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Antitakeover Legislation: Not Necessary, Not Wise

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ANTITAKEOVER LEGISLATION: NOT NECESSARY, NOT WISE

I. INTRODUCTION

The current wave of corporate acquisitions is not the first to occur. Corporate acquisition activity has historically run in cycles with peaks corresponding to periods of strong economic growth. Current acquisition activity is said to be the fourth wave in the history of corporate combinations.[1]

The first wave of corporate combinations occurred after a depression in 1893 and continued until a recession in 1904.[2] This period was marked by the formation of huge companies such as Standard Oil and U.S. Steel

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[1] CONG. Q., Aug. 17, 1985, at 1632.

[2] ECON. REP. OF THE PRESIDENT 192 (1985).

which were created to dominate their respective markets.[3] These companies emerged and devoured smaller companies in an attempt to establish monopolies. In response, the Roosevelt Administration began enforcement of the Sherman Act[4], which had been passed in 1890 to prohibit monopolization and restraints of trade. Further government regulation ensued in 1914 when the Clayton Act[5] was passed. Among the specific practices outlawed by the Clayton Act were acquisitions of a company's competitors and interlocking directorates.

A second burst of corporate combinations began during a period of economic growth in the 1920's.[6] During that period, emerging automobile companies attempted to establish vertical monopolies over all aspects of the production process. The second wave of activity lasted until the depression in 1930.[7]

After the stock market crash in 1929, government regulation focused on the stock market.[8] In 1934 the Securities and Exchange Commission was established as an independent governmental agency, founded for the express purpose of adding stability to the securities market and protecting investors by requiring full disclosure of material information.

After World War II business combinations increased steadily and culminated in the third major wave of activity during the late 1960's and early 1970's.[9] It has been said that this period was marked by the rise of the tender offer, but most of the business combinations during this period occurred through negotiated mergers and acquisitions. During the third wave, the trend was toward diversification of product lines as companies sought to combine with businesses unrelated to their major product line.[10]

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[3] CONG. Q., Aug. 17, 1985, at 1632.

[4] 15 U.S.C. §§ 1-7 (1982).

[5] 15 U.S.C. §§ 12-27 (1982). In Standard Oil Co. v. United States, 211 U.S. 1 (1911), the Sherman Act was interpreted to prohibit only unreasonable restraints of trade. *Standard Oil* limited the effectiveness of the Sherman Act and prompted the enactment of the Clayton Act to close the loopholes of the Sherman Act.

In 1950 the Clayton Act was amended to include mergers and acquisitions carried out by asset acquisitions as well as stock sales. J. LIEGERMAN & G. SIEDEL, BUSINESS LAW AND THE LEGAL ENVIRONMENT 1019-24 (1985).

[6] CONG. Q., Aug. 17, 1985, at 1632.

[7] ECON. REP. OF THE PRESIDENT 192 (1985).

[8] CONG. Q., Aug. 17, 1985, at 1632.

[9] *Id.*

[10] *Id.* Annual takeovers during the 1960's exceed the current rate of takeover activity. However, the current real dollar value of acquisitions and mergers is almost double the respective activity that occurred during the 1960's. ECON. REP. OF THE PRESIDENT 193 (1985); Hood & Benge, *Golden Parachutes and the Business Judgment Rule: Towards a Proper Standard of Review*, 94 YALE L.J. 909, 916 n.40 (1985). Nineteen eighty-six was a record year for dollar-volume activity. *Merger Activity Expected to Ease, not Halt*, Wall St. J., Jan. 2, 1987, at 8 B, col. 3. *See also infra* note 17.

In response to the heightened acquisition activity, the Williams Act[11] was passed by Congress to govern tender offer activity. Through a series of provisions, the Williams Act requires that corporations which acquire more than five percent of the stock of another corporation file a statement of background and intentions with the Securities and Exchange Commission within ten days after purchase. The Act requires that all tender offers remain open for at least twenty days and permits shareholders who tender their shares to withdraw them within the first fifteen days of the offer or at any time if the shares have not been purchased within sixty days of the tender offer. Further, the Act provides that an offeror must purchase tendered shares on a pro rata basis, that all tendered shares must be purchased at the same price, and that increases in the offer price must also benefit shareholders who tendered prior to the increase. The Williams Act was labeled a neutral regulation, but it had the effect of reducing takeover activity for several years.[12]

The current wave of takeover activity began after the recession during the early 1970's and it has involved transactions of a magnitude unknown in prior years.[13] Causes for the recent surge of takeover activity have been attributed to a number of factors. Increased costs and environmental constraints have often made the acquisition of another corporation a cheaper and more efficient means of expansion than building.[14] Advantageous income tax treatment[15] and the availability of "junk bonds" as a means to finance acquisitions are other contributing factors.[16] The most direct and obvious reason for increased acquisition activity, however, has been the decline in the market value of stock to a level where the price-earnings ratio is exceptionally low or where the decline causes the value

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[11] 15 U.S.C. §§ 78m(d)-(e), 78n(d)-(f)(1982)(amending the Securities and Exchange Act of 1934).

[12] CONG. Q., Aug. 17, 1985, at 1632.

[13] S. LEE & R. COLEMAN, HANDBOOK OF MERGERS, ACQUISITIONS AND BUYOUTS 607 (1981). During the current wave of takeover activity a pattern of increased activity has been reflected through the world. *E.g.*, *Takeover Struggle in Canada*, 20 MERGERS & ACQUISITIONS 19 (Spring 1985); *Big-Deal Flavor Hits the U.K.*, [1985] 12 NAT'L REV. CORP. ACQUISITIONS (TWEED) No. 46 (Dec. 16, 1985).

[14] S. LEE & R. COLEMAN, *supra* note 13.

[15] *E.g.*, Smith v. Van Gorkom, 488 A.2d 858 (Del. 1985)(Merger motivated by desire to make use of non-refundable income tax credits).

[16] "Junk bonds" are bonds issued to finance a takeover. The label is given to these bonds because they are high risk investments which are not investment grade. The Federal Reserve Board began to consider the application of restrictions on "junk bonds" during the latter months of 1985. [1985] 12 NAT'L REV. CORP. ACQUISITIONS (TWEED) No. 45 (Dec. 9, 1985). In January of 1986 the Board approved a plan which restricts "junk bond" financing of takeovers. The plan requires that half the bond financing is backed by assets other than target company stock. *Tinkering Around with Corporate Takeovers*, FORTUNE 101 (Feb. 3, 1986).

of a company or its underlying assets to exceed aggregate market value of outstanding stock.[17]

Increased takeover activity has prompted congressional hearings[18] and has resulted in the proposal of several bills at the federal level to reform takeover regulations.[19] The design of proposed legislation has generally focused on the elimination or reduction of the perceived coercive effect of "two tier, front-end loaded" tender offers.[20] Legislative approaches include either a total elimination of such offers[21] or provisions which

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[17] Low stock prices characteristic of the current wave activity represent a sharp contrast to third wave activity. During the third wave stock prices were much higher relative to the price per earnings ratio and underlying asset values. The higher stock prices made many companies impervious to takeover threats. Thus, the only practical means to acquire companies was through negotiation.

Current stock values have created fierce competition among buyers and enabled purchases to be profitable at substantial premiums over the stock market value and at higher price per earnings multiples. *See* [1985] 12 NAT'L REV. CORP. ACQUISITIONS (TWEED) No. 32 (Sept. 2, 1985). *See also Corporate Takeovers (Part 1) Hearings Before the Subcommittee on Telecommunications, Consumer Protection, and Finance of the Committee on Energy and Commerce, House of Representatives*, 99th Cong., 1st Sess. (Serial No. 99-99) 530 (1985)[hereinafter CORPORATE TAKEOVERS (PART 1) or CORPORATE TAKEOVERS (PART 2)] (The stock market's continued undervaluing of the assets of corporations caused the proliferation of takeovers)(Statement of John J. Phelan, Jr., Chairman of the New York Stock Exchange).

[18] On May 23, June 12, and October 24, 1985, hearings on corporate takeovers were held before the Committee on Energy and Commerce of the House of Representatives. Transcripts of testimony, witness statements, and supportive documentation amounting to nearly fifteen hundred pages are compiled in CORPORATE TAKEOVERS (PART 1) & (PART 2).

[19] [1985] 6 BUS. LAW. UPDATE (A.B.A.) No. 1, at 1-3 (Sept./Oct 1985). "Dozens of bills were introduced [in 1985], calling for everything from a temporary ban on hostile takeovers to requirements that raiders spell out the impact their deals would have on the target companies' communities." *Tinkering Around with Corporate Takeovers*, FORTUNE 101 (Feb. 3, 1986).

[20] Two tier tender offers usually provide for a cash payment to tenderors on the first tier, while second tier tenderors receive subordinated debt in lieu of cash. It is claimed that stockholders are forced to sell on the first tier, even though they do not want to accept the deal, because they may otherwise be forced to accept the less desirable second tier. Finkelstein, *Antitakeover Protection Against Two-Tier and Partial Tender Offers: The Validity of Fair Price, Mandatory Bid, and Flip-Over Provisions Under Delaware Law*, 11 SEC. REG. L.J. 291, 293 (1984).

[21] S. 860, 99th Cong., 1st Sess. § 1, 131 CONG. REC. S 4011 (1985). Proposed legislation, however, extends beyond provisions affecting the tender offer itself. For example, Ohio Senator Howard Metzenbaum, the sponsor of S. 860 submits that the proposed legislation would "deal with the new realities dominating the corporate tender offer arena" in the following manner:

> The legislation would prohibit front end loaded two tier offers; it would prohibit partial tender offers where a bidder seeks more than 21 percent of the target's stock unless he tenders for all shares at the same price or unless he has the consent of the issuer; it would restrict greenmail; it would require tender offers to be open for sixty business days; it would prohibit targets, once a tender offer is announced, from making "structural changes" in the company, such as selling the

provide for a voting procedure whereby a tender offer cannot be completed without the approval of the shareholders of both the bidder and target corporation.[22]

This Note will consider the merits of antitakeover legislation with special emphasis on legislative proposals which, like second generation state takeover statutes, would subject tender offers to the approval of shareholders. But discussion and analysis are also applicable to federal proposals which seek to restrict takeovers through regulatory restrictions rather than a shareholder vote, as well as to second generation state takeover statutes. The view taken herein is that all antitakeover legislation, whether at the federal or state level, is neither necessary nor wise.

In part II, this Note will examine the proposed antitakeover legislation which prescribes procedures for shareholder approval of tender offers. In part III the propriety of legislation in general will be discussed. Requisites to appropriate legislation will be identified as an inadequacy of existing common law, an ability of the legislature to provide broad resolution of the perceived problem, and the absence of negative implications as a result of a proposed enactment.

In part IV the criteria outlined in part III will be applied to proposed antitakeover legislation. First, the adequacy of the business judgment rule in the corporate control context will be supported. Next, the inability of Congress to define and resolve perceived problems will be considered. Finally, the implications attendant to antitakeover legislation will be discussed. Specifically, consideration will be given to economic effects, the effects on shareholders' rights, and the concurrent effect of recent changes in the income tax code which would accompany the passage of the proposed antitakeover legislation.

Part V will examine the constitutional validity and effectiveness of second generation state takeover statutes. The pronounced constitutional validity and demonstrated effectiveness of second generation state takeover statutes revitalizes state takeover acts and obviates the need for federal legislation.

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crown jewels or issuing poison pills, without shareholder approval and; it would close the "ten day window."

CORPORATE TAKEOVERS (PART 2) at 5 (Prepared Statement).

[22] H.R. 1480, 99th Cong., 1st Sess. § 1, 131 CONG. REC. E 857 (1985).

II. Proposed Antitakeover Legislation

Extensive consideration has been given to federal antitakeover legislation.[23] Numerous proposals designed to counter perceived problems

[23] Congress, as well as the Securities and Exchange Commission, corporate executives, so called "corporate raiders," commentators, the securities industry, and the White House have assessed current acquisition trends in consideration of whether federal legislation should be enacted. *See, e.g.*, Corporate Takeovers (Part 1) & (Part 2); SEC, Committee on Tender Offers, Report of Recommendations (1983); *Top Executives Voice Support for Moves In Congress to Curtail Takeover Abuses*, Wall St. J., Mar. 5, 1987, at 54, col. 5; *Goodyear Asks for Help in Preventing Takeover*, Wall St. J., Nov. 12, 1986, at 24, col. 3; *Pickens, Chairman of Goodyear Urge Takeover Limits*, Wall St. J., Apr. 2, 1987, at 6, col. 1.; *35 Concerned CEO's Launch League Against Hostile Raids'*, [1985] 12 Nat'l Rev. Corp. Acquisitions (Tweed) No. 36 (Sept. 30, 1985); Corp. Fin. Week, Aug. 19, 1985, at 3; Note, *Tender Offer Defenses: The Need for National Guidelines in Light of Mobil*, 21 San Diego L. Rev. 1151 (1984). *Latest Insider Arrest Bring Urgency to Push for Overhaul*, Wall St. J., Feb. 13, 1987, at 12, col. 5 ("both lawmakers and stock-market professionals said yesterday's arrests send a clear signal: An overhaul of takeover and securities practices has become increasingly likely."); *Taking a Look at Takeovers*, Chicago Tribune, Nov. 20, 1986, § 3, at 1, col. 1 ("Reagan administration is taking another look at corporate takeover legislation in the wake of the Ivan Boesky [insider trading] case.").

Perceiving that new legislation is inevitable and possibly far-reaching, the Securities Industry Association has proposed recommendations for tender offer activity. Among the recommendations are prohibitions on greenmail payments, poison pill provisions, acquisitions of target stock beyond the five percent required reporting threshold (i.e., completely shut the ten-day window), and the extension of the mandatory minimum offering period for tender offers from the current twenty business days to thirty calendar days. *Securities Industry Association Urges Congress to Tighten Takeover Regulation*, Wall St. J., Mar. 26, 1987, at 62, col. 1.

Heretofore antitakeover legislation has been enacted only at the state level. Prior to 1982 states had extensively enacted statutes designed to enable target corporations to resist contested tender offers. Trevor & Edwards, *State Regulation of Corporate Takeovers: Developments Since Edgar v. Mite Crop.*, 43 J. Buyouts & Acquisitions 1, 2 (1985). *See also Will 'Poison Pill' Lose Its Taste?*, Nat'l L. J., Nov. 10, 1986, at 3, col. 1. The general thrust of state statutes was to invoke administrative hearings to review and determine the substantive fairness of an offer. Sargent, *Do the Second-Generation State Takeover Statutes Violate the Commerce Clause?*, 8 Corp. L. Rev. 3, 5 (1985). Tender offers were temporarily halted during the review period and permanently halted if required disclosures or if the offer were deemed substantively unfair. State statutes applied to all tender offers, thus, their effect impacted on interstate commerce.

In Edgar v. MITE Corp., 457 U.S. 624 (1982), an Illinois antitakeover statute was overturned on commerce clause grounds. Since *MITE* state statutes have changed their focus from regulation of securities offerings to the regulation of the internal affairs of corporations organized under state law. Sargent, *supra*. Post-*MITE* or second generation state antitakeover statutes generally regulate changes in corporate control under the states' traditional power to regulate the internal affairs of corporations. *MITE*, 457 U.S. at 638. In Cardiff Acquisitions, Inc. v. Hatch, 751 F.2d 906 (8th Cir. 1984), a Minnesota statute of this nature, that did not assert power to suspend offers outside Minnesota was upheld.

Federal legislation has been proposed because constitutional limitations on state regu-

attributed to increased acquisition activity have been presented to Congress.

In 1983 the Securities and Exchange Commission (SEC) Advisory Committee issued a report on tender offers.[24] The report made fifty recommendations which were studied by the SEC. As a result of SEC studies a legislative proposal was made which would have restricted both offensive and defensive takeover tactics.

