' stock. *See* Magenheim & Mueller, *supra* note 136. Furthermore, some financial economists candidly acknowledge uncertainty as to the reasons for heightened takeover activity, as made clear by Professor Michael Bradley in proceedings before the SEC:

> I don't know exactly what's going on. That's the next level of study. What we do is, we're going from the aggregate to the particular; that particular is going to require numerous case studies, going in and finding out what is actually happening. And I know there are a lot of us in this business who are trying to convince Ph.D. students to take that as a line of inquiry, to get them to find out exactly what's happening in

From there it is but a short step to an even bolder conclusion about takeover benefits:

> The available evidence, however, is that mergers and acquisitions increase national wealth. They improve efficiency, transfer scarce resources to higher valued uses, and stimulate effective corporate management. They also help recapitalize firms so that their financial structures are more in line with prevailing market conditions.[140]

However attractive, this thesis immediately strikes one as at odds with the realities of many takeovers. If takeovers are motivated by the pursuit of "synergies" or the ousting of incompetent management, why do so many bidders not revitalize the target but immediately dismember it?[141] The answer seems to be that nobody really knows exactly why takeovers take place or what the sources of shareholder wealth gains are.[142] The term "synergy" is a conveniently vague, catchall term explaining nothing. In spite of this lack of knowledge, however, some retain faith in the workings of the market for corporate control, asserting that "fair competition among rival management teams can prevent acquiring firms from effecting value-decreasing takeovers and target managers from defeating value-increasing acquisitions."[143]

More direct evidence on the efficiency outcomes of many mergers casts some doubt on such a confident assessment of corporate acquisitions. Professor F.M. Scherer and Mr. David Ravenscraft have assembled substantial direct evidence on mergers showing that acquired companies during the 1960's and early 1970's were, on average, highly profitable before being acquired and that, after being acquired, often experienced a decline in profitability.[144] When tender offer acquisitions were isolated from their data,

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> these acquisitions. . . . The point is that it's taken us this time to get to this point in the aggregate data, and that's exactly what we want to do, find out exactly where those synergies are coming from.

SEC Economic Forum, supra note 14 at 65-66 (testimony of Professor Michael Bradley).

140. *1985 Economic Report, supra* note 14, at 196.

141. Peter Drucker has suggested that inflation may play a role in takeovers by distorting the relationship between asset and stock values. "In any inflation the cost of capital goods tends to rise much faster than the price of the goods they produce. It thus becomes economical to buy already existing capital assets rather than to invest in new facilities and new machines. So any company that is rich in fixed assets is worth more when dismembered—that is, when its capital assets are being sold as pieces of real estate, as factories, as machinery and equipment—than it is worth on a realistic price/earnings ratio based on the value of its output. This is one of the distortions which the raiders exploit." Drucker, *Corporate Takeovers—What is to be Done?* THE PUBLIC INTEREST, Winter 1986, at 3, 6. In essence, Drucker is suggesting that bidders do not utilize the acquired assets but seek to "arbitrage" the markets for corporate assets and stock, buying stock simply to gain control over assets and then selling off the assets. *See supra* note 92.

142. Bradley & Rosenzweig, *supra* note 15, at 1410-11.

143. *Id.* at 1411.

144. D. Ravenscraft & F. M. Scherer, *The Profitability of Mergers* (Dec. 1985) (working paper) (copy on file at Washington & Lee Law Review office). Using F.T.C. "Line of Business" accounting profitability data between 1974 and 1977, Ravenscraft and Scherer compared lines

similar outcomes were found.[145] Scherer and Ravenscraft conclude that their findings are "difficult to reconcile with the conjecture that mergers turned out on average to be profit-increasing and efficiency-enhancing"[146] and suggest that "the hypothesis that tender offer acquisitions are on average efficiency-increasing warrants much more skepticism than it has received thus far in the literatures of economics, corporate finance, and securities law."[147]

In another recent study, Professors Herman and Lowenstein, having examined fifty-six hostile tender offers initiated between 1975 and 1983, also found a significant decline in the acquired company's post-merger financial performance, and concluded that hostile takeovers do not necessarily lead to efficiency gains.[148] These studies, along with post-acquisition market share declines observed by Professor Mueller,[149] raise substantial doubts as to whether only inefficiently managed companies are acquisition targets or whether there are always useful "synergies" in a takeover. They also raise a serious question as to whether acquirors are serving larger societal interests by "breaking up" or possibly mismanaging what may have been well-run businesses.

Evidence of the type gathered by these recent studies undoubtedly will be controversial and will spawn yet further studies. If supported, however, such findings have potentially important implications for corporate governance. First, depressed stock prices that make an acquisition feasible may not reflect a governance or efficiency "problem" that needs remedying, or at least one that necessarily will be remedied through a change in corporate control. Instead, many takeovers may be motivated by reasons having nothing to do with utilizing corporate resources more efficiently. Second, if the less efficient use of corporate resources is not a social good to be encouraged, the claim that takeovers are uniformly good for shareholder wealth, good for corporate governance, *and* good for society at large may not be true. While takeovers undeniably are good for selling shareholders

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of business that had substantial merger activity between 1950 and 1970 with lines that did not. While the Ravenscraft-Scherer findings run counter to the claims of those who rely on stock price evidence, they are in line with earlier work which also found few efficiency gains from mergers. *See, e.g.*, Hogarty, *The Profitability of Corporate Mergers*, 43 J. OF BUS. 317, 325-26 (1970). *See generally*, K. DAVIDSON, *supra* note 2, at Ch. 15 (reviewing pre-1984 evidence).

