DELAWARE'S TAKEOVER STATUTE: OF CHILLS, PILLS, STANDSTILLS, AND WHO GETS ICED

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I. Introduction

The Delaware legislature has passed a moderated version of the New York takeover statute.[1] The New York provision,[2] and hence the Delaware provision, are known in the takeover community as "business combination" acts. Business combination acts exclude for a period of years from the class of a firm's potential merger partners those entities that acquire a substantial block of firm stock without prior approval from firm directors.[3] Various other states including Arizona,[4] Connecticut,[5] Georgia,[6] Idaho,[7] Indiana,[8] Kentucky,[9] Minnesota,[10] Missouri,[11] New Jersey,[12] Pennsylvania,[13] Washington,[14] and

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1. *Compare* Del. Code Ann. tit. 8, § 203 (1988) *with* N.Y. Bus. Corp. Law § 912 (McKinney 1986). *See generally* Veasey, *Delaware's Takeover Law: A Statute was Needed to Curb Abuses*, N.Y. Times, Feb. 7, 1988, § 3, at 2, col. 1 (comparing Delaware and New York statutes).

2. N.Y. Bus. Corp. Law § 912 (McKinney 1986). *See also* Note, *The Constitutionality of Second Generation Takeover Statutes*, 73 Va. L. Rev. 203, 211-12 (1987) (discussing New York statute).

3. *See* Special Report, *The Battle Over Tender Offer Reform: From the States and the Courts to Congress*, 20 Sec. Reg. & L. Rep. (BNA) 60, 69-70 (Jan. 15, 1988) (discussing history of the business combination act). Lewis Black, a member of the Council of the Corporation Law Section of the Delaware Bar, the body responsible for drafting the statute, called it "one of the most controversial pieces of corporate legislation that has been introduced in the legislature." He noted that it is "unprecedented that there has been a substantial minority vote on a proposal in the corporation law section."

4. Ariz. Rev. Stat. Ann. §§ 10-1221 to -1223 (1987).

5. 1988 Conn. Acts 88-350 (Reg. Sess.), *Legislative Briefs*, 20 Sec. Reg. & L. Rep. (BNA) 925 (June 17, 1988).

6. Ga. H.B. No. 1571, *Legislative Briefs*, 20 Sec. Reg. & L. Rep. (BNA) 503 (Apr. 1, 1988).

7. Idaho Code §§ 30-1601 to -1614 (1988).

8. Ind. Code Ann. § 23-1-43 (Burns 1987).

9. Ky. Rev. Stat. Ann. §§ 271A.396-398 (Michie/Bobbs-Merrill 1986).

10. Minn. Stat. Ann. § 302A.673 (West 1987).

11. Mo. Stat. Ann. § 351.459 (Vernon 1988).

12. N.J. Stat. Ann. § 14A:10A (West 1987).

13. Pa. Stat. Ann. tit. 15, § 1910 (Purdon 1988).

14. Wash. Rev. Code § 23A.50 (1988).

Wisconsin[15] have business combination acts. Of these, the Delaware provision, however, is the mildest.[16] The statute thus seems to represent a mid-course compromise[17] between those who view hostile takeovers as destructive and those who view them as beneficial.[18] As

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15. WIS. STAT. ANN. § 180.25(9)(a) (West 1987).

16. Maine, Pennsylvania, and Utah have statutes, known as appraisal or redemption rights statutes, that are more severe than business combination acts. Shareholders in these states have the right, triggered by someone purchasing a large block of firm stock, to cash out of a firm at a price defined in the statute. This right to cash out exists regardless of whether or not the purchaser is contemplating a takeover. ME. REV. STAT. ANN. tit. 13-A, § 910 (1987); PA. STAT. ANN. tit. 15, § 1910 (Purdon 1988); UTAH CODE ANN. § 16-10-76.5 (1986). An early draft of the Delaware statute contained a redemption rights provision. *Delaware May Staunch Leveraged Takeovers*, INVESTMENT DEALERS' DIGEST, Nov. 23, 1987, at 47.

17. Delaware Governor Michael N. Castle issued a statement on the signing of the statute that reflects the basic compromise contained in the legislation. A portion of the statement is noted below:

> Takeover artists argue that they are protecting shareholders from shoddy or poor management practices. I would argue that, while there are no doubt corporation managements which need to be shaken up, the greater effect is to simply substitute one bad practice for another—but one that harms the entire national economy in the process.
>
> When management decisions must routinely take into account the short-term effect on stock prices rather than the long-term benefit to the corporation and its shareholders, then the so-called corporate raiders and takeover artists are playing a direct role in weakening our position in the world economy. . . .
>
> On the other hand, we should not protect entrenched management which fails to respond to competition. This statute does not prevent fully funded, legitimate takeover in which someone wants to manage a company and make it more profitable and more productive.
>
> It is not overly restrictive, as are the laws in many states which have recently passed legislation. It provides the proper level of protection to both corporate managers and the shareholders who actually own the corporations.
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> We have a special responsibility, here in Delaware, because of our unique position. . . . I believe that the balanced approach we have adopted will allow this to occur.