Offensive restrictions would have narrowed the ten-day filing window for reports disclosing purchases of more than five percent of a company's stock and allowed the SEC to stay additional stock purchases for up to two days. In addition, defensive restrictions would have prevented a target company from acquiring its own stock via self-tender;[25] issuing securities or stock rights during a tender offer period when shareholders would thereby acquire more than five percent of the outstanding shares;[26] and modifying executive or director compensation[27]

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lations place the bulk of all takeovers beyond the reach of existing, direct regulation. Treavor & Edwards, *supra*, at 5.

The constitutionality of second generation state takeover statutes was upheld in Dynamics Corp. of Am. v. CTS Corp., 107 S. Ct. 1637 (1987). The validity of broad enabling provisions now provide a potent means for self help takeover defenses. *See infra* notes 200-16 and accompanying text.

[24] SEC, COMMITTEE ON TENDER OFFERS, *supra* note 23.

[25] SEC, COMMITTEE ON TENDER OFFERS, *supra* note 23, at 21-23.

[26] Stock rights plans contingent upon a change of control are commonly called "poison pills". Poison pills are a defensive tactic designed to bar all tender offers by providing stockholders with the right to purchase stock at bargain prices in the event of a takeover not receiving the approval of the board of directors. Moran v. Household Int'l, Inc., 490 A.2d 1059 (Del. Ch. 1985), *aff'd*, 500 A.2d 1346 (Del. 1985).

A poison pill stock rights plan may also have the effect of restricting an effort to conduct a proxy contest to replace the board of directors. Middleton, *Takeover Tactics Tested in Delaware*, Nat'l L.J., June 3, 1985, at 28 (Argument of plaintiff counsel in *Moran*).

The effect of a poison pill stock rights plan on the market price of stock is the subject of much debate. *Compare Turning A Profit From Takeover Attempts*, Wall St. J., June 4, 1986, at 26, col. 3 ("The poison pill is likely to generate increased returns to the target's shareholders.") *with* CORPORATE TAKEOVERS (PART 2) at 23 ("Poison pills have a negative impact on the market price of the issuer's shares.")(Statement of John S.R. Shad, Chairman of the Securities and Exchange Commission). Moreover, it is questionable that the precise impact of poison pills or other tactics employed in the takeover context is determinable. *See Will 'Poison Pill' Lose Its Taste*, Nat'l L.J., Nov. 10, 1986, at 3, col. 1. *But see* Brief for the Securities and Exchange Commission, Amicus Curiae at 28, Moran v. Household Int'l, Inc., 500 A.2d 1346 (Del. 1985)(even the weakest defensive tactics have a "significant effect" and they deter tender offers by at least 26%).

[27] Many corporations have employed preventive devices, commonly referred to as "shark repellants," to forestall tender offers.

> These preventative devices, which take the form of charter provisions, bylaws, or binding agreements between management and the target corporation, are designed to discourage an aggressor from making a tender offer in the first place.
>
> One technique that sometimes is characterized as shark repellant is the "golden parachute" agreement. Such an agreement, made between key management

during the pendency of a tender offer. Other provisions of the SEC proposal would have prohibited a target company from purchasing its own stock from anyone holding more than three percent of a class of securities for less than two years.[28] The SEC has not supported a subsequent legislative proposal.[29]

> employees and the employer corporation, provides for lucrative severance pay upon a change of managerial control resulting from a takeover by an aggressor corporation. Classification of a golden parachute agreement as a shark repellant is presumed on the theory that it discourages takeover attempts because it visits a substantial financial cost on the target corporation, which ultimately must be absorbed either by the aggressor corporation or by the shareholders of the target corporation.

Hood & Benge, *Golden Parachute Agreements: Reasonable Compensation or Disguised Bribery?*, 53 UMKC L. REV. 199, 200-01 (1985).

[28] The draft bill was designed to attack payment of "greenmail". Greenmail is an issuer corporation's purchase of its own stock at a premium price in order to induce a raider to drop a takeover attempt. CONG. Q., Aug. 17, 1985, at 1634. Hence, settlements are structured such that payments to the would-be raider fall outside what has been defined as "greenmail." After dropping his takeover bid for Goodyear, Sir James Goldsmith remarked: "The fact that I'm receiving 50 cents less than the $50 being offered shareholders is symbolically very important to me." *Nimble Financier*, Wall St. J., Nov. 21, 1986, at 1, col. 6. But in addition to the buyback price Goldsmith received expenses—about thirty seven million dollars. Plus, he received cash for his shares while Goodyear's other shareholders were relegated to awaiting the prospects of Goodyear's restructuring efforts. *Id.*; *Goodyear Could Be More Efficient Firm As It Focuses on Tires and Cuts Costs,* Wall St. J., Nov. 24, 1986, at 4, col. 2.

[29] *SEC Won't Review Proposals on Tender Offers*, Washington Post, Apr. 5, 1985, at 1, col. 4. The SEC supports the closing of the ten-day filing window, but it has opposed extending the tender offer period from twenty to sixty days; requiring purchasers of twenty percent of a corporation's stock to make an offer for all of its stock; and restrictions on takeover defensive tactics. *SEC Opposes Takeover Curbs*, [1984] CORP. ACQUISITIONS, MERGERS, AND DIVESTITURES (P-H) 8 (Nov. 1984).

The SEC has exercised its rulemaking ability to cure perceived tender offer abuses. In July 1985, the SEC proposed new rules which would require that tender offers be extended to all security holders of a class of securities subject to a tender offer ("all-holders rule") and that all security holders of the class be paid the *highest consideration offered* to any security holder ("best-price provision"). Additionally, the proposals would have required that a tender offer remain open for ten business days after an *increase* in the *amount of securities sought* through a tender offer. Proposed Amendments to Tender Offer Rules, Exchange Act Release No. 34-22198, 50 Fed. Reg. 27976 (July 9, 1985)(regarding proposed Rule 14d-10); Tender Offers by Issuers, Exchange Act Release No. 34-22199, 50 Fed. Reg. 28210 (July 11, 1985)(regarding proposed amendments to Rule 13e-4).

The SEC re-proposed an amendment to Rule 13e-4 and a new Rule 14d-10 which required that a tender offer remain open for a minimum period of ten business days after a *decrease or an increase* either in the *consideration offered* or the *percentage of shares sought* in the offer. The "best-price provision" was also revised to apply to the highest price *paid* rather than the highest price *offered*. Proposed Amendments to Tender Offer Rules, Exchange Act Release No. 34-22791, 51 Fed. Reg. 3186 (Jan. 24, 1986)(supplanting, in part, proposals made in Exchange Act Release No. 34-22198, *supra*).

In Amendments to Tender Offer Rules; All Holders and Best Price, Exchange Act Release No. 34-23421, 51 Fed. Reg. 25873 (July 17, 1986), the SEC announced the adoption of the

Proposed legislation currently before Congress reflects, in varying degrees, the recommendations of the SEC Advisory Committee. The least

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"all-holders requirement," as revised, in new Rule 14d-10 (applying the "all-holders requirement" and "best-price provisions" to bidders). Revised amendments to Rule 13d were also adopted. As amended, Rules 13e-4(f)(8)-(f)(10)(ii)(applying the "all-holders requirement" and "best price provision" to an issuer or affiliate), parallel new Rule 14d-10(a)-(d)(2).

Amended Rules 13e-4(f)(1)(ii) and 14e-1(b) extend the mandatory minimum offering period whenever there are changes in the consideration offered or the percentage or amount of securities sought. Rules 13e-4(f)(2) and 14d-7 extend a tendering shareholder's right to withdraw tendered shares until the expiration of the offering period.

The SEC adoption of the "all-holders requirement" was apparently precipitated by the fact that defensive tactics employed by the Unocal Corporation were sustained, in part, due to the Commission's failure to adopt its previously proposed rules. Unocal responded to a tender offer with a selective self-tender, a tender offer to all shareholders *except* the original tender offeror. *SEC Bans Biased Tender Offers*, Nat'l L.J., July 28, 1986, at 3.

The court in Unocal Corp. v. Pickens, 608 F. Supp. 1081, 1082 (D. Cal. 1985), speculated that the SEC's failure to adopt the proposed rules was based on either a lack of rule-making authority or a SEC policy that did not require that tender offers be open to all shareholders. The SEC's ultimate adoption of the "all-holders" rule lacks authority in the context of a self tender offer by an issuer.

In Schreiber v. Burlington Northern, Inc., 472, U.S. 1 (1985), the Supreme Court held that the Williams Act is solely a disclosure statute which limits the SEC's authority to insuring compliance with disclosure requirements. Opponents of the SEC-adopted rules argue that, on the basis of *Schreiber*, the SEC lacks authority to adopt the rules. *SEC Bans Biased Tender Offers*, *supra* at 18.

The SEC contends that its authority for the "all-holders requirement" lies within the broad enabling provisions of the Exchange Act of 1934. The validity of the rules is based on the proposition that "[s]o long as the rule promulgated pursuant to such general rulemaking authority is 'reasonably related to the purposes of the enabling legislation it will be sustained.'" Exchange Act Release No. 34-23421, *supra* at 25875 n.16 (quoting Mourning v. Family Publications Serv., Inc., 411 U.S. 356, 369 (1973)). A reasonable relation to a statutory purpose is premised upon the contention that "nontendering shareholders are within the class for whose protection the Williams Act was designed." *Id.* at 25878 n.28 (quoting Hundahl v. United Benefit Life Ins. Co., 465 F. Supp. 1349, 1368 (D. Tex. 1979)).

Exchange Act Release No. 34-23421 disingenuously fails to refer to Unocal Corp. v. Mesa Petroleum Co. 493 A.2d 946 (Del. 1985)(selective self-tender upheld as a valid exercise of business judgment), or Unocal Corp. v. Pickens, 608 F. Supp. 1081, 1082 (D. Cal. 1985)(court notes that the SEC proposed, but failed to adopt similar tender offer rules in 1977 and 1979). The rules adopted by the SEC were proposed soon after and they were doubtless prompted by the *Unocal* cases.

More notably, the SEC fails to address and consider the impact of the Supreme Court's decision in Piper v. Chris-Craft Indus., Inc., 430 U.S. 1 (1977), on the rules it adopted. *Piper* held that parties which are regulated by the Williams Act do not fall within the class intended to be protected by the Act. Specifically, a tender offeror is not within the class protected by the Williams Act.

SEC authority for the rules is predicated on the "nontendering shareholder" being within the class protected by the Williams Act. But where, as in both *Unocal* cases, a target company responds to a tender offer with a self-tender offer which excludes the initial tender offeror, pursuant to *Piper* will not fall within the class protected by the Williams Act. The SEC's "all-holders" rule, therefore, is wholly without authority with respect to a selective self-tender offer made in response to a tender offer. Thus, the "all-holders" rule

restrictive of several bills proposed by Congress in 1985 was the *Shareholder Democracy Act of 1985.*[30] The *Shareholder Democracy Act* proposed amendments to Sections 13 and 14 of the Securities and Exchange Act of 1934. The Act would implement a two-step shareholder approval process which would essentially put acquisitions on the same basis as mergers by requiring approval of both bidder and issuer shareholders.[31] The effect of the Act is to make it unlawful to take delivery of or pay for securities tendered without the approval of a majority of voting shares, plus a majority of all voting shares after exclusion of shares held by the bidder and the target companies.[32] A quorum for a special shareholders' meeting to vote on a tender offer would consist of a simple majority of shareholders.

The *Shareholder Democracy Act* further prescribes that a tender offer remain open for at least sixty business days rather than for the currently applicable offering period of twenty days. A person planning to acquire shares via tender offer would also be required to report his future intentions and submit a statement concerning the impact of the tender offer on the community. A potential acquirer must specifically state whether he would mortgage or otherwise encumber significant assets of the bidder or target company; make changes that would significantly affect the communities in which either corporation has operations; make significant changes affecting management, organized labor, or employees; make changes in the business or corporate structure; affect a merger; or make any changes that would affect the production of goods or performance of services for any governmental agency.

More restrictive legislative proposals include the *Corporate Productivity Act of 1985*[33] and the *Shareholder Fairness Act of 1985.*[34] The *Corporate Productivity Act of 1985* would prohibit acquisition of fifteen percent or more of a company's voting shares unless a majority of the target company's independent directors or two-thirds of its voting stockholders approve the bidder's tender offer.[35] The Act would require that all

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is not valid in the context of the responsive, selective self-tender offer which prompted its adoption.

For another analysis of SEC tender offer rulemaking, see *Significant 1986 Regulatory and Legislative Developments*, 42 Bus. Law. 827, 840-45 (1987).

[30] H.R. 1480, 99th Cong., 1st Sess. § 1, 131 Cong. Rec. E 857 (1985).

[31] The proposed voting process represents an unprecedented expansion of shareholder voting rights. *See infra* note 142 and accompanying text.

[32] State incorporation laws could increase, but not decrease the required approval margin.

[33] S. 706, 99th Cong., 1st Sess. § 1, 131 Cong. Rec. S 3243 (1985).

[34] S. 860, 99th Cong., 1st Sess. § 1, 131 Cong. Rec. S 4011 (1985).

[35] The *Corporate Productivity Act of 1985* is more restrictive than the *Shareholder Democracy Act of 1985* because it requires approval of two-thirds, rather than a simple

acquisitions exceeding fifteen percent of a target company may only occur via a tender offer and subject to approval requirements. Potential acquirers would be required to disclose to the target company's shareholders their plans for the target company, including any changes in the location of its principal executive office; material business activities; customer or supplier relationships; employment policies; or existing management.

The *Shareholder Fairness Act of 1985* would completely prohibit two-tier, front-end loaded tender offers. Additionally the Act would restrict greenmail payments;[36] prohibit defensive tactics after announcement of a tender offer; extend the tender offer period to sixty days; and narrow the current ten-day filing window to two days.

Despite the amount of discussion, criticism, and investigation given to federal antitakeover legislation no consensus as to the best course of action has emerged.[37]

During 1985, takeovers were a hot topic of national interest. Delays in the introduction of legislation "allowed a once feverish interest in curbing takeovers to subside," and support for legislation dwindled.[38] Legislative initiative remained in abeyance, and no major legislation was enacted in 1986.[39] Legislative impetus has, once again, become vigorous

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majority, of voting shareholders unless an offer is approved by a majority of directors at the outset. The different degree of restrictiveness may be attributable to the fact that the *Shareholder Democracy Act of 1985* was designed specifically to work in conjunction with, rather than instead of state takeover statutes.

[36] The greenmail provisions of the *Shareholder Fairness Act of 1985* parallel the legislation that the SEC proposed in 1983. *See supra* text accompanying note 28; Trevor, Edwards & Moellenberg, *Proposed Federal Tender Offer Reform Legislation: The Shareholder Democracy Act of 1985*, 56 CLEVELAND B.J. 282, 284 (1985).

[37] *Compare* CORPORATE TAKEOVERS (PART 1) at 191 ("takeovers are, in aggregate, beneficial to the economy.")(prepared statement on behalf of the Office of Management and Budget) *with id.* at 696 ("The present environment which abounds in hostile bids . . . [is] clearly negative for our national welfare.")(prepared statement on behalf of the American Society of Corporate Secretaries, Inc.). *See also id* at 619 ("there is no broad consensus as to what the problem is.")(exhibit submitted by the American Stock Exchange); *id.* at 710-12(realizing takeover efforts have both positive and negative results and suggesting a cautious approach)(prepared statement on behalf of the National Conference on Public Employee Retirement Systems).

[38] *D'Amato Accused on Anti-Takeover Bill*, New York Times, Nov. 25, 1986 § 12, at 6.