145. D. Ravenscraft & F.M. Scherer, *Life After Takeover* (Sept. 1986) (working paper) (copy on file at Washington & Lee Law Review office). Ravenscraft and Scherer found that pre-takeover profitability of targets was only "slightly inferior" to that of industry peers.

146. Ravenscraft & Scherer, *supra* note 144, at 34.

147. Ravenscraft & Scherer, *supra* note 145, at 13.

148. Herman & Lowenstein, *The Efficiency Effects of Hostile Takeovers: An Empirical Study (a study in proceedings of Columbia University's Center for Law and Economics Studies* Conference *on Takeovers and Contests for Corporate Control)* 19-26 (Nov. 1985) (copy on file at Washington & Lee Law Review office).

149. Mueller, *Mergers and Market Share*, 67 REV. ECON. & STAT. 259 (1985) (substantial 1950-72 declines in market share experienced by acquired businesses as compared to control group companies).

who obtain premiums, they do not necessarily serve a commendable governance function, do not inevitably serve society's interest in moving resources to more productive uses, and do not usefully serve local or other noninvestor interests that may be adversely affected by the altered utilization of a corporation's assets. As such, a pro-takeover stance rooted in the stock price evidence may be unable to claim advancement of society's efficiency concerns as a reason for requiring management essentially to auction the companies they manage. Rather, such a position may have to rest more narrowly on shareholder gain.

Investor gain may be sufficient justification of takeovers for those who remain committed to the view that corporations should be managed for capital providers. If it cannot also be claimed, however, that takeovers fairly consistently eliminate rather than cause corporate waste and dislocation such a view may rapidly lose many adherents.

B. The Effects of Threatened Takeovers

The impact of heightened takeover activity is felt not only by corporations actually taken over, but also by those whose managements expect or fear a takeover. In fact, this is one of the supposed virtues of an active market for corporate control.[150] The risk of excessive deterrence, however, has led numerous persons to criticize takeovers as causing a variety of corporate ills. These ills essentially stem from possible "over-responsiveness" by management to the demands of capital providers and include management preoccupation with short run performance, a decline in product research and development and innovation generally, too great a fear of corporate liquidity, and a reduction in employee morale.[151]

Such claims might be viewed as naturally suspect when made by those with a great deal to lose in takeovers—management and its allies. Moreover, such assertions are difficult to measure, and even if quantifiable, are not conclusively attributable to the influence of takeovers. Nevertheless, responsible persons have made these claims often enough that serious study should be given to the effects of rampant takeover activity on the behavior of threatened corporations. The task is not simply to discern prevalent trends in corporate activity, but to isolate persuasively the role of the takeover threat in those trends.

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150. Easterbrook & Fischel, *supra* note 18, at 1174. Professors Easterbrook & Fischel argued that the threat of takeover causes managers "to reduce agency costs in order to reduce the chance of takeover, and the process of reducing agency costs leads to higher prices for shares." *Id.*

151. Drucker, *supra* note 140, at 12-14; Drucker, *A Crisis of Capitalism,* Wall St. J., Sept. 30, 1986, at 32; Fogg, *Takeovers: Last Chance for Self-Restraint,* 63 HARV. BUS. REV. 30 (Nov.-Dec. 1985); Hayes & Abernathy, *Managing Our Way to Economic Decline,* 58 Harv. Bus. Rev. 67 (1980); R. REICH, THE NEXT AMERICAN FRONTIER 140-72 (1983). *See also* "The End of Corporate Loyalty?" Bus. Wk., Aug. 4, 1986 at 42. *But see,* Jarrell & Lehn, *Takeover Threats Don't Crimp Long-Term Planning,* Wall St. J., May 1, 1985 at ___; Pound, Lehn, Jarrell, Are Takeovers Hostile to Economic Performance? *Regulation,* (Sept./Oct. 1986) at 25.

One such effort—and others should be expected—is that of Professor Coffee.[152] Professor Coffee describes two observable phenomena—the dramatic increase in the debt load of many corporations and the widespread enterprise restructurings currently taking place. He considers these to be efforts by management simultaneously to placate shareholders and to so decompose the corporation as will ward off a possible takeover attempt.

For example, an attractive company with little debt might borrow heavily and utilize the proceeds to repurchase stock, thereby substituting debt for equity. This both pleases shareholders who receive substantial distributions and frustrates potential bidders who might plan to finance stock purchases by borrowing against target assets.[153] Similarly, companies that restructure themselves by selling or spinning off subsidiaries or divisions and distributing proceeds or stock to shareholders can thwart a bidder by ridding themselves, oddly enough, of desirable businesses.[154]

Ultimately, Professor Coffee seeks to link these phenomena with a new theory of the firm in which takeovers are seen as a means of enabling shareholders to impose their greater preference for risk on management and other corporate participants. Since shareholders receive all the upside return on riskier activity, but share the risk of failure with creditors, they may prefer a significant amount of debt. Furthermore, management and other employees have their labor (and perhaps capital) heavily invested in one firm, while shareholders often hold a diversified portfolio of investments. As such, Coffee theorizes that management is less likely than shareholders to desire a risky course of action for the enterprise since doing so exposes a higher percentage of their firm-specific investment to loss.[155] The threat of takeover and resulting job loss, however, lead management to take actions—incurring debt and restructuring—that, however pleasing to shareholders, management would not otherwise undertake. Thus, the market for corporate control leads corporations to act in accordance with shareholder risk preference rather than management's.

If Professor Coffee's thesis is coupled with this Article's earlier argument that courts appear to be moving toward requiring greater management allegiance to investor interests, shareholders may be gaining allies in both the courtroom and the boardroom. The critical issue raised by these developments is twofold: "Why shouldn't corporations diligently advance share-

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152. Coffee, *Shareholders Versus Managers: The Strain In The Corporate Web* (Jan., 1986) (Working Paper No. 17) (copy on file at Washington & Lee Law Review office).

153. *Id.* at 36.

154. *Id.* at 46. Empirical evidence suggests that spin-offs create shareholder wealth. McDaniel, *supra* note 19, at 421 & n. 39. The SEC's Chief Economist expects to see a significant amount of such restructuring as firms try to avoid being acquired. FED. SEC. L. RPTR. (CCH) No. 1173, April 16, 1986, at 6.

155. Coffee, *supra* note 152, at 13-20. *See also* Baumol, *supra* note 93 at 89 n.9 ("[s]ome risks that are worthwhile from the stockholders' point of view are likely to be unattractive to management because if they turn out well no special rewards may accrue to the company officers, whereas if they turn out badly, management may be in trouble.").

holder welfare, both in and prior to a takeover?" and "What does the triumph of shareholder interests signify for other private and societal interests?" Are the latter interests largely aligned with those of investors as many proponents of takeovers claim? On the last question, Professor Coffee speculates that such constituencies as creditors facing greater risk of default on corporate obligations, employees facing layoffs from corporate streamlining, and the state itself as ultimate risk bearer may not be well served[156] and, interestingly, may in some respects be more closely aligned with management's more conservative risk preferences.[157] If so, perhaps neither particular constituencies nor, as indicated earlier,[158] society's desire for an efficient use of resources are furthered by the present pro-investor takeover climate.

Of course, it is possible that management has been unduly cautious in its risk preferences and that corporations will profit by shareholders' newfound influence. Moreover, without more widely-accepted information about the actual effects of corporate leveraging and restructurings on noninvestor interests, it is not definitively known whose interests are served and whose are hurt by such activity. The present point, however, is that even if and when those questions are answered more convincingly, the findings may suggest, as appears to be the case, that corporate behavior beneficial for investors may not, on balance, be good for others. As a result, corporate takeover responses aimed at maximizing shareholder wealth, whether judicially-imposed or management-initiated, may conflict with the belief that as important social institutions corporations must be managed to serve other interests as well.[159] How does this possibility bear on corporate governance?

IV. Three Perspectives On Corporate Takeover Stances

Once it is acknowledged that investor interests and those of others might differ, several questions emerge. As a policy matter, should takeovers

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156. Coffee, *supra* note 152, at 62-65.

157. *Id.* at 86. For those who believe management may consider these noninvestor interests in formulating takeover strategy, this Article's earlier criticism, *supra* note 110, of the judicial failure to clarify the oft-used statement that management is a fiduciary for the "corporation and its shareholders" is inappropriate. If noninvestor and investor interests diverge, these people might argue that management consideration of such "corporate" interests is, if not paramount to, at least on an equal footing with its duty to shareholders. That is one possible conclusion, but it certainly gives management considerable discretion to pick and choose the beneficiaries of its awesome power. *See supra* note 178 and accompanying text.

158. *See supra* Section A of Part III.

159. Professor Werner recognized the dual claims of investors and others on corporate activities: ". . . managers have become targets of two forces that often push in different directions. One, centered about the stock market, urges decisions in the interest of shareholders. The other, growing out of public opinion and fear of restrictive legislation, urges decisions in the community's interest. The two can often be reconciled. But where this is impossible and meeting community standards is likely to affect shareholders adversely, managements have subordinated community to shareholder interest. Community good-will, desirable as that may be, has had to bow to shareholder satisfaction." Werner, *Management, Stock Market And Corporate Reform: Berle And Means Reconsidered,* 77 Colum. L. Rev. 388, 410 (1977). Essentially, Professor Coffee's argument on the effects of threatened takeovers is one aspect of this larger concern.

nonetheless be encouraged, or at least not impeded, because they are so clearly beneficial for those who provide capital to corporations? Armed with new evidence and theories on the adverse consequences of takeovers for noninvestors, should management be allowed to respond to or prepare for a takeover by somehow taking account of such interests? If that is unacceptable, how then, if at all, should the interests of others who are vitally affected by corporate activities be factored into either society's or a particular corporation's stance toward takeovers?

Arguably, such questions are premature given the lack of authoritative evidence on the net effects of takeover activity. Yet, that evidence, if ever available and widely accepted, is years away. Meanwhile, takeovers proceed unchecked. Reconsidering larger questions of institutional purpose and the efficacy of decisionmaking arrangements can provide in the interim a useful sense of context, reminding us of what is ultimately at stake in more particularized squabbles.