[39] *E.g., Merger Activity Expected to Ease Not Halt*, Wall St. J., Jan. 2, 1987, at 8B, col. 3.

because of insider trading,[40] controversial takeover attempts, and target buybacks.[41]

In early 1987, federal legislative proposals again focused on takeovers. Renewed interest in takeover legislation has adopted a different approach and emphasis. Proposals have spurned the "shareholder democracy" notion and its attendant shareholder approval of tender offers. Instead, the emphasis of the more recent legislation is to regulate the tactics viewed as abusive or unfair. Current legislative proposals strive to balance the rights of bidders and target corporations through the imposition of additional onerous procedural and disclosure rules which have long been the touchstone of tender offer regulation.[42]

The *Tender Offer Reform Act of 1987*[43] includes procedural changes which would extend the minimum tender offer period to require an offer to remain open for sixty days, shorten the ten day window for open market purchases to twenty–four hours, and require that acquisitions in excess of ten percent of a corporation's stock occur via a tender offer.

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[40] *E.g.*, *Latest Insider Arrests Brings Urgency to Push for Overhaul*, Wall St. J., Feb. 13, 1987, at 12, col. 5; *Wall Street May Face Big Changes in the Wake of Boesky Scandal*, Wall St. J., Dec. 3, 1986, at 1, col. 6. The SEC Chairman, however, does not believe that legislation should be predicated on a surge of insider trading. *Latest Insider Arrests Bring Urging to Push for Overhaul*, Wall St. J., Feb. 13, 1987, at 12, col. 6 ("the insider trading scandal shouldn't be the impetus for takeover legislation, since insider trading is parasitical activity, not the 'driving force' behind takeovers."). *Accord Market Madness: No Easy Answers*, Nat'l L. J., Feb. 2, 1987, at 32 (comments of Stephen Fraidin).

The *Tender Offer Disclosure and Fairness Act of 1987*, S. 1323, 100th Cong., 1st Sess. § 1, 133 CONG. REC. S 7594 (1987), is a legislative package which is directed at both insider trading and takeovers. Takeover related provisions would close the ten-day window for reporting holdings to the SEC. The Act would require reporting within one day while also reducing the reporting threshold from five percent to three percent. The twenty day minimum tender offer period would be extended to thirty five days and a formal tender offer would be mandated upon the acquisition of fifteen percent of a corporation's stock.

Disclosure requirements would require identification of financing sources and fees. Additionally, a formal statement of whether the acquisition is for investment or takeover purposes would be required. Acquirers for investment purposes would be precluded from making a tender offer for six moths.

Additional provisions prohibit greenmail or stock buybacks at a premium, self-executing "poison pill" provisions, and restrict the use of pension funds to pay takeover debts. *See also Senate Bill Seeks Stiffer Penalties For Insider Cases*, Wall St. J., June 5, 1987, at 4, col. 2.

[41] *Nimble Financier*, Wall St. J., Nov. 21, 1986, at 1, col. 6 (Ohio enacts special legislation to block the takeover of Goodyear); *Goodrich Buyback of Icahn's Stake Criticized by Judge*, Wall St. J., Jan. 16, 1987, at 6, col. 2 (judge finds ample evidence to support a claim of corporate waste in Samuel M. Feinberg Testamentary Trust v. Carter, 652 F. Supp. 1066 (S.D.N.Y. 1987)).

[42] *What the SEC Needs*, Wall St. J., May 28, 1987, at 26, col. 1; CONG. Q., May 2, 1987, at 835.

[43] H.R. 2172, 100th Cong., 1st Sess. § 1, 133 CONG. REC. H 2540 (1987). For a similar bill proposed in 1987, see *supra* note 40. *See also The Corporate Takeover and Insider Abuse Act*, S. 1324, 100th Cong., 1st Sess. § 1, 133 CONG. REC. S 7666 (1987).

Additionally, open market purchases of target corporation stock would be suspended for thirty days following the withdrawal of a tender offer.[44]

New prohibitions in the Act prevent greenmail payments and golden parachute provisions. SEC rulemaking authority would be extended, and the Act would require the issuance of rules to restrict the use of defensive tactics in response to a takeover bid. Shareholder approval for the defense tactic would also be required.[45]

Required disclosures include a bidder's statement describing tender offer terms and the inclusion in the management proxy statement of the director nominees of certain significant shareholders. The Act also requires an affirmative response to inquiries relating to takeover rumors.

Apparently convinced that more regulation must be the answer, Congress continues to draft takeover legislation. Proper recognition has not been afforded to the possibility that targeted abuses are the product of an ill-advised regulatory scheme emanating from the adoption of the Williams Act. Reform may be essential, but current legislative proposals may be further cause, rather than the cure, for targeted abuses. Congress should consider the original error in its ways and act to repeal the Williams Act rather than to extend its reach.[46]

III. The Propriety of Legislation Generally

Prerequisites to the propriety of any particular legislation are a common law deficiency,[47] a superior decision-making ability of the legislature over the ability of courts, and the absence of negative implications that may thwart the democratic will of the people.[48] All three prerequisites are necessary before legislation is appropriate. Absent these prerequisites the prevailing common law scheme is preferable, despite any imperfections.

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[44] Open market purchases were an effective takeover method for Hanson Trust PLC. *Dingell-Markey Bill Would Bar Raiders From Fast Open-Market Moves on Firms*, Wall St. J., Apr. 27, 1987, at 2, col. 3.

[45] The Act may cause the constitutionality of second generation state takeover statutes to once again become an issue. At present, the Act does not address the issue of pre-emption, but the issue is to be resolved as the bill moves forward. CONG. Q., May 2, 1987, at 836.

Without question, the self-executing provisions of OHIO REV. CODE ANN. § 1701.16 (Anderson Supp. 1986), would be pre-empted by the Act's provisions which expressly require shareholder approval of defensive tactics. *See also infra* note 216.

[46] Henry Manne suggests that the repeal of the Williams Act is essential to promote a desirable takeover policy and to resolve insider trading by removing poorly designed regulations. *The Real Boesky-Case Issue*, New York Times, Nov. 25, 1986, at A-27, col. 1.

[47] Where a void is adequately filled by common law doctrines or where legislation is otherwise not necessary the common law scheme is sufficient.

[48] *See generally* G. CALABRESI, A COMMON LAW FOR THE AGE OF STATUTES (1982); H. HART & A. SACKS, THE LEGAL PROCESS (1958)(discussion of law-making).

A. *Deficiency at Common Law*

The principal instrument of the American legal system has been common law.[49] The American legal system might be conceived of as existing without statutes, but not without common law.[50] The genius of the common law system is its capacity for orderly growth.[51] Legislative intervention is appropriate when there is a need for laws either more structured or more immediate than courts can afford.[52] Before legislation is appropriate, however, it should be clear beyond debate that judicial solutions are unsatisfactory and that they will not be changed by the judiciary.[53]

A deficiency of common law is an important prerequisite for legislation because long range implications accompany statutory interventions.[54] Accordingly, prior to any legislative enactment, there should be a manifest need for an instant resolution and no alternative except the enactment.

B. *Comparative Abilities of Legislatures and Courts*

Legislatures inherently have a superior ability over courts to gather and consider facts. In contrast, courts are not well situated to make certain decisions because they do not have the data to know what should be done, nor do courts have the ability to obtain such information.[55]

Additionally, issues which legislative consideration would reveal would not be at stake and thus not made apparent in a singular adversarial court setting.[56] Legislatures are in a position to gather and consider facts while not confronted with one specific issue that demands instant resolution. The broad scope of legislative inquiry, in contrast with narrow judicial inquiry,[57] is more conducive to providing resolution once and for all. Since legislatures establish predetermined results before disputes occur, justified expectations which could be cut off by retroactive

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[49] G. CALABRESI, *supra* note 48, at 4.

[50] E. FRUEND, STANDARDS OF AMERICAN LEGISLATION 34 (1965).

[51] Lum v. Fullaway, 42 Hawaii 500, 502-03 (1958).

[52] G. CALABRESI, *supra* note 48, at 5. However, the perception of need for legislation rather than the actual, existing current need for legislation may be predominant. *Id.* at 45 (during the New Deal era legislation was generally deemed appropriate.)

[53] H. HART & A. SACKS, *supra* note 48, at 726.

[54] *See infra* notes 65-68 and accompanying text.

[55] G. CALABRESI, *supra* note 48, at 146. As a practical matter the superior decision making ability of legislatures may represent only a potential for better decision efficacy. Cohen, *Hearings on a Bill - Legislative Folklore?*, 37 MINN. L. REV. 34, 38 n.5 (1952)("Congress utilize[s] data reported by staff only to bolster a preconceived notion or position dictated by party commitments.").

[56] G. CALABRESI, *supra* note 48, at 146.

[57] Judicial inquiry is limited to the issues raised by the facts of a particular case while legislative inquiry addresses all possible issues in a defined context.

judicial action may not be defeated by legislation which provides advance warning of its imminence.[58]

Legislatures, however, should impose exacting standards on themselves to insure that their decision-making ability in a given situation is not only superior to that of a court, but that there are adequate assurances of reliability in absolute terms.[59] Legislation should be justified by its absolute effectiveness and broad applicability, rather than by the inane fact that it is the product of extensive investigation and deliberation. Prior to enactment, legislation should be justified on the basis that it is a sensible, measured approach which will successfully resolve the issues addressed; it should not be justified on the grounds that it will merely offer to provide better redress than current judicial doctrines.

Drafters of legislation should seek a general solution capable of broad resolution in all future situations.[60] The mere applicability of an enactment to all future situations is, however, not sufficient justification; concerns of justice and equity must also be served. An inability to design a statute to achieve these concerns, while contemporaneously affording broad resolution of the issues addressed should be an indication that a legislature should not act. Narrow, *ad hoc* judicial decisions may be more capable of flexibility and adaptation to contrasting factual situations and, therefore, more desirable than legislation. Where concerns of justice and equity cannot be readily accommodated, legislative action may result in a statute that is either too general and easily circumvented or too restrictive and binding on the future because of detailed rules.[61]

C. Absence of Negative Implications

Particular needs for immediate resolution, coupled with the gradual progression of the law, can create the perception that legislative lawmaking is appropriate even where common law might have been capable of

[58] G. CALABRESI, *supra* note 48, at 146. Legislative law operates prospectively, applying only to those cases which arise after its enactment. Conversely, judicial law-making functions retrospectively—affecting acts, duties, and rights occurring or existing before the law came into force.

[59] Legislatures could adopt self-limiting doctrines whereby no action is taken on an issue when the legislature's ability to provide resolution is only theoretically, but not actually, superior to the ability of courts to decide. Legislative enactments could then be limited to situations where legislatures possess an absolute ability to resolve the situation addressed. *Cf.* G. CALABRESI, *supra* note 48, at 45 (During the New Deal neither courts nor legislatures were capable of obtaining facts and developing standards capable of providing resolution of agreed problems.).

[60] H. HART & A. SACKS, *supra* note 38, at 800.

[61] G. CALABRESI, *supra* note 48, at 167-68 (Non-categorical statutory language allows courts to go beyond the limits of a statute to decide a pressing case.); H. HART & A. SACKS, *supra* note 48, at 802 (Legislation subjects law in that field, for the indefinite future, to rigid techniques of development or non-development.).

adequately resolving matters.[62] The momentary dominance of a crisis can compel legislative actions bearing everlasting adverse effects.[63] Politicians have only imperfect knowledge of the present and future preferences of constituents.[64] Similarly, the long-range implications of legislation are not always envisioned. It is, therefore, inevitable that legislatures will perpetuate, rather than correct, common law defects or deficiencies.[65]

Although legislation may be considered preferable to conditions prevailing in its absence, it may seriously harm the economy. Government regulations can encourage inefficiency, contribute to inflation, and serve as a vehicle to protect special interests rather than the public interest.[66] Legislators must consider all side effects incident to a particular enactment. Resolution of one situation may cause greater, irreparable harm elsewhere.[67] The propriety of legislation is dependent upon whether full

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[62] G. CALABRESI, *supra* note 48, at 5.

[63] The New Deal created adverse effects that last today: A trend toward precise rule delineation rather than compilations of common law. G. CALABRESI, *supra* note 48, at 5; G. GILMORE, THE AGES OF AMERICAN LAW 96 (1977)("Unfortunately, with the New Deal, a style of drafting which aimed at unearthly and superhuman precision came into vogue . . . "). The proliferation of inefficient programs and agencies also resulted from the New Deal. G. CALABRESI, *supra* note 48, at 44-58; B. SIEGAN, REGULATION, ECONOMICS, AND THE LAW 88, 70 (1979):

> For a bureaucrat the first law is to keep on doing what you are doing, whether it is necessary or not. The second law is to do more of what you are doing, whether it is necessary or not. The third law is to do something else in addition to what you are doing, whether it is necessary or not. The fourth law is that whatever you are doing, you must do it inflexibly. [The fifth law is that i]n bureaucratic action costs do not matter or are subsidiary, except where they are costs to the government or to the regulatory body itself.

[64] S. ROSE-ACKERMAN, CORRUPTION, A STUDY IN POLITICAL ECONOMY 20 (1978).

[65] E. FREUND, STANDARDS OF AMERICAN LEGISLATION 72 (1965). *See also International-Debt Experts Worry That Congress Will Tinker With Problems and Make It Worse*, Wall St. J., Mar. 12, 1987, at 62, col. 1 ("Congress is more likely to harm than help the situation.").

[66] B. SIEGAN, THE INTERACTION OF ECONOMICS AND THE LAW 171 (1977); *Consumer Groups Draw Fire for Ignoring Regulation's Cost*, INSIGHT 44 (Feb. 16, 1987).

[67] *See supra* note 63. The presence and effect of other legislation affecting the area addressed by proposed legislation should be considered before additional actions are taken. H. HART & A. SACKS, *supra* note 48, at 721. Legislators must be sure that other pending or recently passed enactments will not adversely impact the area of concern. If other measures have recently or will soon affect the area considered by legislators, subsequent legislation should not follow until the effect of prior legislation can be assessed.

Should the prior enactment fail to be completely satisfactory, legislators can learn from the mistakes made and, more importantly, avoid compounding mistakes. Alternatively, if the prior enactment is completely or partially successful, legislators will have better insights into the type of revisions which would be advantageous. Again, there would be a minimization of mistakes and a potential for a resolution with a minimum of restrictions invoked.

For a discussion of the potential effects of concurrent changes in the tax code and antitakeover legislation, see *infra* notes 174-199.

consideration is given to the long-range implications which may follow; therefore, legislatures should seek and find assurances both of the desirability of an enactment's result and of its long-range implications.[68]

Legislation which overtly thwarts the democratic will of the people is unlikely due to the obvious political ramifications. More subtle thwarting, however, often occurs. Legislation commonly bears conclusory, fallacious titles which purport to make the enactments seem above reproach.[69] In this type of legislation legislators presuppose agreement where no consensus is apparent; in essence, legislators act without regard to public needs and desires.

The effects of most legislation are not immediately apparent. It takes time for the impact of legislation to be realized and for a consensus of opinion relative to that impact to be formed. Generally, new laws represent or only run obliquely counter to the prevailing majority view. Few serious problems exist initially, but later changed circumstances render laws inconsistent as they no longer serve current needs or represent the thinking of current majorities.[70] Problems incident to legislation which is, or becomes, inconsistent with the social or legal environment should induce legislators to exercise restraint. Statutes passed during times of crisis or in an experimental spirit should be carefully considered and drafted narrowly if action is deemed necessary.[71]

When laws are no longer functional, they may fail to comport with societal changes.[72] The result of statutory law-making is that laws are currently governing us that would not and could not be passed today. Continuity and change will always be essential to an effective, efficient legal system.[73] While the law must change to meet the changing needs of society, abrupt or frequent changes are not desirable. Legislation should be written narrowly and applied sparingly. Legislatures should be

[68] *Cf.* G. GILMORE, *supra* note 63, at 95 ("One of the facts of legislative life . . . is that getting a statute enacted in the first place is much easier than getting the statute reviewed so that it will make sense in the light of changed conditions."); H. HART & A. SACKS, *supra* note 48, at 721 (Few controversial acts of Congress are repealed; their staying power is greater than Constitutional doctrines of the Supreme Court); 5 THE WRITINGS OF THOMAS JEFFERSON 121 (Paul L. Ford ed. 1895)("No society can make a perpetual constitution, or even a perpetual law. The earth belongs always to the living generation.").