With that in mind, in prescribing target company behavior there appear to be three possible kinds of responses to the issues raised above. These perspectives deal with the takeover posture of particular companies. They do not deal with the takeover issue by bluntly reducing the aggregate level of takeover activity through "macro" policies since, presumably, many takeovers do serve useful functions, and to halt such transactions altogether may be an overreaction. The harder task is identifying, at least roughly, those particular transfers of control that serve—by some accepted measure—useful purposes, and determining whether market forces playing themselves out through present or altered decisionmaking structures can accomplish those purposes. If the manner in which takeover outcomes are currently being decided is unsatisfactory, but no alternative arrangement for better identifying those takeovers that "should" proceed can be devised, then a policy response directed at the aggregate level of takeover activity may be required.

First Perspective. Require target management both in preparing for and responding to takeovers to focus exclusively on enhancing shareholder well being as measured by stock prices. If this orientation leads to unsatisfactory results for noninvestor interests, either let those interests fend for themselves or rectify the adverse effects directly through public intervention.[160]

Obviously, the precise manner in which this perspective might be fully implemented would be the subject of debate. For example, the passivity-resistance dispute would need resolution as to which is better for shareholders.[161] If some version of the "resistance" notion prevails, as is likely, discussion must focus on desirable (and permissible) management tactics for maximizing shareholder gain and on how courts might better review the propriety of such tactics. Reposing greater control in management through

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160. An example of public intervention to protect noninvestor interest would be to provide job retraining and other transitional benefits to employees terminated as a result of a takeover.

161. *See infra* note 104.

such devices as nonredeemable poison pill plans or "super voting" stock that can completely prevent takeovers would be prohibited.[162] Judges would intensify their scrutiny of other defensive measures—e.g., whether and when directors must redeem poison pill plans—to ensure that they are utilized solely to improve shareholder well being. The point is that this perspective would, on all fronts, require shareholder interests to be paramount to those of management and others.

Several comments can be made about this perspective. First, it probably assumes that changes in corporate control generally lead to a more efficient use of resources. If true, this is good from a societal wide point of view, at least over the "long run." Nonetheless, it occurs at the expense of those specific noninvestor interests not served by such a rapid realignment of resources.[163] Furthermore, as indicated,[164] recent evidence challenges this optimistic view of the efficiency outcome of many corporate combinations, thereby making appropriate an inquiry into whether the full costs of such activity are worth the gains.

Second, this perspective also assumes that any adverse effects of completed takeovers on particular noninvestor interests are identifiable within a reasonable time period, economic in nature, capable of being remedied (presumably by governmental action), and not too costly to correct—in short, that the effects can be ascertained, measured, alleviated, and determined to be "worth" the gains. It is naive, however, to believe that we are anywhere close to identifying the full effects of recent takeover activity, a task that will require considerable time and study. Consequently, we are in no position to state with assurance that the wrenching effects of such activity are purely economic and, on the whole, beneficial or capable of mitigation after the fact.

Third, at present such a perspective is biased in favor of takeovers because of the disparity of evidence on takeover effects for investors and noninvestors. The abundant stock price evidence on which this perspective relies shows takeovers to be unqualifiedly good for target shareholders while evidence on takeover consequences for noninvestor interests is less developed. The result is a policy vacuum that creates a hospitable climate for takeovers

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162. In July, 1986, the New York Stock Exchange proposed dropping its longstanding rule requiring all shares of public companies to have equal voting rights. The end of the one-share, one-vote rule has generated strong reaction. *See, e.g., SEC Rule Change Sparks Ire*, The Nat. L. J., July 21, 1986, at 26. The SEC will hold hearings on the proposal in December, 1986.

163. Professor Demsetz recently expressed this view:

> [Takeovers] don't serve the interest of everyone. They don't serve the interest of management that might be displaced. And they don't serve the interest of employees that may have to seek employment elsewhere. There is no way to effect change without having someone bear costs. It might be in the country's interests to soften the costs through unemployment insurance, subsidy, or whatever the case may be, but I don't think it is desirable for the economy to be run by firms that individually seek to do this, nor do I think it's possible in a free enterprise system.

SEC Economic Forum, supra note 14, at 16 (testimony of Professor Demsetz).

164. *See supra* Section A of Part III.

while addressing the "costs" of such activity, if at all, only after the fact. The uneven evidence on the effects of takeovers for investor and noninvestor interests undoubtedly has contributed to the current absence of meaningful federal public policy aimed either at regulating the aggregate level of takeover activity—through tax, antitrust, credit,[165] or other "macro" policy—or at identifying and encouraging only those acquisitions that are likely to result in acceptable outcomes.

Fourth, even if takeovers are not in the public interest, this perspective holds that public officials must stem the workings of the market if that is considered necessary, not private managers who are neither authorized nor equipped to make such "political" or "moral" decisions.[166] Instead, management must serve shareholders—its only true constituency—whether or not that orientation is ever proven to be detrimental to others. Moreover, to constrain management discretion, faithful service to shareholder interests needs a benchmark. In takeover situations, the standard is maximizing shareholder price returns, not simply preservation of or longer term profit maximization for the entity.

In this perspective then, the law's aim is simple. First, it should provide an informative, non-coercive atmosphere in which investors can consider and act on takeover offers, thereby deciding the entity's fate.[167] Second, the law should prevent management from retaining corporate control when such control is inimical to shareholder interests and should require management to procure the largest reasonable premium.[168] By furthering shareholder well being in this manner, the law will enable the marketplace to remedy the serious imbalance in management-shareholder relations, a longstanding and central problem of corporate governance.