[69] Legislation often bears a title prefaced with "fair" or includes "equity" or other similarly conclusive language as if to place an enactment above reproach. Equity, fairness, and similar concepts are abstract notions legislators treat loosely and employ frequently. *See, e.g., U.S. Fair Trade Laws Are Anything But*, Wall St. J., June 3, 1987, at 26, col. 4.

[70] G. CALABRESI, *supra* note 48, at 6; *supra* note 68.

[71] Care should be taken to avoid the inherent possibility of adverse effects of legislation. *See supra* note 63.

[72] Courts are unable to keep laws functional in the presence of a statute. General respect for statutes precludes courts from overriding or acting interstitially. G. CALABRESI, *supra* note 38, at 6-7.

[73] *Id.*

cautious not to be overly responsive as they may indefinitely impose the will of temporary or non-existent majorities.

After careful consideration and upon reaching a conclusion that there is a deficiency at common law, legislatures should then only act when they are in a position to afford broad resolution of a problem without thwarting the democratic will of the people—either currently or prospectively. Legislation of the utmost propriety is guided by the credo:

> Legislation is needed, not to repress the forces through which judge-made law develops, but to stimulate and free them . . . . The judicial process is to be set in motion again, but with a new point of departure, a new impetus and direction. In breaking one set of shackles, we are not to substitute another.[74]

IV. The Propriety of Antitakeover Legislation

A. *The Adequacy and Applicability of Common Law: The Business Judgment Rule*

Judicial inquiry into the decisions made by a corporation's board of directors is governed by the business judgment rule.[75] The business judgment rule has been formulated in myriad ways by courts and commentators.[76] Formulations of the business judgment rule generally include a factual presumption that directors in good faith exercised their best business judgment.[77] On the basis of the presumption, a decision by directors will not be overturned by courts unless the basis for the presumption is successfully rebutted.

The deference given to business judgments is the result of several policy justifications designed to encourage economic development.[78] The rule provides encouragement for the most competent people to serve as directors by eliminating the fear of personal liability for mistakes. Human fallability transcends all aspects of life—including corporate

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[74] Cardozo, *A Ministry of Justice*, 35 Harv. L. Rev. 113, 117 (1921).

[75] *See generally* Arsht, *The Business Judgment Rule Revisited*, 8 Hofstra L. Rev. 93 (1980).

[76] *E.g.*, Norlin Corp. v. Rooney Pace Inc., 744 F.2d 255 (2d Cir. 1984); Pantor v. Marshall Field & Co., 646 F.2d 271 (7th Cir. 1981), *cert. denied*, 454 U.S. 1092 (1981); Arsht, *supra* note 75, at 112; Note, *Tender Offer Defensive Tactics and the Business Judgment Rule*, 58 N.Y.U. L. Rev. 621 (1983).

[77] Arsht, *supra* note 75, at 112.

[78] Note, *The Business Judgment Rule in Derivative Suits: Has Unchecked Discretion Gone Too Far?*, 53 UMKC L. Rev. 257, 258 (1985).

decisions. Courts, therefore, adopted a standard of review that would encourage qualified people to assume positions of authority.[79]

Further justification for the business judgment rule stems from its ability to allow room for the discretion necessary in the development of policies and decision-making.[80] Wide latitude is afforded to directors to promote efficient and effective corporate operations. A recent justification for the business judgment rule lies in the nature of the decision under review. Courts are not well suited to assess complex corporate matters and courts cannot operate the nation's businesses.[81] The inability of courts to deal with the subject matter at issue in business decisions is further compounded by current overcrowding in the courts.[82]

The interrelationship and cumulative effect of policy justifications has resulted in a powerful common law rule. Judicial inquiry is not, however, completely precluded by the business judgment rule because prerequisite conditions limit its application. The business judgment rule presumption will only apply in the absence of a breach of the duty of care in the process of making the decision under review.

Before courts invoke the business judgment rule and its attendant presumption, consideration is given to the facts and circumstances surrounding a business decision in order to assess the extent to which directors complied with their duty of care.[83]

The elements which generally comprise the duty of care are a conscious exercise of judgment; an informed decision; good faith and disinterested decision-making; and a rational basis for the decision.[84] Discharge of the duty of care is contingent upon compliance with the legal standard of care with respect to each element of the duty of care.

Generally, the legal standard by which the duty of care is measured is one of reasonableness.[85] During the performance of functions, directors

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[79] Note, *supra* note 76, at 651.

[80] Zapata Corp. v. Mandonado, 430 A.2d 779, 782 (Del. 1981)(The business judgment rule exists to promote the free exercise of managerial power). *See also* Note, *supra* note 76, at 651; Note, *supra* note 78, at 258 (same).

[81] Note, *supra* note 76, at 651. *Cf.* Gilson, *A Structural Approach to Corporations: The Case Against Defensive Tactics in Tender Offers*, 33 STAN. L. REV. 819, 1010-12 (1981)(The business judgment rule functions primarily as a "statement of judicial restraint.").

[82] Note, *supra* note 78, at 259.

[83] Note, *The Misapplication of the Business Judgment Rule in Contests for Corporate Control*, 76 NW. U.L. REV. 980, 984 (1984).

[84] A.L.I., PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS 56, 59, 61, 62 (Tent. Draft No. 3, 1984).

[85] Casey v. Woodruff, 49 N.Y.S.2d 625 (Sup. Ct. 1944)(There is no conflict between the business judgment rule and negligence); Briggs v. Spaulding, 141 U.S. 132 (1891)(Directors are bound to use the amount of care that a careful and prudent man would use under similar circumstances). However, there is some dispute as to the application of the standard. *Compare* Veasey & Manning, *Codified Standard: Safe Harbor or Unchartered Reef? An Analysis of the Model Act Standard of Care Compared With Delaware Law*, 35 BUS. LAW. 919

should exhibit the care of an "ordinarily prudent person would reasonably be expected to exercise in a like position and under similar circumstances."[86] The standard of care is flexible and accommodates the special skills or expertise of directors as well as the factual setting in which an alleged dereliction of duty arose.[87]

Initial judicial inquiry should not consider the merits of a business decision. If, on the other hand, directors fail to discharge their duty of care,[88] the business judgment rule is no longer applicable and any resulting business decision will be fully reviewed.

(1980)("reasonably" as used in the MODEL BUSINESS CORPORATION ACT invites judicial scrutiny of business decisions) *with* Arsht & Hinsey, *Codified Standard—Same Harbor But Chartered Channel: A Response*, 35 BUS. LAW 947 (1980)("reasonably" is a codification of the traditional duty of care standard).

[86] A.L.I., *supra* note 84, at 6. The trend may be towards requiring greater skill and diligence on the part of directors. *Compare* Everett v. Phillips, 288 N.Y. 227, 229, 43 N.E.2d 18, 20 (1942)(Deference given to a business judgment notwithstanding the court's recognition: "Errors may be so great that they demonstrate the unfitness of directors to manage the corporate affairs.") *with* Smith v. Van Gorkom, 488 A.2d 858 (Del. 1985)(eminently qualified directors held liable for perfunctory consideration of merger agreement). More stringent review, however, may result from the context of the business decision. *See, e.g.*, Note, *supra* note 83, at 987 (Circumstances surrounding decisions concerning corporate control require a director's "utmost diligence and attention"); Manning, *Reflections and Practical Tips on Life in the Boardroom After Van Gorkom*, 41 BUS. LAW. 1, 5 (1985)(The non-uniform application of the business judgment rule results because the criteria within the rule varies with the issue at stake.).

[87] A.L.I., *supra* note 84, at 23.

[88] Corporations are the creatures of the state of incorporation. Thus, the authority of the corporation as well as the obligations imposed on the exercise of corporate authority are fixed by state law. State corporate statutes define a limited number of required director functions. Rather than defining the essential functions of directors, state corporation statutes traditionally require only that a corporation is managed by a board of directors. Thus, the corporation itself is the primary source for establishing the functions of directors. Corporate functions may be imposed on directors by the provisions of the articles of incorporation, by-laws, or shareholders' and board resolutions. Directors' functions are also fixed by the conventions adopted in corporate operations. *Id.* at 13-14.

The standard of care is fixed by state common law or statutory provisions. States where common law sets the standard have adopted the following formulations: "due care"; "care or ordinary care"; "care that an ordinary prudent person would exercise under similar circumstances"; and "care exercised by prudent person in his own affairs". State statutory provisions have adopted or are based in the MODEL BUSINESS CORPORATION ACT § 35 (1979), formulation which requires "care as an ordinary prudent person in a like position would use under similar circumstances." Statutory variations from the MODEL ACT essentially add "reasonable inquiry", delete "like position", or substitute "due care".

Certain state statutes have imposed specific duties on directors which include liability for accepting or giving a bribe, kickback, or similar payment; denying shareholders rightful access to books and records; consent or authorization to stock transactions prohibited by state law; and knowingly allowing or causing a materially false report to be made. Moody, *State Statutes Governing Directors of Charitable Corporations*, 18 U.S.F.L. REV. 749, 759-60 n.46 (1984)(citing PRINCIPLES OF CORPORATE GOVERNANCE AND STRUCTURE: RESTATEMENT AND RECOMMENDATIONS 164-73 (Tent. Draft No. 3, 1984)).

Ohio has gone further than any other state and it has fixed the duty of care nadir.

The business judgment rule has been criticized for being inadequate in the corporate control context.[89] Critics argue that less deference should be given to decisions concerning the control of a company because of inherent tendencies toward self-interest by directors who stand to lose control. To some extent the criticism has been heeded as judicial decisions involving corporate control have begun to erode the deference given to directors under the business judgment rule.[90]

Two recent decisions illustrate the applicability as well as the adequacy of the business judgment rule in the corporate control context. In *Smith v. Van Gorkom*,[91] the court held that the presumption of the

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Furthermore, the standard of care is applied automatically to all Ohio corporations without shareholder approval. OHIO REV. CODE ANN. § 1701.59 (Anderson Supp. 1986), enacted as part of Am. Sub. H.B. 902, 116th Gen. Assembly, 1986 Ohio Legis. Serv. 5-1096 (Baldwin), virtually eliminates the duty of care in Ohio.

A breach of the duty of care must be supported by clear and convincing evidence which proves "that the director has not acted in good faith, in a manner he reasonably believes to be in or not opposed to the best interest of the corporation, or with the care that an ordinary prudent person in a like position would use under similar circumstances." OHIO REV. CODE ANN. § 1701.59(C)(1) (Anderson Supp. 1986). Moreover, a director's reasonable beliefs may be based on the affects of a change in control or his termination or potential termination OHIO REV. CODE ANN. § 1701.59(C)(1)(a)-(c) (Anderson Supp. 1986)

The new Ohio law imposes liability "only if it is proved by clear and convincing evidence in a court of competent jurisdictions that [a director's] action or failure to act involved an act or omission undertaken with deliberate intent to cause injury to the corporation or undertaken with reckless disregard for the best interests of the corporation." OHIO REV. CODE ANN. § 1701.59(D) (Anderson Supp. 1986).

The Ohio legislation recognizes that directors are usually better able to make business judgments than the courts and that liberal duty of care laws are essential to encourage qualified directors to serve as board members. *See* Herzel & Katz, *Smith v. Van Gorkom: The Business of Judging Business Judgment*, 41 BUS. LAW. 1187 (1986).

[89] *E.g.*, Note, *supra* note 76, at 660 ("A less deferential version of the business judgment rule should be applied [in decisions affecting corporate control] because of the inevitable self-interest of directors."); Comment, *Tender Offer Defenses: The Need for National Guidelines in Light of Mobil*, 21 SAN DIEGO L. REV. 1151, 1167 (1984)("The business judgment rule, with its strong presumption of good faith on the part of directors, is . . . inadequate to address the conflict of interest inherent in tender offer defenses."). *Contra* Lipton, *Takeover Bids in the Target's Boardroom*, 35 BUS. LAW. 101, 104 (1979)("Takeover bids are not so different from other major business decisions as to warrant a unique sterilization of the directors in favor of direct action by the shareholders.").

[90] Gerlits & Barnard, *Poison Pill Defense Lays Open Corporate Boards*, Nat'l L.J., May 27, 1985, at 18, col. 1 (Special Section).

[91] 488 A.2d 858 (Del. 1985). *Van Gorkom* involved a bizarre factual setting referred to by one commentator as a "legal soap opera." Manning, *supra* note 86, at 1.

Van Gorkom was the president and chairman of the board of directors of Trans Union, a diversified holding company. Van Gorkom unilaterally decided to contact a potential acquirer and proposed the sale of Trans Union. 488 A.2d at 866. Ultimately, Van Gorkom reached an agreement in principle to sell Trans Union without knowledge, consent, or authorization of other board members. After finalizing the agreement Van Gorkom convened the board and obtained approval for the sale.

Neither Van Gorkom nor any other board member ever read a proposed or actual sale

business judgment rule will not apply when directors exhibit a lack of due care with respect to their duty to make informed decisions. In *Van Gorkom* the business judgment rule was not pierced[92] or circumvented. Rather, the rule never applied. The merits of the board's decision were reached only because the rule did not apply.

The principle issue in *Van Gorkom* was the duty to make an informed decision. Directors failed to meet the appropriate standard of care with respect to this duty because they did not perform their functions with the care that an "ordinarily prudent person would reasonably be expected to exercise in a like position and under similar circumstances."[93]

In addition to illustrating when the business judgment rule is inapplicable, *Van Gorkom* provides proof of the rule's general adequacy.[94] The business judgment rule operates in concert with the proper discharge of the duty of care. In so doing the rule affords directors protection when protection is consistent with policy objectives, while allowing for complete consideration of the merits of a decision in the breach of duty.

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agreement prior to its execution. Van Gorkom made oral representations based on his discussion with the potential acquirer, but without the benefit of a proposed agreement. Van Gorkom later executed the agreement at a social event although he had not read it prior to execution. *Id.* at 867-69.

The court found that the business judgment rule did not apply because the plaintiffs were able to show that there was no basis for an informed decision since Trans Union never formally attempted to assess its stock value. The only analysis made considered only the feasibility of a leveraged buyout. *Post hoc* justifications for the sale were rejected on the basis that the duty to make an informed decision relates to the time of the alleged dereliction. *Id.* at 868, 877.

Hanson Trust PLC v. ML SCM Acquisition, Inc., 781 F.2d 264 (2d Cir. 1986), presents a similar situation with similar results in the context of a lock-up option.

[92] *Contra* Manning, *supra* note 86, at 1 ("the court there [in *Van Gorkom*] pierced the business judgment rule").

[93] A.L.I., *supra* note 84, at 6. A high standard of care was, therefore, warranted because of both the background and expertise of the Trans Union directors as well as the absence of compelling circumstances that would create an urgency that would justify a hasty decision. The board was eminently qualified, and ideally positioned to reach an informed decision, and it was not impaired from doing so; yet it gave only perfunctory considerations to the sale agreement.

In an extraordinary decision such as a sale of the corporation, the standard of care will require that directors perform functions to the utmost of their abilities. Note, *supra* note 83, at 987. The decision by Trans Union's directors represents a clear departure from that standard.

It should be noted that in reaching its decision the Delaware Supreme Court relied on findings of fact contrary to those established in the Court of Chancery. The dissent bitterly opposed the majority's evidentiary conclusions and would have held that Trans Union's directors acted in an informed manner based on its collective experience and longstanding familiarity with corporate affairs. 488 A.2d at 893-98 (McNeilly, J., dissenting).

[94] A $23.5 million settlement was reached in *Van Gorkom*; the liability imposed will serve to assure proper respect for the proper discharge of directors' duties. Manning, *supra* note 86, at 1 (Editor's note).

The adequacy of the business judgment rule in the corporate control context[95] is illustrated in *Unocal Corporation v. Mesa Petroleum Co.*[96] Principally at issue in *Unocal* was the duty of good faith and disinterested decision-making. Since the tendencies toward self-interest are inherently present when control is threatened, the burden of proof evidencing good faith was shifted to the Unocal directors.[97]

Unocal illustrates the adaptation of the business judgment rule to the changing business environment. Control is always a motive in decisions that impact a corporation's capital structure.[98] The business judgment rule has evolved to respond to inherent control conflicts precipitated by business trends to assure the pursuance of directors' duties while serving to protect the goals and justifications on which the rule is based.[99]

Once control is identified as a motive the burden of proving an

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[95] *Van Gorkom* involved uncontested corporate control, but it is discussed primarily to illustrate when and how the business judgment rule is applied.

[96] 493 A.2d 946 (Del. 1985). In *Unocal*, the court held that the directors' duty of care extends to protecting the corporation from perceived control threats, provided that the defensive measure is adopted in good faith and on an informed basis. The court further held that a defensive response to a perceived control threat meets the required standard of care when it reasonably relates to the threat perceived to shareholders.

Unocal Corporation was faced with a two-tier, front-end loaded tender offer. Unocal's board of directors immediately met to consider the tender offer. Both Unocal senior management and its investment bankers surveyed recent industry experience and concluded that the tender offer price did not represent the reasonable value of Unocal's stock. After consultation with outside counsel, a group of outside directors proposed a defensive response to the full board. The response was adopted to fulfill a perceived obligation to protect shareholders from an inadequate price and coercive tactics. *Id.* at 949.

[97] In *Unocal*, the initial burden of proof evidencing good faith that shifted to the directors required them to demonstrate that they had reasonable ground to believe that a threat to "corporate policy and effectiveness existed" and that the adopted defensive measure was reasonable in relation to the perceived threat. But *Unocal* does not require the board's justification of the response in light of all other hypothetical responses. The good faith of the Unocal directors was indicated by their extensive investigation and deliberations prior to reaching a decision. *Id.* at 955.

The overall reasonableness of the Unocal response to the Mesa tender offer was sustained on the basis of specific factual circumstances. Unocal directors were required by state statute to protect the corporation and its shareholder from perceived threats. The past practices of Mesa and the effect of its current tender offer on Unocal and its shareholders were extensively considered by the Unocal board prior to reaching a decision. The conclusion that the Mesa offer was coercive in nature and that it would negatively affect the Unocal capital structure was consistent with the nature and effect of similar activities initiated by Mesa. Since the board of directors had become highly informed prior to making a decision, it was in a good position to decide on a course of action. Furthermore, the court concluded that the Unocal board of directors had an affirmative duty to act in some manner with respect to the Mesa tender offer based on analogous statutory requirements which required director action in traditional areas of corporate change. *Id.* at 954 n.8.

[98] Gruenbaum, *Defensive Tactics and the Business Judgment Rule*, 4 CORP. L. REV. 263, 265 (1981).

[99] *See supra* text accompanying notes 78-82.

absence of self-interest shifts to the directors. The effect of the shift of the burden of proof was to eliminate the business judgment rule presumption with respect to good faith. The business judgment rule is the starting point for inquiry into directors' decision-making process, but the rule does not excuse directors on the basis of their bare exercise of judgment.[100] Shifting burden of proof requirements assures that the existence of good faith will be assessed as a preliminary matter to assure that a business judgment is not a pretext for the board's action.[101]

Refinements of the business judgment rule, demonstrated in *Unocal*, reflect the law's propensity toward the balancing of interests. Gauging the balance or relation between the perceived danger to the corporation and its shareholders, which implicates a threat to corporate control, and the resulting directors' decision provides adequate assurance that directors' duties will be fulfilled in a disinterested manner. Balancing requires that a decision be reasonable rather than made on a rational basis. This distinction results in a definite construction of directors' discretion when corporate control is implicated.[102] Requiring decisions to be reasonable in relation to perceived harm ensures that directors' decisions will be limited and responsive to the harm rather than to self-interest concerns.

The balancing that takes place is only a partial balance that does not attempt to consider the myriad potential decisions within the purview of management, but requires justifiability in the course chosen. In this manner, the goals and justifications of the business judgment rule continue to be protected.

Fully to scrutinize directors is to ignore reality. Corporations cannot operate on a day-to-day basis.[103] Long-range planning is necessary to optimize profitability. Control is required to implement long range planning and achieve desired results. Optimization of profits is the duty of directors. That duty generally requires control. Liability should not be imposed when not clearly warranted as it would interfere with the discharge of directors' duties.

The business judgment rule is adequate and proper because it affords the discretion necessary for corporate growth and productivity while

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[100] Arsht, *supra* note 75, at 100.

[101] *Cf.* Kassel v. Consolidated Freightways Corp., 450 U.S. 662, 687 (1981)(Rehnquist J., dissenting)(Before rational basis deference is given to a state legislature, the Court should first consider whether safety motivations were merely a pretext for the legislation under review.).

[102] A.L.I., *supra* note 84, at 10 ("'rational basis' is intended to permit a significantly wider range of discretion than the term 'reasonable.'").

[103] Proponents of antitakeover legislation suggest that corporate activity is now driven by takeover threats. Further, it is asserted that long-term prospects are sacrificed in favor of short-term considerations. CORPORATE TAKEOVERS (PART 1) at 3 (prepared statement of Timothy Wirth Chairman of the House of Representatives, Committee on Energy and Commerce, Subcommittee on Telecommunications, Consumer Protection, and Finance).

assuring accountability. The business judgment rule is necessary because its underlying justifications remain intact despite fundamental changes in the corporate environment. While the prevailing environment is now more conducive to corporations in general, the director's duty is still owed in every context. Complex changes have occurred in the structure and operation of the corporations extending the director's duty into every new realm. In light of the ultra-pervasive duties imposed on directors, the business judgment rule is essential to address the concerns which justify its existence, and, more importantly, to allow directors to assume those duties.[104]

The adequacy of the business judgment rule forestalls the need for antitakeover legislation. In *Van Gorkom* and *Mesa* the courts noted that the outcome of each case turned on the precise factual background of each case. A congressional mandate cannot be flexible enough to accommodate equitably specific circumstances which are inevitably different for every corporation and its shareholders.[105]

Even if the business judgment rule were unsatisfactory, it is not clear beyond debate that further developments will not emanate from the courts.[106] Unless and until courts fail to be responsive to the ever–

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[104] Ironically, directors may be under a duty to pursue acquisitions to take advantage of situations where stock value does not represent the underlying value of a corporation or its assets. *See* [1985] 12 NAT'L REV. CORP. ACQUISITIONS (TWEED) No. 32 (Sept. 2, 1985).

Conversely, if takeover trends continue directors may be held liable for failing to adopt defensive tactics when they would have optimized productivity and growth or liability may result after defensive tactics are adopted and deemed contrary to the best interests of the corporation and its shareholders. Bruno, Leidecker, & Forgrimson, *Sizing Up Your Company's Takeover Vulnerability*, 20 MERGERS & ACQUISITIONS 42 (Summer 1985)(Management can handle "its own takeover susceptibility whether it wants to get the highest price or put up a stout defense.").

[105] *Cf.* Coleman, *Efficiency, Utility, and Wealth Maximization*, 8 HOFSTRA L. REV. 509, 550 (1980)(criticizing the law and economics movement because of its attempts to "globalize" private disputes).

Proponents of antitakeover legislation argue that the existence of legislative parameters would deter over abundant or exotic litigation. This argument ignores the obvious consequences which would doubtless accompany the chilling effect of proposed legislation. If all litigation and all takeovers could aptly be deemed bad or undesirable, elimination thereof would clearly be beneficial. But when every instance bears markedly different consequences and implications a common barrier is no more likely to help than hinder the effects on the community, management, organized labor, employees, or any other goal which has been the aim of antitakeover legislation.

[106] *See supra* note 53 and accompanying text. Further developments in the business judgment rule may be on the horizon. In Moran v. Household Int'l, Inc., 490 A.2d 1059 (Del. Ch. 1985), *aff'd*, 500 A.2d 1346 (Del. 1985), a stock rights plan was upheld despite the absence of an imminent takeover threat at the time of adoption.

Moran represents an anomalous situation. The plaintiffs in *Moran* were one of Household International's directors and another corporation for which that director served as chairman of the board. The plaintiffs were privy to inside information and had contemplated a

changing business and social environment, directors should be allowed to set up takeover defenses as they deem appropriate or to adopt takeover plans pursuant to the best interests of their corporation and shareholders. Legislation should not help or hinder these duty-based decisions when there is neither a need to do so nor an equitable means to do so. Congress should not tie the hands of directors by restricting their options, adding costs, and increasing uncertainty.[107]

B. *Relative Ability of Courts Over Congress*

Congress theoretically has a better decision-making ability than courts because it has greater resources for gathering and considering facts.[108] Legislation is usually justifiable because Congress is able to conduct a more complete and thorough appraisal of a particular issue than is possible in courts. The theoretical superiority of Congress, however, does not automatically translate into an actual decision-making superiority.[109] Economic and business complexities can create situations involving diverse and interrelated events such that their implications are not comprehensible, despite the broad investigative ability of Congress.[110] In

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leveraged buyout of Household. Thus, *Moran* was decided under facts which suggest the breach of a fiduciary duty and reek of the notion of insider trading.

More conventional situations have produced results far less deferential to the corporation adopting a defense mechanism. In fact, when the sale of control of a corporation becomes imminent a fiduciary duty to obtain the best possible price for a target corporation's shares arises. In Revlon Inc. v. McAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1986), a poison pill and an exchange offer were upheld as reasonable in response to an offer. But a lock-up option and a no-shop agreement granted to a white knight were unreasonable in light of an offering price which made the sale of control inevitable. *Accord* Edelman v. Fruehauf Corp., 798 F.2d 882 (6th Cir. 1986).

Moreover, over-priced poison pill provisions, which in purpose or effect, deter all hostile offers will be seen as an entrenchment device and will not be sustained. In Dynamics Corp. of Am. v. CTS Corp., 794 F.2d 250 (7th Cir. 1986), *aff'g*, 637 F. Supp. 406 (N. D. Ill. 1986), the adoption of a rights plan was enjoined as it was unreasonable under the two-prong *Unocal* business judgment rule test. A second rights plan was not enjoined by the district court. Dynamics Corp. of Am. v. CTS Corp., 635 F. Supp. 1174 (N. D. Ill. 1986). But on appeal the second rights plan was remanded for a determination of the reasonableness of its triggering percentage and exchange price. Dynamics Corp. of Am. v. CTS Corp., 805 F.2d 705 (7th Cir. 1986). *Accord* Buckhorn, Inc. v. Ropak Corp., 656 F. Supp. 209 (S. D. Ohio 1987)(poison pill rights plan enjoined upon the directors failure to meet the burden of establishing reasonableness), *aff'd*, 815 F.2d 76 (6th Cir. 1987).

Takeover defense tactics—especially the poison pill are also being resisted outside the courts. *Institutional Holders Inked by 'Poison Pill'*, Wall St. J., Mar. 10, 1987, at 6, col. 1. Thus, the evolving common law scheme and/or public sentiment may ultimately put an end to the once exotic business judgment rule litigation emanating from the specter of takeover threats.

[107] *See supra* text accompanying notes 55-57.

[108] *See supra* text accompanying note 55.

[109] *See supra* text accompanying notes 59-61.

[110] *See* CONG. Q., Aug. 17, 1985, at 1631 (Comments of Timothy E. Wirth, D-Colo.,

these situations, Congressional decision-making ability is not superior to that of the courts.

When the pre-eminent ability of Congress does not result in an absolute superiority over the courts, the situation is not susceptible to legislation. When congressional efforts cannot provide a clear answer truly superior to judicial resolutions, an attempt to provide a broad resolution is not wise.[111] Incremental judicial resolution is preferable to a sweeping legislative mandate because of the risk that legislation may perpetrate rather than correct a perceived deficiency.

Problems perceived to be incident to recent surges in takeover activity represent a situation where the theoretical decision-making superiority of Congress does not translate into an actual decision-making superiority. Congress does not have an actual ability to determine whether takeovers are inherently good or bad.[112] Congressional consideration of antitakeover legislation has been marked by an inability to define or ascertain the existence of a problem worthy of, or susceptible to, legislative action. This inability is manifested not only by a lack of clear consensus and absolute differences of opinions, but also by the fact that the implications associated with takeovers are admittedly not understood by Congress.[113]

The inability of Congress to understand the implications of takeover activity results from the nature of its inquiry. Congress is attempting to consider takeover activity in aggregate. Takeover activity is not susceptible to collective consideration because takeovers *per se* are not inherently good or bad.[114] The merits of a takeover can only be assessed individually. Only the context in which each individual event occurs can determine the merits of a particular action.

Congress has doubtless been influenced by individual instances which represent extreme cases that should not form the basis for overall policy.[115] Media depictions of takeover activity suggest that abuses are widespread and that legislation is urgently needed. The extremes represented by these depictions, however, are not indicative of takeover ability

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Chairman of the House Energy and Commerce Subcommittee)(Despite in-depth hearings, he is not sure that any legislation is necessary).

[111] *See supra* notes 59-65 and accompanying text.

[112] *See supra* note 110.

[113] CONG. Q., Aug. 17, 1985, at 1631 (comments of Rep. Mike Synar, D-Okla.). *See generally* CORPORATE TAKEOVERS (PART 1 & 2) (extremely divergent views on various aspects of takeovers were expressed by participants in the Congressional hearings).

[114] *Market Madness: No Easy Answers*, Nat'l L.J., Feb. 2, 1987, at 30 (comments of district court Judge Sweet). *See also Roundtable: Corporate Techniques in Acquisitions and Divestitures*, 20 MERGERS & ACQUISITIONS 24, 24-36 (Spring 1985).

Takeover activity may be susceptible to administrative restraints, but legislation does not propose such treatment. *But see supra* notes 40 & 41.

[115] *M & A Legislation Debated*, 19 MERGERS & ACQUISITIONS 4 (Winter 1985).

in general. The consensus of participants in takeover activity, who form opinions based on experience and observation rather than media hype, is that contested takeovers represent a small part of all mergers and acquisitions. Participants admit that some abuses occur in takeover situations, but the abuses are rare and not susceptible to legislation.

Congress should accept its limitations with candor and defer to courts in the resolution of takeover disputes. The complex and varying nature and goals of every corporate organization limit the applicability of comprehensive legislation. Individual corporations are in the best position to guide and control their own destinies. Obviously, an acquisition decision by one corporation creates consequences which may not be desirable for another corporation. When disputes arise and they cannot be privately resolved, the traditional resort has been to the courts. Courts, rather than Congress, are the best forum for takeover disputes. Courts are better equipped to analyze the individual factual settings in which takeovers occur. *Ad hoc* judicial decisions are capable of resolving extreme cases as well as cases falling within a middle ground.[116]

The movement for antitakeover legislation should be viewed in proper perspective. Despite evidence that takeovers create benefits to shareholders by causing stock prices to rise, antitakeover legislation has been initiated under the guise of shareholder protection. Congressional impetus for legislation emerges chiefly from the pleas of corporate management, while shareholders, whose interests are presumably in need of protection have seldom voiced their opinion.[117]

Given the inherent decision-making superiority of Congress, it is significant that it has not been able to conclude that takeovers are in fact detrimental, nor has it been able to formulate a legislative approach capable of applying equitably to all circumstances.[118] Under these conditions, Congress should be candid and abstain from passing legislation since it cannot fully comprehend the implications of the matter in question. Otherwise, problems greater than those perceived to accompany takeovers may result.[119] Accordingly, Congress should defer to the courts rather than respond to pressure from business interests.