This pro-investor vision of the corporation is certainly the orthodox economic one, though clearly in takeovers the potential tension between investor and other interests is more obvious and pronounced. It has also

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165. In January, 1986, the Federal Reserve Board made "junk bonds" subject to federal margin rules. *See* Hershey, *FED Adopts "Junk Bond" Curbs*, N.Y. Times, January 9, 1986 at D1. In effect, the rules provide that debt secured principally by acquired stock may not account for more than 50% of the acquisition price. Presumably, bidders and their counsellors will seek methods of circumventing this prohibition. Moreover, the SEC's Office of the Chief Economist recently conducted a study of "junk bond" financing and concluded that there was no need for regulation to curb its use. [Current] FED. SEC. L. RPTR. (CCH) 84,011 (JUNE 20, 1986).

166. For Professor Stone's recent response to this general position see Stone, *supra* note 13, at 566-73. Stone's defense of "voluntary" corporate responsibility, while forceful, provides management with considerable leeway in takeovers. His assertion that "adverse precedential consequences" are simply one cost of voluntarism, *id.* at 570-71 n.14, seems unsuited to takeovers. Managers might easily adopt a one-time "socially responsible" stance in takeovers while eschewing it in operating decisions, rather than vice versa, and remain undisturbed by any inconsistency in attitude. The issue is whether management's ability to so act will lead to substantially reduced accountability to shareholders by defusing takeovers without at the same time leading to any sustainable "socially responsible" action.

167. This is essentially the aim of the federal tender offer laws.

168. This goal is the domain of state corporate fiduciary laws.

influenced federal policy and, as argued,[169] there is a discernible trend in decisional law toward this view. No doubt the law has been remiss in favoring management's end of its relationship with investors. But this perspective forgets that the corporation is a web of mutual interdependencies. The shareholder claim on corporate activities is not inherently superior to that of others on either "ownership" or, in takeovers, risk-bearing grounds. Ultimately to rest the corporation's legitimacy on faithful allegiance to capital is to demean the contributions of others and, in the end, to expect very little of the institution.

Second Perspective. Enable target management to prepare for or respond to a takeover attempt by taking into account and possibly protecting noninvestor constituencies.[170]

This perspective often is espoused by management,[171] a group that outside the takeover setting may or may not be particularly receptive to noninvestor considerations.[172] This view is shared by several state legislatures which have sought to protect local noninvestor interests from the serious dislocation believed to follow from many takeovers.[173] Finally, this perspective might be considered the natural extension of Dodd's call for management to act as "trustee" for noninvestor interests,[174] or Professor White's suggestion that corporations behave as good "citizens."[175]

Courts have long allowed management to assume (or argue that it was assuming) this role by obscuring any distinction between duty to the corporate enterprise and duty to shareholders, and by almost reflexively applying the business judgment rule to challenged defensive measures. *Revlon* and other recent decisions portend a judicial effort to require stricter allegiance to investor interests and to return the corporate sufferage to shareholders on takeover decisions. Yet, if developing evidence reveals a divergence of investor and noninvestor interests in takeovers, this judicial trend may lead to a renewed claim that management be empowered to defend against

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169. *See infra* Section C of Part II.

170. This perspective is somewhat similar to what Professor Clark has recently called "high idealism." Clark, *What is the Proper Role of the Corporation?*, in PUBLIC-PRIVATE PARTNERSHIP: NEW OPPORTUNITIES FOR MEETING SOCIAL NEEDS 195, 205-210 (H. Brooks, et. al eds. 1984). Professor Clark considers arguments for and against this orientation, concluding that "no one knows with certainty that corporations transformed in accord with some leading version of high idealism would fail to make a net improvement in the overall welfare of our society. The hard questions are ultimately empirical ones, and high idealism has not yet been tried on a significant scale in the American setting." *Id.* at 210. It has been, however, increasingly articulated—whether or not ultimately practiced—by target management in takeovers. *See supra* note 29 and accompanying text.

171. *See supra* note 29 and accompanying text.

172. For a view that noninvestor factors are considered in corporate decisionmaking, see Subak, *Takeovers: Where Are We? Where Do We Go?*, 41 BUS. LAW. 1255, 1257 (1986).

173. *See* Johnson, *supra* note 27, at 190 nn.18-20.

174. *See infra* notes 39-40 and accompanying text.

175. *See* White, *supra* note 10.

takeovers, not from self interest, but on behalf of other valued claimants.[176]

The implications of such a perspective are several. First, if management could altogether prevent a takeover out of supposed solicitude for one or more noninvestor groups, shareholders would have no "right" to receive tender offers and premiums for their stock. Even if management did not completely thwart a takeover attempt, but merely sought a resolution that was more favorable to noninvestor interests than other options, that too might damage investors if such an outcome did not also provide the maximum premium.