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[116] *See supra* text accompanying notes 60-61.

[117] ECON. REP. OF THE PRESIDENT 203 (1985); CONG. Q., Aug. 17, 1985, at 1631-36. "Most of the proposed laws were introduced by Congressmen from districts where an unfriendly takeover sent management scurrying to Washington for protection. *Tinkering Around With Corporate Takeovers*, FORTUNE 101 (Feb. 3, 1986); *Goodyear Asks for Help in Preventing Takeover*, Wall St. J., Nov. 12, 1986, at 24, col. 3.

[118] *See supra* text accompanying notes 60-61.

[119] *See supra* notes 62-65 and accompanying text.

C. *Implications of Antitakeover Legislation*

1. Economic Effects

a. Economic Benefits of Takeovers

Evidence indicates that takeovers produce substantial wealth to shareholders and result in an aggregate net benefit to the economy.[120] Economic benefits result from takeover activity through efficiency gains created by volume production and distribution systems. Takeovers can produce economies of scale which create opportunities which would otherwise be unavailable.[121] Further opportunities may become available through technology transfers not possible between unrelated corporations. An increased market share that occurs after an acquisition produces per unit cost reductions capable of offsetting higher consumer prices usually associated with oligopolous industries.

Takeovers can produce substantial economic gains by causing assets to be shifted to higher valued uses.[122] Optimization of asset-use potential will result from the combined corporations' ability to capitalize on alternate opportunities previously unavailable on a stand-alone basis. Economic gains may stem from actual utilization or increased market valuation based on greater use potential.

Takeovers also encourage management improvements.[123] Inefficient management can be displaced or supplemented by talented professional managers who can implement new corporate strategies. "The dominant view, for which empirical studies have provided support, is that mergers and takeovers primarily reflect efforts to wrest corporate control from inefficient, entrenched management in order to realize the full potential of a firm's assets."[124]

Management has an inherent tendency to protect its own interests, rather than the interests of shareholders. Management may resist economically beneficial business combinations to perpetuate itself. A takeover, or the threat of a takeover, therefore, tends to cause an alignment of management and shareholder interests.[125] The potential occurrence of a takeover will cause management to adopt capital structures responsive to existing financial conditions. A capital structure that comports to the prevailing financial environment will enhance stock

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[120] ECON. REP. OF THE PRESIDENT 197 (1985).
[121] CONG. Q. Aug. 17, 1985, at 1633.
[122] ECON. REP. OF THE PRESIDENT 197 (1985).
[123] *Tender Offer Law Under Fire*, 20 MERGERS & ACQUISITIONS 9 (Spring 1985); CONG. Q., Aug. 17, 1985, at 1633.
[124] *Staff Studies*, 73 FED. RESERVE BULL. 270 (1987).
[125] ECON. REP. OF THE PRESIDENT 188 (1985).

value, thereby benefitting shareholders, while simultaneously serving as an efficient takeover defense.[126]

b. Economic Consequences of Shareholder Tender Offer Approval

The effect of requiring shareholder approval prior to the completion of a tender offer will be to reduce the number of takeovers. Regardless of the manner in which shareholders ultimately vote on any particular tender offer, the requirement of shareholder approval would make takeovers more difficult. The extended time period necessarily involved in the shareholder approval process would deny the potential acquirer of both secrecy and speed as well as imposing additional costs and increased risk.[127]

Legislation would impose artificial costs to a potential acquirer. Increasing the time period for completion of a tender offer in order to poll shareholders would allow management of the target company to avert the tender offer. Target management would have additional time to implement defensive tactics or to seek an alternate buyer.[128] Potential acquirers would be forced to pay higher premiums to overcome defensive tactics or to abandon the takeover attempt. The increased premiums then required would cause a reduction in takeover volume. Thus, individual gains to a small number of shareholders would be greater, but aggregate gains among all shareholders would be reduced with decreased takeover volume.

The possibility of a takeover represents an important check on management.[129] A reduced possibility of takeover would cause management to become entrenched and lack incentive for growth. Antitakeover legislation would shield management from market disciplines which would have required productivity. Since shareholders are effectively precluded from removing incumbent management due to the prohibitive

[126] *Id.* at 189; *Roundtable: Strategies of Takeover Attack and Defense*, 19 MERGERS & ACQUISITIONS 24, 33 (Winter 1985).

[127] Austin & Bernard, *Tender Offer Update: 1985*, 20 MERGERS & ACQUISITIONS 67, 67-69 (Spring 1985).

[128] *Shot-Gun Weddings*, [1985] 12 NAT'L REV. CORP. ACQUISITIONS (TWEED) No. 10 (Mar. 11, 1985).

[129] *E.g.*, Manne, *Mergers and the Market for Corporate Control*, 73 J. POL. ECON. 110 (1965). At the time of Manne's article, mergers rather than tender offers were the principal means to effect takeovers. Changed market conditions have made the tender offer the principal means of effecting takeovers at the current time. *See supra* note 17 and accompanying text. Even proponents of antitakeover legislation recognize that takeovers represent an important mode of assuring management accountability. CORPORATE TAKEOVERS (PART 2) at 2 (Statement of Ohio Senator Howard Metzenbaum)(also expressing the opinion that shareholders need protection to assure fair and equitable treatment).

expense of a proxy fight,[130] management would not be compelled to enhance stock value.

The possibility of a takeover forces management to be efficient. The threat of a potential takeover causes management action to avoid vulnerability. The best defense against a takeover is a high stock value.[131] The stock market determines stock value, therefore, it is the stock market and not voting that protects shareholders.[132] Accordingly, antitakeover legislation should not be passed since it would adversely affect shareholders.

Economic forces also forestall the need for antitakeover legislation. Recent surges in acquisition activity are an economic phenomena. The four major waves of acquisition activity have occurred during periods of heightened economic activity.[133] The current wave of activity will inevitably pass.

Takeovers themselves will seek an equilibrium. The efficiency of the market has made it difficult for acquisitions to pay off financially.[134] Evidence suggests that acquisition activity has peaked.[135] These self-limiting economic factors combined with efficient defensive tactics preclude any need for antitakeover legislation.

2. Effects on Shareholder Rights

a. Expansion of Shareholders Voting Rights

America's genius . . . lies in not taking any abstract doctrine to its logical extreme.[136]

A corporation is a nexus for contracts.[137] An essential party of the nexus is the contractual relationship between the corporation and shareholders. The contract provides for separation of ownership and management and, in turn, grants to shareholders certain rights, including the right to vote in limited circumstances.

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[130] During the 1970s the sophisticated use of the proxy machinery enabled shareholders to "assert the slumbering powers of shareholder democracy." CORPORATE TAKEOVERS (PART 1) at 613-14 (address of Bevis Longstreth). Notwithstanding the potential efficacy of the proxy as a vehicle to effect shareholder sentiment, substantial costs often render a proxy fight impracticable.

[131] ECON. REP. OF THE PRESIDENT 189 (1985).

[132] Easterbrook & Fischel, *Voting in Corporate Law*, 26 J. L. & ECON. 395, 397 (1983).

[133] *See supra* text accompanying notes 1-13.

[134] *Roundtable: Corporate Techniques in Acquisitions and Divestitutes*, 20 MERGERS & ACQUISITIONS 24, 26 (Spring 1985)(Comments of Arthur A. Just, Manager of Investment Strategy, General Electric Co.).

[135] CONG. Q., Aug. 17, 1985, at 1636.

[136] R. DWORKIN, TAKING RIGHTS SERIOUSLY 20 (1977).

[137] Baysinger & Butler, *The Role of Corporate Law in the Theory of the Firm*, 29 J. L. & ECON. 179 (1985).

Traditionally voting rights have been given to holders of common stock while voting rights have less frequently been given to preferred stock and bond holders.[138] State statutes have given corporations broad latitude in delegating voting rights.[139] Despite the broad latitude afforded corporations by state statutes, almost all publicly held corporations have adopted a uniform voting scheme to comply with stock exchange rules. Shareholders elect directors who, in turn, select management.[140] Shareholders vote on a limited number of issues at an annual meeting, but special elections are not otherwise held.

State law has shaped the issues upon which shareholders have traditionally voted.[141] The basic issues on which shareholders vote are actions that involve fundamental corporate changes, such as mergers, liquidations, and charter amendments.[142] Shareholder voting has been required in these situations because they have been considered extraordinary in nature. Shareholder voting is not required by state law and is not otherwise granted to shareholders for general business decisions.[143]

Shareholders delegate decision-making authority via their election of the board of directors.[144] This delegation results in a separation of ownership and management, and the purpose of which is to optimize efficiency.[145] Efficiency results from placing the individuals best suited to run the company in management positions.[146] Delegation permits specialization which enables management to develop talent and knowledge

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[138] Easterbrook & Fischel, *Voting in Corporate Law*, 26 J. L. & ECON. 395, 403 (1983).

[139] *Id.* at 399.

[140] *Id.* at 400.

[141] *Id.* at 415.

[142] Fundamental corporate changes have not traditionally included takeovers. Only major corporate changes initiated by management have been subject to shareholder approval. Moran v. Household Int'l, Inc., 490 A.2d 1059, 1070 (Del. Ch. 1985)("shareholders do not possess a contractual right to receive takeover bids"), *aff'd*, 500 A.2d 1346 (Del. 1985).

Takeovers are not a fundamental change and they do not warrant shareholder approval. Takeovers are a corporate opportunity and consequence which results from the careful planning of an acquirer as well as the actions and inactions of the target corporation and the market and economic conditions. Conversely, mergers and consolidations involve negotiations and prospective decisions which must necessarily involve bilateral shareholder approval.

[143] Shareholder approval of certain transactions may be obtained in order to avoid legal liability. However, shareholders generally cannot ratify fraud and courts will scrutinize actions that may be motivated by self interest. *See* Flieger v. Lawrence, 361 A.2d 218 (Del. 1976)(scrutiny of potential self-interest); Saxe v. Brady, 184 A.2d 602 (Del Ch. 1962)(waste of corporate assets cannot be ratified without unanimous shareholder consent). *See also* Claman v. Robertson, 164 Ohio St. 61, 128 N.E.2d 429 (1955)(disinterested majority of shareholders can ratify director's fraud).

[144] ECON. REP. OF THE PRESIDENT 187 (1985).

[145] Demsetz, *The Structure of Ownership and the Theory of the Firm*, 26 J.L. & ECON. 375, 376 (1983).

[146] Easterbrook & Fischel, *supra* note 138, at 427.

necessary for the operation of large, complex business organizations.[147] Shareholders benefit through the greater expertise gained by management. The corporation also realizes a cost savings because the discretion afforded by shareholder delegation of decision-making authority reduces the number of items to be negotiated in business decisions.[148]

The effect of antitakeover legislation which requires shareholder approval prior to completion of a tender offer is the expansion of the voting rights of shareholders. The additional voting right would be imposed on corporations without its consent. The additional right would at least theoretically enhance the stock value to the shareholder,[149] but without compensation to the corporation.

A shareholder's decision to purchase stock in a particular company is an entirely voluntary choice. At the time of purchase a shareholder enters into a limited contractual relationship with the company. The terms of the contractual relationship are formed by state law and corporate charter provisions, and the contract itself authorizes the corporation to make all decisions not otherwise expressly provided.[150]

An expansion of shareholder voting rights after a contractual relationship is created is not necessary. Dissatisfied shareholders have ample opportunity to express their dissatisfaction with management or take steps to protect their interests. Prior to purchasing stock, a potential investor has the ability to obtain ample information on the company it is considering.[151] Financial information and charter provisions can provide an investor with a basis to determine whether the allocation of rights and the corresponding benefits which accompany stock ownership comport with one's conception of equity. After shares are purchased, any changes in charter provisions will be subjected to shareholder scrutiny. If the shareholder does not approve of a particular charter amendment, the votes allotted to its shares provide the means to oppose such changes. A shareholder also has the option to sell its shares at any time and invest elsewhere.

Given the limited contractual relationship between a corporation and its shareholders, changes in that relationship should only occur incrementally through existing rights of shareholders.[152] Shareholders are

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[147] ECON. REP. OF THE PRESIDENT 180 (1985).

[148] Easterbrook & Fischel, *supra* note 138, at 401.

[149] All other things being equal, a share is worth more when accompanied by voting rights. *See* Bhaget & Brickley, *Cumulative Voting: The Value of Minority Shareholder Voting Rights*, 27 J.L. & ECON. 339, 340-41 (1984).

[150] Easterbrook & Fischel, *supra* note 138, at 402.

[151] *Cf.* Baysinger & Butler, *supra* note 137, at 191 (Shareholders have the choice to invest in firms incorporated in strict corporate jurisdictions).

[152] The proper balance between shareholder control and management discretion permits effective management. Unnegotiated changes in the relationship between shareholders and

granted voting rights to the extent that they are beneficial to the entire enterprise.[153] The limited voting rights granted to shareholders correspond to the limited liability and accountability of shareholders. Conversely, management is held accountable for its actions and may be subject to liability. Shareholder voting as prescribed in antitakeover legislation would grant authority without imposing accountability and it will undermine the corporate benefit motive behind the initial limitations on shareholder voting.

The purported goal of granting shareholders the right to approve takeovers is to provide them with a means of protection against takeovers that would not be beneficial. In reality a shareholder's new-found right would be of little value. Shareholders have consistently manifested indifference toward voting matters and they have traditionally sided with management in voting situations.[154]

Proponents of regulations that expand voting rights ignore the realities of shareholder voting and instead assume that shareholders demand more involvement in the corporate decision making process.[155] It is further assumed that shareholder indifference to voting is attributable to defects in the regulatory process. It is argued that the lack of shareholder involvement is due to the lack of information necessary to vote intelligently on corporate activities. Thus, additional disclosures have been called for as a means to prompt shareholders to vote in a meaningful way.[156]

Increased disclosure, along with additional voting rights, will not add significance to shareholder voting. Shareholders lack the incentive and expertise to identify and evaluate takeover implications. The complex nature of business combinations cannot be comprehended by most shareholders.[157] Hence, disclosures will be of little or no value to shareholders. Shareholders will be subjected to disclosures from management and from the bidding corporation.[158] Disclosures will only create confusion among shareholders. Conflicting viewpoints will be advanced by management and the bidder. Each viewpoint will be equally supported by factual information. The complexity of disclosures would be congruous to the complexity of the transaction proposed. Disclosure is not susceptible to simplification, because simplification inherently injects the subjectivity

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a corporation would adversely affect management efficiency. *See* Baysinger & Butler, *supra* note 137, at 180.

[153] Easterbrook & Fischel, *supra* note 138, at 396.

[154] *Id.*

[155] *Id.* at 424.

[156] Ferrara, Starr & Steinberg, *Disclosure of Information Bearing on Management Integrity and Competency*, 76 Nw. U.L. Rev. 555, 605-12 (1981).

[157] *Cf.* Cong. Q., Aug. 17, 1985, at 1631 (Highly educated and experienced Congressmen are unable to comprehend the implications of takeovers).

[158] *See supra* note 31 and accompanying text.

of the preparer. Increased disclosures will not add significance to shareholder voting rights because they will only inform shareholders who have expertise and would have otherwise sought out information through existing channels.

Apart from the questionable informational value of disclosures is the matter of costs. Since disclosure is costly and must be borne by investors, increased disclosure will ultimately be detrimental to shareholders.[159] In addition to costs actually incurred in the disclosure process, there may be a deterrent effect on profit-maximizing activity. Required disclosures may cause corporations to forego takeovers or other activities which might be profitable. Disclosure costs in dollars spent and dollars foregone may exceed the benefits or increase the risks of a proposed activity.[160]

The expansion of shareholder rights would also act to deny stock market participants their expectation of profit.[161] The effect of the time delay required for shareholder voting would provide corporations with the ability to restrict their stock sales. Corporations could use the interim voting period to persuade its shareholders not to accept the tender offer, or find an alternate purchaser while simultaneously mounting a defensive response to the tender offer.