Initially, granting management such power might be regarded as further erosion of the already limited incidents of stock ownership. But what rights inhere in a share of stock? Capital providers are surely entitled to conscientious and ethical effort toward long run profit maximization. Does stock ownership also include the right to act *en masse* with fellow shareholders in abruptly shortening investment horizons whenever an outsider perceives an opportunity to arbitrage the asset and stock markets? Mobility of capital is generally desirable for those possessing as well as those needing funds. Acknowledging that, further consideration of the exact nature of an investor's rightful "ownership" claim on a corporation embedded in a myriad of relationships would still be useful. This is particularly important since capital is more agile than other resources and the critical issue is less the need for continual economic adjustment than the abruptness with which takeovers cause such change. Perhaps capital providers simply cannot remain isolated from the problems caused by single-minded attentiveness to their interests in takeovers and must be more patient in seeking returns or in moving to new endeavors. This may seem an odd turn of events to those who have long bemoaned the relative impotence of investors in corporate activities, but perhaps takeovers have changed the corporate landscape that dramatically.

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176. State legislation may be needed for the requisite authority. Pennslyvania's corporate statute was amended in 1983 to specifically authorize directors and officers to consider the interests of employees, suppliers, customers, and local communities in deciding what is in the best interest of the corporation. PA. STAT. ANN. tit. 15, § 1408 (Purdon 1985). In 1984, Ohio enacted a similar provision. OHIO REV. CODE ANN. § 1701.59 (Page 1985). While directors must consider the interest of investors, they may also consider the interests of employees, suppliers, creditors, customers, the community, and the state and national economy. *Id.* If such legislation meets the same fate as other state takeover legislation, *see supra* note 27 and accompanying text, federal legislation or shareholder consent through charger amendment will be necessary. *See, e.g.*, Article X of Certificate of Incorporation of Control Data Corporation, *reprinted in* AOKI, *supra* note 10, at 179, which provides as follows: "[T]he board of directors . . . shall, in connection with the exercise of its judgment in determining what is in the best interests of the corporation and its shareholders, give due consideration to all relevant factors, including without limitation, the social and economic effects on the employees, customers, suppliers, and other constituents of the corporation and its subsidiaries and on the communities in which the corporation and its subsidiaries operate or are located." Apparently, such charter amendments are becoming more frequent and one such provision has even served as the basis for a board of directors rejecting a cash acquisition offer. *See* Sussman & Sussman, *Litigation Intensifies on Duties of Targets Directors,* Legal Times, May 26, 1986, at 10, 12, n.38.

Second, in this perspective the real issue then is not simply premiums for shareholders, but determining the significance of takeovers in assuring management accountability to the long-run interests of the enterprise. Given the nagging problem of accountability, it is tempting to embrace the takeover as a welcomed panacea. But, again, accountability to whom, for what end? Presumably, what is desired are mechanisms for efficiently assuring that management does not shirk or prefer its own interests to those of the enterprise. That objective ultimately serves investor as well as other interests congruent with the chosen business policy, but, economic and corporate finance theory notwithstanding, it may be altogether different than facilitating the desire of many shareholders to extract value from an enterprise as rapidly as possible.

Perhaps other methods of disciplining management have been slighted, both "market" mechanisms and the more traditional "rules" approach. An invigorated proxy system—with institutional investors playing a more active role—and more meaningful intra-corporate litigation are possibilities for keeping management alert and its loyalties undivided. The product market, certainly a more vigorous disciplinarian in an increasingly international market, and the market for management services are still operating, eventually culling out unneeded products and talents at a pace that allows some time for preparation and adjustment. Perhaps it is not essential that alleged inefficiencies be immediately driven from sight through the harsh workings of the market for corporate control. Shock can severely damage social as well as human organisms, sometimes disabling the usual decisionmaking mechanisms and causing regrettable actions. Less hurried, more thoughtful adaptation to the incessant process of "creative destruction"[177] may have important benefits.

Finally, given the need for greater attentiveness to noninvestor considerations and conceding limits on shareholder entitlements, one still wonders whether management is trained or equipped to serve as Platonic guardian, mediating the appetite of shareholders for a premium and the desire of employees and the local community to mightily resist. Even if management overcame its inherent conflict of interest in takeover decisions and generally made the "right" decisions, its sheer ability to play this role might be unsettling.[178] Equally troubling is the possibility that this "free hand" may not be adequately checked by market or other monitoring mechanisms, or tempered by management's hoped-for sense of responsibility and recognition of the need to maintain public trust. Moreover, by its very nature there is no way to know how management will exercise its discretion. Discretion may

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177. J. Shumpeter, Capitalism, Socialism and Democracy Ch. VII (1942).

178. One response to this concern is that corporate management currently has a great deal of unchecked power that, assumedly since it is allowed to continue holding such power, is being exercised in roughly the ways society expects. It is ironic that, in the name of limiting management discretion, a proscription of stewardly behavior might prevent management from doing what many in society probably expect of it in takeovers.

be used to implement defensive measures—e.g., selling "crown jewels" and effecting various "scorched earth" tactics—that injure the business and diminish shareholder prospects for a premium. On the other hand, discretion might be exercised to help shareholders and damage noninvestor interests through management efforts to preempt takeover attempts that themselves seriously hobble a company's future. Thus, the problem for those who adopt this perspective is the lack of any steady reference point for management's behavior and a perception, by many, that it is more a rationalization for bolstering management power than a sign of genuine compassion for noninvestors.

Third Perspective. Assuming that the aggregate level of takeover activity is not significantly reduced by policy initiatives or other factors, devise one or more means of allowing advance consideration of investor and noninvestor interests in takeovers.

This perspective is grounded on the belief that corporations and the forces affecting them are important to the well being of persons and groups other than just shareholders. Any substantial doubt as to whether takeovers, whatever their wealth benefits for shareholders, generally serve a critical governance or resource reallocation function should prompt the search for innovative means of assessing—or at least providing avenues of expression for—various claims on a corporation in a way that will give them genuine attention and consideration. Unlike the First Perspective, however, this perspective does not simply deal with the consequences of completed takeovers, nor, as in the Second Perspective, does it utilize management as the sole mechanism for protecting noninvestor interests. Instead, it seeks to tamper with the management-centered decisionmaking apparatus of the corporation, meliorating its deficiencies with the creation of some body or process designed, ideally, to "perceive, to project consequences, to weigh alternatives, etcetera, roughly in the way a responsible person does."[179] The aim of this perspective is much the same as that recently described by Lord Wedderburn in a larger, not specifically takeover-related context:

> The need is for mechanisms, both internal to and external to the enterprise, through which wider social responsibility can emerge,. . . [T]he difficulties now lie not so much in the identification of constituencies to be represented as in the methods and procedures by which their equitable representation can evolve. On that basis, democratic processes might establish procedures through which diverse claims of social "constituencies" in corporate groupings could be, at least transitionally, balanced. That balance might be accepted as . . . only the basis for the next round of argument.[180]

Currently, there is no broadly-based consensus to solve the quandary of requiring management to focus on one rather than another interest group by

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179. Stone, *supra* note 13, at 560. *See generally* P. FRENCH, COLLECTIVE AND CORPORATE RESPONSIBILITY Ch. 3 (1984) (arguing for view of corporation as moral actor).

180. Wedderburn, *supra* note 45, at 44.

proceeding in this manner, either in a general sense or as applied specifically to the takeover issue.[181] Furthermore, however worthy the abstract aim, it might be extremely difficult to attain agreement on either the methods or the calculus to be used in weighing various interests affected by a takeover and in determining whether a particular takeover should take place and, if so, on what terms. Moreover, some might consider such intrusion into corporate decisionmaking to be too radical, preferring instead that various constituencies become more adept at "bargaining" with the corporation on takeover aspects of their relationship. Finally, however unsatisfying the other perspectives, that alone is certainly no guarantee that this perspective is workable.

These are not trivial objections. Nonetheless, at the risk of hindering further consideration of this perspective by revealing the current dearth of concrete proposals for its implementation, the following may serve as a beginning point for more imaginative solutions: use of wholly independent directors[182] or committees to evaluate takeovers;[183] board or takeover committee representation of various constituencies;[184] special public "directors" with limited tenure appointed specifically for consideration of takeover issues;[185] former Justice Goldberg's recommendation for the establishment

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181. For examples of this approach in non-takeover settings, *see* Stone, *supra* note 13, at 563-64.

182. The Delaware Supreme Court recently indicated that concerns about a takeover attempt's effect on corporate policy and effectiveness are "materially enhanced" when defensive measures are approved by a board comprised of a majority of outside independent directors. *Unocal*, 493 A.2d at 955. *See also* Polk v. Good, 507 A.2d 531 (Del. 1986) (presence of ten outside directors on Texaco's 13 person board, coupled with investment banking and legal advice, constituted prima facie showing of good faith and reasonable investigation in connection with a challenged transaction). In *Revlon* it was not clear that a majority of directors were "truly outside independent directors." 506 A.2d at 176 n.3. *See also* Edelman v. Fruehauf Corp., [Current] FED. SEC. L. RPTR. (CCH) 92,863 (6th Cir. 1986) (approval of management buy-out by independent directors did not shield transaction from attack where directors "rubber stamped" proposal).

183. In 1983 shareholders of Superior Oil Co. adopted a proposal to create an independent committee to consider any takeover offer for 45% or more of the company's shares. The purpose of the committee was to determine whether the offer was fair, and if so, to recommend acceptance of the offer to the full board. Davis, *supra* note 64, at 9 n.41. Such a committee would, under the Third Perspective, assess the offer from a broader point of view.

184. On constituency representation, *see* R. NADER, M. GREENE AND J. SELIGMAN, TAMING THE GIANT CORPORATION 152-83 (1976); *see* STONE, WHERE THE LAW ENDS: THE SOCIAL CONTROL OF CORPORATE BEHAVIOR 134-83 (1975). For a recent critique of constituency representation on the board using a "transaction costs" analysis, *see* Williamson, *Corporate Governance*, 93 YALE L. JOURNAL 1197 (1984). *See also* Solomon, *Restructuring the Corporate Board of Directors: Fond Hope—Faint Promise*, 76 MICH. L. REV. 581, 598-602 (1978) (critical of "non-establishment" directors participation in operating decisions).