When a corporation opts to place its shares on a public market, legislation should not provide a means for corporations to restrict stock sales. Once a corporation reaps the benefits of the public market it should also accepts its risks. Predominant among the risks assumed by publicly traded companies is the loss of corporate control. Aside from choosing non-public status,[162] corporations can adopt charter provisions or capital structures which will prevent takeovers. Both measures would require shareholder approval, but the protection afforded to shareholders through voting rights would not then interfere with reasonable expectations investors have on the public stock market.

The corporate structure has worked well for a long time without granting shareholders the right to approve takeovers. Experience has indicated that shareholders do not want additional voting rights. Furthermore, shareholders cannot effectively utilize the right to approve takeovers. Moreover, additional voting rights will undermine the fundamental purpose that initially limited voting rights, namely efficiency optimization.[163]

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[159] Easterbrook & Fischel, *supra* note 138, at 424.

[160] *Id.*

[161] Even a would-be raider has had the traditional right to accumulate stock in a free market atmosphere. [1984] 11 NAT'L REV. CORP. ACQUISITIONS (TWEED) No. 46 (Dec. 3, 1984).

[162] Many firms are "Going Private" to avoid control problems or to create employee ownership. [1984] 11 NAT'L REV. CORP. ACQUISITIONS (TWEED) No. 39 (Oct. 15, 1984).

[163] *See supra* notes 144-48 and accompanying text.

At least one commentator has questioned the wisdom of shareholder voting in all circumstances. Professor Chayes perceives as futile the efforts to revive shareholder

b. Impairment of Shareholder Property Rights

The primarily economic responsibility of the federal government is not to make choices for people, but to provide an environment in which people can make their own choices.[164]

The powers of corporate democracy have long been at the disposal of shareholders.[165] Proponents of antitakeover legislation providing for shareholder approval of takeovers seek something very different. If successful, the results will benefit incumbent management to the detriment of shareholders.[166] The realities ignored by proponents of antitakeover legislation make it apparent that they "are using the rhetoric of shareholder's democracy to further goals other than wealth maximization."[167]

Calls for corporate democracy have argued that poison pill stock rights plans deny shareholders the exercise of private property rights.[168] Voting rights and restrictions are contractual in nature; such rights and restrictions co-exist with ownership of the corporation. Accordingly, voting rights need not be protected to the extent of private property rights.[169]

Ironically, antitakeover legislation, initiated under the guise of shareholder protection,[170] would impair private property rights in an effort to bolster less valuable contractual rights.[171] An expansion of shareholder

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democracy. Additionally, he believes "that the stockholder *deserves* his voiceless position in the corporation, because he is less affected by the giant corporation than other persons—employees, suppliers, customers, and the community." Kripke, *The SEC, Corporation Governance, and the Real Issues*, 36 BUS. LAW. 173, 177 (1981)(emphasis original)(citation omitted).

[164] ECON. REP. OF THE PRESIDENT 4 (1985)(President Ronald Reagan, in a message to the Congress of the United States).

[165] Aronson v. Lewis, 473 A.2d 805, 811 (Del. 1984)(If stockholders are displeased with the action of their elected representatives, the powers of corporate democracy are at their disposal to turn the board out.); First Nat'l Bank v. Bellotti, 435 U.S. 765, 794 (1977)("Acting through their power to elect the Board of Directors or to insist upon protective provisions on the corporation's charter, shareholders normally are presumed competent to protect their own interest.").

[166] For instance, proposed antitakeover legislation would afford management time and flexibility enabling it to forestall takeover attempts, while shareholders would obtain new voting rights of questionable value, and tenderor purchase restrictions would seriously impair their ability to sell their stock. *See supra* text accompanying note 32.

[167] Easterbrook & Fischel, *supra* note 138, at 424 n.84.

[168] Middleton, *supra* note 26, at 28 (Plaintiff's oral argument in Moran v. Household Int'l, Inc., 490 A.2d 1059 (Del. Ch. 1985)).

[169] *See* A. BERLE & G. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY 355 (1932)(Shareholders have "released the community from the obligation to protect them to the full extent implied in the doctrine of strict property rights.").

[170] *See supra* text accompanying note 117.

[171] *See supra* text accompanying notes 154-58.

voting rights as prescribed by proposed legislation[172] would simultaneously restrict the shareholder's right to sell his stock under the favorable conditions present during a takeover bid. Legislation that makes it unlawful to buy or take delivery of stock prior to shareholder approval of a tender offer necessarily restricts a shareholder's ability to sell. Antitakeover legislation, in effect, represents a poison pill that would impose a predetermined restriction on shareholders' property rights during a takeover bid, but without requiring their prior contractual consent.

The thrust of federal securities regulations has always been to require disclosures sufficient to allow individual investors to make individual investment decisions.[173] Legislative proposals are directly contrary to this long-standing notion. They would provide shareholders in aggregate with the means to make investment decisions which would bind all shareholders. Proposed departures from traditional methods of securities regulation effectively represent a serious impairment of shareholder property rights. Should corporate democracy be adopted, as intimated by proposed antitakeover legislation, the loss of valuable property rights would be accompanied by little, if any, shareholder protection.

3. Concurrent Effect of Tax Law Changes

Federal tax consequences are an important factor in corporate takeovers. Certain features of the tax code may have an impact on takeover activity in general, and on the attractiveness of particular takeovers. The general organization of the tax code indirectly affects aggregate takeover activity, while specific code provisions more directly affect the merits of particular takeovers.

The general organization of the tax code has indirectly contributed to increased acquisition activity by prescribing different tax treatment for corporate and individual taxpayers as well as among types of taxable events.[174] Interest paid by a corporation to a debt security holder is not

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[172] *See supra* text accompanying notes 30-36.

[173] *E.g.*, Edgar v. MITE Corp. 457 U.S. 624, 639 (1982)("Congress intended for investors to be free to make their own decisions."); Fleet Aerospace Corp. v. Holderman, 637 F. Supp. 742, 758 (S. D. Ohio 1986)("permitting the investor to make his or her own independent decision"), *aff'd*, 796 F.2d 135 (6th Cir. 1986), *vacated*, 107 S. Ct. 1949 (1987); Martin-Marietta Corp. v. Bendix Corp., 690 F.2d 558, 567 (6th Cir. 1982)(congressional policy permits each individual investor "to make his own independent but informed decision whether to sell."); Great W. United Corp. v. Kidwell, 577 F.2d 1256, 1276 (5th Cir. 1978)(*"let the investor decide for himself."*)(emphasis original), *rev'd sub. nom* Leroy v. Great W. United Corp., 443 U.S. 173 (1979)(reversed on venue grounds).

[174] JOINT COMMITTEE ON TAXATION, FEDERAL INCOME TAX ASPECTS OF HOSTILE TAKEOVERS AND OTHER CORPORATE MERGERS AND ACQUISITIONS (AND S. 476, AND S. 632) (JCS - 985) 4-5 (Apr. 19, 1985).

taxed at the corporate level because the interest is deductible from the corporation's revenues.[175] Dividends paid by a corporation are, conversely, taxed at the corporate level prior to distribution to shareholders. Thus, dividends are subject to a "double tax" as they are also taxed at the individual level.[176] Corporate income not distributed to shareholders will be taxed at the individual level only when appreciated stock value is realized upon a sale or disposition of stock.[177] Prior to 1987, realized appreciation was afforded favorable tax treatment at the individual level, therefore, reinvestment of corporate earnings, rather than distribution in the form of dividend was encouraged by the general organization of the tax code.[178]

Limited investment opportunities or liquidity concerns may lead to cash accumulations at the corporate level.[179] Cash accumulations serve the dual purposes of making acquisitions possible for a bidder with excess cash and of making a target with excess cash especially attractive.[180]

The general deductibility of interest is another factor that encourages acquisitions. Interest deductibility affects corporate takeovers in a two-fold manner. First, it enables a company to finance a takeover by subsidizing debt financing via the deductibility of interest payments.[181] Second, it produces a relative advantage for companies with a high debt-to-equity ratio. Since debt financed takeovers effectively increase the debt-to-equity ratio of an acquired corporation, a takeover may increase stock price to reflect the tax advantages associated with the debt financing.[182]

Although takeovers are often motivated by many non-tax factors, specific tax code provisions have, in the past, directly enhanced the merits of a particular acquisition.[183] "The carryover of tax attributes from one company to another can lead to the acquisition of corporations

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[175] Direct deductibility of interest payments allows corporations to effectively distribute pre-tax revenues. *See* I.R.C. § 162 (1986); I.R.C. § 163 (1986).

[176] *See* I.R.C. § 61(a)(7)(1984). *But see* THE PRESIDENT'S TAX PROPOSALS TO THE CONGRESS FOR FAIRNESS, GROWTH AND SIMPLICITY 120-29 (1985)(proposed reduction of double taxation of corporate earnings distributed to shareholders).

[177] JOINT COMMITTEE ON TAXATION, *supra* note 174, at 5.

[178] *See* I.R.C. § 1202(a)(1984). The Section 1202(a) capital gain deduction was eliminated by the Tax Reform Act of 1986, Pub. L. No. 99-514, § 311, 100 Stat. 2085 (1986); Conference Report to 1986 Act at II-106. Reinvestment of corporate earnings continues to be encouraged by the greater profit-making ability of the corporation over alternative investment opportunities available to investors.

[179] JOINT COMMITTEE ON TAXATION, *supra* note 174, at 506.

[180] *Id.*

[181] *Id.* at 5, 45-47. Thus, an acquirer may be able to obtain a company for less than its underlying asset value or below its price per earnings ratio while effectively paying only a portion of the financing cost. *See supra* text accompanying note 17.

[182] JOINT COMMITTEE ON TAXATION, *supra* note 174, at 5.

[183] *Id.* at 9.

primarily because of these attributes."[184] The most commonly sought after tax attributes are the net operating loss and investment tax credits.[185]

Tax attributes inherently may be more valuable to one company than to another. For example, a net operating loss would be more valuable to a company with excessive income and may possibly cause a more favorable tax rate to be applied.[186] Similarly, because an investment tax credit is non-refundable in nature, its complete utilization can only occur when tax liability either equals or exceeds the amount of the credit.[187] Thus, companies may have credits currently unavailable for use which would be readily available to companies with sufficient taxable income. Favorable tax attributes can reach a magnitude such that they cannot be ignored as a potential inducement for takeovers.

Although the *Tax Reform Act of 1986*[188] emanated from a social change philosophy and was designed for general reform purposes, the Act forecloses many of the incentives which have previously condoned takeover activity. The long-standing *General Utilities* doctrine was substantially repealed.[189] The repeal of the *General Utilities* doctrine will discourage takeovers by substantially increasing the tax cost of acquisitions.

Tax costs in asset purchases will increase because a target or selling corporation will now be taxed on the gain from the sale. Stock purchases become less advantageous because the acquiring corporation must either forego a favorable tax basis and depreciation deductions, or the sale will be fully taxable[190] as if it were an asset purchase. In any event, the additional tax cost must be borne by the acquiring corporation, and the effect of the additional cost will discourage takeover activity.[191]

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[184] B. Bittker & J. Eustice, Federal Income Taxation of Corporations and Shareholders 2-30 (4th ed. 1979). *But see* I.R.C. § 383 (1986); I.R.C. § 382 (1986); I.R.C. § 269 (1986)(code limitations on the use of net operating losses, excess credits, and built-in losses).

[185] Favorable basis and non-recognition of gain provisions may also have existed. *See* I.R.C. § 338 (1984); I.R.C. § 337 (1984). *See also* Joint Committee on Taxation, *supra* note 174, at 7, 10, 11, 23 37. *But see* I.R.C. § 47 (1984); I.R.C. § 1245 (1986); I.R.C. § 1250 (1986)(provisions for recapture of depreciation deductions and investment tax credits).

[186] *See* I.R.C. § 172 (1986)(net operating loss deduction); I.R.C. § 11 (1986)(corporate tax rate schedule).

[187] *See* I.R.C. § 38(c)(1984)(general business credit limitation).

[188] Pub. L. No. 99-514, 100 Stat. 2085 (1986)[hereinafter 1986 Act].

[189] General Util. Operating Co. v. Helvering, 296 U.S. 200 (1935)(holding that a corporation realizes no taxable income on a distribution with respect to its stock).

[190] 1986 Act § 631; Conference Report to 1986 Act at II–198; [1986] 13 Nat'l Rev. Corp. Acquisitions (Tweed) No. 33 (Sept. 8, 1986). *See also* I.R.C. § 338 (1986)(deemed asset acquisition pursuant to the operative provisions of I.R.C. §§ 336 & 337, as amended by 1986 Act § 631).

[191] *See* Faber, *The Search for Consistency in Corporate Acquisitions*, 13 J. Corp. Tax'n 187, 232 & n.102 (1986)(acquisitions will be seriously disadvantaged if tax consequences cause carryover-basis acquisitions to become the norm).

Takeovers will be further discouraged by tightened restrictions on the use of net operating loss carryovers. Provisions of the *Tax Reform Act of 1986* limit the availability of net operating losses to offset income of the acquiring corporation.[192] Hence, the effective cost of takeovers is again effectively increased and takeover activity is further discouraged.

Various tax reform proposals, other than the 1986 Act, have specifically sought to restrict or remove beneficial tax attributes and to impose taxes specifically designed to disfavor "hostile" takeovers. Several proposed bills, specifically designed to apply to "hostile" takeovers, would disallow interest deductions on indebtedness used to finance takeovers deemed hostile.[193]

Regardless of whether these tax proposals are viewed as imposing a new tax or eliminating current preferential treatment, their effect clearly would negatively impact the desirability of all takeovers. The immediate impact would be to discourage the economically desirable takeover.[194] In the process shareholder wealth would suffer as shareholders would be precluded from profits which could have resulted from takeover premiums or from the increased profitability attainable through efficiencies which can be created by combined resources.

More importantly, tax law changes may produce adverse long range effects. Once enacted into law, it is likely that they would remain in effect indefinitely.[195] As economic conditions change, environmental factors may not inherently favor takeovers and new restraints would place unneeded burdens on potential takeovers.[196] Moreover, if both tax based and general antitakeover legislation become effective, the concurrent

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[192] 1986 Act § 621; Conference Report to 1986 Act at II-170, 172 ("After an ownership change . . . the taxable income of a loss corporation available for offset by pre-acquisition NOL carry forward is annually limited to a prescribed rate times the value of the loss corporation's stock on the date of the ownership change.").

[193] JOINT COMMITTEE ON TAXATION, *supra* note 174, at 55-56 ("A 'hostile offer' is defined as an offer to acquire stock of a corporation if such offer is disapproved by a majority of the continuing independent members of a corporation's board of directors."). I.R.C. § 279 (1986), currently limits the interest on "corporate acquisition indebtedness", but its narrow scope has made its limitations easy to award. M. KATZ & R. LOEB, ACQUISITIONS AND MERGERS 133 (1985).

Since these proposed bills only remove the bias favoring debt financing, they would effectively create a defense or bargaining tactic for a target corporation. Conceivably, target corporations could negotiate an increased offering price on the basis of the tax consequences which would correspond to their disapproval of an offer.

Rather than discriminating against hostile takeovers, these proposals should seek to eliminate the bias favoring debt financing. A better approach would be to make reforms which favor equity financing without regard for the context in which the financing occurs.

[194] *See supra* text accompanying notes 120-27.

[195] *See supra* notes 64-74 and accompanying text.

[196] *See supra* notes 1-17 and accompanying text.

effect will severely curtail takeover activity. In the future, foreclosed takeover options will result in foregone growth and productivity.