185. Stone, *Public Directors Merit a Try*, HARV. BUS. REV. 20, (March-April 1976); Stone, *supra* note 184, at 174-83; Weiss, *Social Regulation of Business Activity: Reforming the Corporate Governance System to Resolve an Institutional Impasse*, 28 UCLA L. REV. 343 (1981) (proposing establishment of National Director Corps). For a balanced critique of "public interest" directors see Conard, *Reflections On Public Interest Directors*, 75 MICH. L. REV. 941 (1977).

of an independent person or institution, modeled after the British Panel on Take-Overs and Mergers, to evaluate takeovers from a broad vantage point;[186] provide affected constituencies with increased stock ownership and/or the right to acquire stock ownership and to participate in the bidding process in the event of a potential control change.[187] In addition, there might be increased disclosure of the expected "impact" of a takeover on various interests along with some protection of these interests, perhaps in the way of payment to them either from target company assets or by the acquiror. Examples might be the payment of severance and/or retraining benefits in the event of employee layoffs of a certain level within a particular period after the change of control and similar payments to enterprise-dependent communities. If the "costs" of many takeovers are indeed borne by employees or communities or, ultimately, society at large, it may be appropriate for investors who are leaving the enterprise with premiums reflecting the value of assets enhanced by noninvestor efforts to absorb some of the costs of their rapid departure.[188]

All of these specific proposals have drawbacks.[189] Unless the practical difficulties are insurmountable, however, what is valuable about this perspective is its unconventional approach, an approach that may be worth ex-

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186. Goldberg, *Regulation of Hostile Tender Offers: A Dissenting View and Recommended Reforms*, 43 MD. L. REV. 225 (1984). Justice Goldberg suggests that tender offers be evaluated for their fairness to the shareholders and to the public. *Id.* at 233. As with proposals to modify the composition of the board, more detail is needed as to the exact composition of such a reviewing panel, how members would be appointed and removed, and precisely what factors ought to be considered in making its evaluation. For a description of the British model see DeMott, *Current Issues in Tender Offer Regulation: Lessons from the British*, 58 N.Y. U. L. REV. 945 (1983).

187. There has been a substantial increase in the use of employee stock ownership plans (ESOPs). *See* Blumstein, *The New Role for Esop's*, N.Y. Times, Jan. 2, 1985, at D-1. *See* Simmons, Ward & Watson, *An Esop Can Be an Effective Anti-Takeover Device*, The Nat'l L. J., June 30, 1986, at 25. *See also* Smith, *Colt Industries Uses Novel Re-Capitalization that Sharply Boosts Debt to Lift Stock Price*, Wall St. J., July 24, 1986, at 53 (describing Colt Industries' plan to increase employee ownership from 7% to at least 30% using debt rather than cash investment by workers). Increasing employee ownership of a corporation is likely to make a takeover more difficult. Less attention has been given to the possibility of providing employees with an option or right of first refusal to purchase stock that is triggered upon commencement of a control contest, or even allowing employees (not just management as in the usual leveraged buyout) to acquire stock from current shareholders at a market price.

188. Professor Coffee also considers the possibility of a "premium-sharing" arrangement. Coffee, *supra* note 152, at 81-87. *See also* Commentary, 1 BUS. & PROF. ETHICS J. 35 (1982) (commentary of Elmer Johnson on article by John Kavanaugh wherein Johnson proposes that in plant relocation decisions corporate board of directors should approve fair plan of severance payment to employees and community). A related idea is the extension of wrongful discharge laws to plant closings. Rhine, *Business Closings and Their Effects on Employees*, 8 IND. REL. L.J. 362 (1986).

189. For example, the issue of enforcement needs to be addressed since an effective means of implementing the desired outcome is needed. Furthermore, these proposals do not deal with the preemptive measures described by Professor Coffee, *supra* Section B of Part III. Nonetheless, management may refrain from taking such actions if there is some assurance that takeovers will be assessed from a standpoint other than just that of shareholders.

ploring because a decision-making body or process not controlled by management may allow for advance consideration and accommodation of various interests in a way that management-dominated boards cannot. That is, if interests other than those of investors are important and if there is at least some doubt as to whether a high level of takeover activity serves such interests, this Third Perspective reminds us that, in formulating law and policy on takeovers, such interests need not be ignored or relegated to the protection of management.

In essence, this perspective considers the view that the current market for corporate control works for the general good as a case yet to be proven, and continued unchecked takeover activity premised on that view to be a massive experiment to test one model of the corporation. Furthermore, this perspective considers the question of "For whom is management a trustee"? to be a legal antinomy, raising objections in whatever direction management turns. This perspective then is simply a suggestion that perhaps some process or body or combination of solutions, whether within or without the corporation, might be better equipped than management and its advisers, judges, shareholders, or the "market" to assess and redistribute the impact of large-scale takeovers.

So viewed, consideration of this Third Prospective may be fruitful simply because takeovers are a social phenomenon which current conceptions of management responsibility are not handling well. Perhaps, upon identification of a particular social problem that touches corporations, it is better not to expect management to be the source of all solutions but to create

> a solution mechanism precisely designed for the purpose with specific powers, decision-making procedures and standards of liability. This reflects precisely the change from an interest group approach [i.e., *who* should management protect] to a problem-oriented, functional approach.[190]

Whatever the preferred perspective, takeover-related developments are presenting a challenge both to corporations themselves and to current attitudes toward the proper ends of corporate and management behavior. Whether seen as a discrete problem or as related to and shedding light upon more general corporate issues, takeovers bring to the fore the significance of corporate activities to our society. Traditional ways of viewing the corporate institution and its goals and decisionmaking structures—prescribed by lawyers and more recently economists—may not take adequate account of this significance.

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190. Teubner, *Corporate Fiduciary Duties and their Beneficiaries,* in CORPORATE GOVERNANCE AND DIRECTORS LIABILITIES 149, 172 (K. Hopt & G. Teubner eds. 1985).