Finally, specific tax legislation which would disallow acquisition related interest deductions are founded on a more flawed basis than general antitakeover legislation.[197] The merits of a particular takeover, or takeovers in general, bear no relation to whether they meet with the approval of target board members. Taxes imposed on this faulty basis would license motivations based solely on retaining control and ignore community impact concerns which comprise a major part of general antitakeover legislation.[198]

"[O]ne thing is clear: the effect of tax and regulatory policies on the market for corporate control is an issue of significant economic and political consequence."[199] Proposed antitakeover legislation of both the tax and regulatory nature is ill–conceived and would discourage beneficial takeover activity. Neither category of legislative proposals seeks to address the particular merits of a given takeover attempt, opting instead to comprehensively encumber all takeover activity. The concurrent effect of tax law changes, with respect to hostile takeovers, along with enactment of regulatory antitakeover legislation would bind the future to rules not now necessary, and their adverse effects would leave the future fated with foregone wealth.

V. The Effectiveness of Second Generation State Takeover Statutes

[A] law can be both economic folly and constitutional.[200]

In *CTS Corporation v. Dynamics Corporation of America*[201] the Supreme Court pronounced the constitutional validity of a second generation state takeover statute.[202] The constitutional validity of the Indiana Control Share Acquisition Act[203] was sustained despite the recognition

[197] *See supra* text accompanying notes 154-60.

[198] *See supra* text accompanying notes 30-35.

[199] Joint Committee on Taxation, *supra* note 174, at 3.

[200] CTS Corp. v. Dynamics Corp. of Am., 107 S. Ct. 1637, 1653 (1987)(Scalia, J., concurring), *rev'g*, 794 F.2d 250 (7th Cir. 1986).

[201] *Id.*

[202] *See supra* note 23. Control Share Acquisition Acts similar to the Indiana Act at issue in *CTS* had previously been struck down as unconstitutional. Fleet Aerospace Corp. v. Holderman, 637 F. Supp. 742 (S. D. Ohio 1986), *aff'd*, 796 F.2d 135 (6th Cir. 1986), *vacated*, 107 S. Ct. 1949 (1987); APL Ltd. Partnership v. Van Dusen Air, Inc., 622 F. Supp. 1216 (D. Minn. 1985); Icahn v. Blunt 612 F. Supp. 1400 (D. Mo. 1985). *But see* Terry v. Yamashita 643 F. Supp. 161 (D. Hawaii 1986)(striking down Hawaii's statute), *rev'd*, 788 F.2d 1566 (9th Cir. 1986).

[203] Ind. Code §§ 23-1-17-1 *et seq.* (Supp. 1986).

that "[v]ery few tender offers could turn the gauntlet that Indiana has set up."[204]

The opinion of the Court is replete with rhetoric which echoes the ostensible purpose of the Indiana Act: "The primary purpose of the Act is to protect the shareholders of Indiana corporations."[205] Repeated reference to the purported purpose of the Act shroud the essence of the Court's commerce clause validation of the Indiana Act. To sustain its commerce clause validity, the Indiana Act needed to bear only a modicum of rationality.[206] Disparate authorities on the merits and demerits of tender offers afforded the scant threat of rationality necessary for the Court to conclude that the Act's purpose is not illusory and that "Indiana has a substantial interest in preventing the corporate form from becoming a shield for unfair business dealing."[207]

CTS also sustained the Indiana Act on pre-emption grounds. In practical effect, the Indiana Act delays completion of a tender offer until fifty days after commencement.[208] The Court found the Act's fifty day period not in conflict with the shorter minimum tender offer period of twenty days and the longer maximum sixty day period for tender offers.

The twenty day minimum tender offer period was not deemed to present a conflict because conditional tender offers, as permitted by Williams Act regulations, were not precluded by the Indiana Act.[209] Further, the Court concluded that the sixty–day maximum tender offer period established the reasonable time period during which a tender offer could be delayed without pre-empting the Williams Act. In effect, the Court equated the permissive maximum tender offer period prescribed by the Williams Act with the mandatory minimum period of delay imposed by the Indiana Act. Thus, the Court's conclusion that a delay within the maximum Williams Act is not unreasonable[210] is a *non sequitur*.

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[204] *CTS*, 107 S. Ct. at 1643 (quoting the Seventh Circuit, 794 F.2d at 263). The Indiana Act deprives acquirers of control shares (twenty percent of the outstanding stock) of voting powers unless a majority of disinterested shareholders vote to authorize control share voting powers.

[205] 107 S. Ct. at 1651.

[206] Upon finding that the Indiana Act did not subject activities to inconsistent regulations, 107 S. Ct. at 1649, the remaining commerce clause obstacle was the Pike v. Druce Church, Inc., 397 U.S. 137 (1970), balancing of the effect on commerce with putative local benefits. Rational basis deference to legislative findings and purpose rendered the Court's further commerce clause analysis a perfunctory discourse. *See* South Carolina State Highway Dept. v. Barnwell Bros., Inc., 303 U.S. 177 (1938).

[207] 107 S. Ct. at 1651-52.

[208] The Act's practical effect was the basis for the Seventh Circuit's invalidation. 107 S. Ct. at 1645; 794 F.2d at 263.

[209] 107 S. Ct. at 1647.

[210] *Id.* The court further concluded that the unquestioned validity of state corporation statutes which delay the time when a successful tender offeror takes control indicate a congressional intent not to pre-empt state laws which delay the acquisition of post tender

A majority of the Court concluded that the Indiana Act paralleled Williams Act purposes by placing disinterested shareholders, in aggregate, on an equal footing with a takeover bidder.[211] But the majority failed to address formidable arguments presented in the dissenting opinion. The Williams Act intended to protect *individual* shareholders.[212] The Indiana Act, however, protects target corporations while serving to "protect" individual shareholders only by preventing them from selling stock at a premium.

The opinion of the Court suggests that shareholders, in aggregate, would or should act in the best interest of the corporation to reject an offer which might be accepted by an individual shareholder.[213] But minority shareholders do not owe a fiduciary duty to act in a corporation's best interest. Moreover, there is no basis for a belief that the interests of the corporation and the individual shareholders will coincide. Thus, it is absurd to subject individual shareholders to the whim of a shareholder majority.

The opinion of the Court is disingenuous and it imparts an undeserved ascription of wisdom to the Indiana Act.[214] More significant is the court's express recognition of the effectiveness of second generation state takeover statutes.[215] Such effectiveness wholly precludes the need for federal

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offer voting control. *Id.* at 1648. But the Court's conclusion is devoid of analysis or explanation. The Court failed to note that tender offer regulation is the only subject-area subject both to federal and state regulation.

[211] 107 S. Ct. at 1645-46.

[212] *Id.* at 1654. *See also supra* note 173.

[213] *Id.* at 1646. *See also id.* at 1654 (White, J., dissenting).

[214] *Accord State Takeover Laws: Constitutional but Dumb*, Wall St. J., May 4, 1987, at 22, col. 4.

[215] Ultimately CTS Corporation shareholders voted not to extend voting rights to the control shares acquired by Dynamics Corporation of America. *Business Briefs*, Wall St. J., May 26, 1987, at 34, col. 1. Thus, the effectiveness of the Indiana Act is graphically demonstrated by its deprivation of effective control to an owner of control shares.

Prior to *CTS*, Unocal Corp. v. Pickens, 608 F. Supp. 1081, 1083 (D. Cal. 1985), "confirm[ed] the ability of state courts to deal with substantive issues of corporation law and corporate governance, including issues of fairness in the corporation's treatment of its shareholders." The court noted a parallel state proceeding which granted an injunction to a target corporation on the basis of its likely success on the merits of a state issue on the overall fairness of a tender offer. Mesa Petroleum Co. v. Unocal Corp., No. 7997, slip op. (Del. Ch. Apr. 22, 1985), *aff'd*, 493 A.2d 946 (Del. 1985).

Under the Williams Act the essential showing to obtain an injunction is virtually impossible. Mobil Corp. v. Marathon Oil Co., 669 F.2d 366 (6th Cir. 1981), *cert. denied*, 455 U.S. 982 (1982), is the only case to impart substantive content to the Williams Act. Furthermore, Schreiber v. Burlington Northern, Inc., 472 U.S. 1 (1985), effectively overruled *Mobil*. Thus, target corporations have generally been relegated to prospective relief. Rondeau v. Mosinee Paper Corp., 422 U.S. 49 (1975).

But federal law other than the Williams Act has been sufficient to warrant injunctive relief. In Burlington Indus., Inc. v. Edelman, No. C-87-274G (D. N.C. Jun. 5, 1987)(mem. op. and order granting preliminary injunction), the use of inside information by a former

antitakeover legislation as Indiana Control Share Acquisition Act clones will doubtless be enacted.[216]

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executive of the target company who acted as a "catalyst and consultant" to a takeover attempt was the basis for an injunction. Further, a takeover financing plan in violation of Federal Reserve Board Regulations G and U warranted a preliminary injunction in Caesars World, Inc. v. Sosnoff, No. CV 87-01622-WJR(Px)(D. Cal. Jun. 12, 1987)(Order Clarifying and Modifying Order Preliminarily Enjoining Defendants).

[216] *Shareholders Need a Knight-Errant*, Wall St. J., May 27, 1987, at 30, col. 3 ("the Indiana approach to hostile takeovers is today a beacon for other states to follow.")(written by the governor of Indiana). But, significantly, Delaware has not rushed to follow Indiana's lead. *Delaware Fails to Adopt Law on Takeovers*, Wall St. J., Jun. 16, 1987, at 2, col. 2.

Barring the enactment of federal legislation which would re-open pre-emption issues, see *supra* note 45, *CTS* may end the chronicled efforts of the Ohio Legislature in its attempts to shield Ohio corporations from market disciplines. Ohio legislators have consistently acted to aid management in fending off takeover threats. In 1981, the Ohio Legislature passed Am. H.B. 455, 114th Gen. Assembly, 1981 Ohio Legis. Serv. 5-593 (Baldwin)(inserting OHIO REV. CODE ANN. § 1331.021 (Anderson 1985) into close corporation legislation at the last minute), as an emergency measure to protect Marathon Oil Co. from a pending takeover bid by Mobil Oil Co. *Judges demolish takeover shield*, The Plain Dealer, June 27, 1986, at 15-B, col. 1; Lorincz, *U.S. Steel Finds Gusher in Find By Ohio*, NORTHERN OHIO BUS. J. 3 (Nov. 23, 1981).

In further reaction to the Marathon takeover bid, the Ohio Legislature enacted the Ohio Control Share Acquisition Act. Am. Sub. H.B. 822, 114th Gen. Assembly, 1982 Ohio Legis. Serv. 5-395 (Baldwin)(enacting OHIO REV. CODE ANN. §§ 1701.831, .832 & 1707.042 (Anderson 1985)). In 1986 the Control Share Acquisition Act was invalidated. Fleet Aerospace Corp. v. Holderman, 637 F. Supp. 742 (S. D. Ohio 1986), *aff'd*, 796 F.2d 135 (6th Cir. 1986), *vacated*, 107 S. Ct. 1949 (1987).

The constitutional validity of the Ohio Control Share Acquisition Act is not established by *CTS*. But the issues addressed on remand fall within narrow parameters. The parties each read *CTS* with different degrees of expansiveness. Fleet argues that the Ohio Act is unconstitutional because the Act extends beyond defining voting rights and prohibits a purchase or sale of control shares. Memorandum of Fleet Aerospace Corporation on the Applicability of *CTS v. Dynamics* at 8-9. The State of Ohio suggests that in practical effect the Ohio Act is identical to the Indiana Act upheld in *CTS*. Specifically, it is argued that the Ohio Act's prohibition on purchases is a distinction of no constitutional significance because "Ohio merely does directly what Indiana accomplishes indirectly." Brief in Support of the Motion of the State Defendants-Appellants at 9.

Fleet's argument is better because the purchase and sale prohibitions in the Ohio Act change the dimension of the shareholder vote. A purchase of "control shares" necessarily removes a significant block of shares from the voting process. The presence or absence of "control shares" in the shareholder vote bears the potential to alter unpredictably the outcome of a shareholder vote. Thus, Ohio's *pre-purchase* voting scheme differs significantly from Indiana's *post-purchase* voting provisions.

But *CTS* indicates that the constitutionality of the Ohio Act will not be judged by the wisdom of its methods. Therefore, the State of Ohio's practical effect theory is constitutionally tenable. Regardless, the outcome of *Fleet* is of little significance. If the more restrictive Ohio Act does not survive constitutional scrutiny the Ohio Legislature can assure the existence of an effective control share acquisition act by swiftly adopting legislation patterned after the Indiana Act.

Undeterred by the setback in *Fleet*, the Ohio Legislature again took specific, emergency measures to adopt statutory amendments designed to forestall a pending takeover bid for

VI. Conclusion

Although the current wave of takeover activity has created a great deal of concern and has prompted repeated calls for federal antitakeover legislation, prevailing conditions do not merit such a drastic departure from the existing regulatory scheme. Takeover activity has traditionally run in cycles, and as economic conditions change heightened activity will doubtless decline. Furthermore, contested takeovers only represent a small portion of aggregate takeover activity. In the few isolated instances where disputes will occur adaptations of common law doctrines to current trends will provide sufficient resolution.

Increased takeover activity is primarily the result of forces independent of law. Existing common law has adequately intervened when symptomatic problems have arisen; thus, federal antitakeover legislation is not necessary.

Moreover, federal antitakeover legislation is not wise. Proposed legislation is ill-conceived and improperly based. Shareholder protection is predominately claimed as the thrust of legislative proposals, yet prescribed shareholder voting procedures or regulatory restrictions would be ineffectual and counterproductive to that end. Rather than affording shareholder protection, proposed legislation would effectively afford protection to management of target corporations. In the process shareholders would be stripped of their best protection by the elimination of market disciplines which serve to best protect their interests.

Congress is neither able fully to comprehend the implications of takeovers nor to draft legislation capable of equitable application in all circumstances. State legislatures have acted out of sheer protectionism rather than careful study. Under such circumstances legislation would undoubtedly increase uncertainty and exact additional costs to the takeover process while positive results are unlikely.

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the Goodyear Tire and Rubber Company. Privately drafted amendments, enacted as a temporary measure, served to fend off the takeover. Am. Sub. H.B. 902, 116th Gen. Assembly, 1986 Ohio Legis. Serv. 5-1096 (Baldwin); *Legis-letter*, 59 Ohio St. B. Ass'n Rep. 1998, 1999 (1986); *Nimble Financier*, *supra* note 41. Apparently pleased with its success, the Ohio Legislature made the Goodyear antitakeover amendments permanent. S.B. 50, 116th Gen. Assembly, 1987 Ohio Legis. Serv. 5-1 (Baldwin).

The heart of the Goodyear amendments is Ohio Rev. Code Ann. § 1701.16 (Anderson Supp. 1986), by which "Ohio . . . became the first state to sanction by statute the 'poison pill' defense." Case & Ellis, *Significant New Corporate Legislation*, 59 Ohio St. B. Ass'n Rep. 2000, 2004 (1986). Other provisions of Am. Sub. H.B. 902 affecting the duty of care are discussed in *supra* note 88.

The brazen protectionism of the Ohio Legislature is doubtless less susceptible to constitutional scrutiny, on pre-emption grounds, in the wake of *CTS*. *But see supra* note 45. But if the Ohio Legislature is to be truely responsive to the long-term needs of Ohio it must temper its quest to be at the forefront of corporate legislation with the realization that beyond creating an atmosphere conducive to corporations, it should not create an atmosphere abusive to shareholders. *See Ohio Takeover Law Cause Stock - Price Fall, SEC Says*, Wall St. J., May 19, 1987, at 6, col. 4.

Efficient, effective management provides the best form of shareholder protection. Operative management cannot be legislatively mandated; therefore, takeover restraints, however oblique, would not be wise.

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