Statement by Governor Michael N. Castle on signing House Substitute 1 for House Bill 396, *reprinted in* C. SMITH & C. FURLOW, GUIDE TO THE TAKEOVER LAW OF DELAWARE, CORPORATE PRACTICE SERIES (BNA) 339, 340 (1988).

See Goldman, *Delaware Anti-Takeover Legislation is Needed*, Nat'l L.J., Feb. 8, 1988, at 31, col. 1 (discussing the history of the Delaware provision by the chairman of the Takeover Law Subcommittee of the governing Council of the Corporation Law Section of the Delaware State Bar Association (Council)). *See also* Black, *Why Delaware is Wary of Anti-Takeover Law*, Wall St. J., July 10, 1987, at 18, col. 4; Hays, *Delaware Effort to Draft Takeover Law Stirs a Debate, Disturbs SEC Members*, Wall St. J., Dec. 14, 1987, at 11, col. 1.

18. *Compare* Lipton, *Corporate Governance in the Age of Finance Corporatism*, 136

with many centrist solutions, however, few are happy with the result, except perhaps lawyers whose clientele includes both bidders and targets.[19]

This is not to say, however, that Delaware's law is the most friendly to bidders of all state laws on the subject; a business combination act is much more intrusive than a pure control share acquisition statute[20] and marginally more intrusive than a pure fair

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U. PA. L. REV. 1, 6-7 (1987) (takeovers focus on short-term profits at the expense of long-term planning) *with* Easterbrook & Fischel, *The Proper Role of a Target's Management in Responding to a Tender Offer*, 94 HARV. L. REV. 1161, 1168-74 (1981) (resistance by a corporation's managers to premium tender offers ultimately decreases shareholder welfare).

19. Mr. T. Boone Pickens, a prominent and frequent bidder in the takeover market, has condemned the statute as "a management protection bill." Kaletsky, *Delaware Makes Its Mark on Corporate America*, Financial Times, Feb. 8, 1988, at 24. Mr. Pickens, and United Shareholders Association—his lobby group, played a very active role in opposing the Delaware legislation. In the end, he got only one vote (the vote was 39-0 in the Delaware House and 19-1-1 in the Delaware Senate). *See* Clough, *Baseball, Apple Pie, and T. Boone Pickens?*, INVESTMENT DEALERS' DIGEST, Mar. 14, 1988, at 25. Clough notes:

> Pickens lost that battle for one simple reason: his image. People in Delaware were offended by an outsider moving in to tell the state what to do. In addition, corporate chief executives, a more familiar sight to the Delaware lawmakers, didn't fail to remind legislators that state revenues were dependent on the income from incorporation.

Id. at 26. The bill was also opposed by several large pension funds, including the California State Teachers Retirement Fund. Labaton, *Anti-Takeover Move Advances in Delaware*, N.Y. Times, Jan. 5, 1988, at D4, col. 1.

On the other side, Mr. Martin Lipton, a celebrated lawyer for takeover targets, dismisses the statute as "a totally meaningless measure—an ineffectual panacea that could actually make some of the takeover abuses worse." Kaletsky, *supra*, at 24. *Compare* Mendelsohn & Berg, *Anti-Takeover Bill Would Shift Balance of Power*, Nat'l L.J., Feb. 8, 1988, at 38, col. 1 *with* Goldman, *supra* note 17, at 31, col. 1 (discussing opposing views on the need for anti-takeover legislation).

The comments of these lawyers that have clients on both sides of takeover battles are uniformly favorable. *See, e.g.*, Barret, *Delaware Moves Closer to Adopting Law to Deter Hostile Takeovers*, Wall St. J., Dec. 9, 1987, at 41, col. 4 (comment of Irwin Schneiderman: "a 'reasonable, down-the-middle approach' "). These lawyers recognize that the law will not stop takeovers but rather will put a premium on creativity in exploiting the law's openings. Of course, legal complexity means a larger role and larger fees for lawyers.

20. A control share acquisition statute gives stockholders the right to decide whether "control shares" acquired by a bidder will have voting rights. Control shares are defined as voting shares acquired that, together with any shares previously owned, place the acquiree in excess of any one of three specified thresholds, usually 20%, 33%, and 50%. *See, e.g.*, IND. CODE ANN. § 23-1-42-1 (Burns 1987). A model control share acquisition statute has been drafted by a joint committee of the North American Securities Administrators Association and members of the American Bar Association Committee on State Regulation of Securities. *See Text of NASAA—ABA*

price statute.[21] Several of the states with these alternate types of

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Model Control Share Act, Preliminary Statement, and Comments, 20 Fed. Sec. L. Rep. (BNA) 708 (May 6, 1988) (defining control shares in terms of voting power).

The list of states with control share acquisition statutes at the time of this writing includes Arizona, Florida, Hawaii, Idaho, Indiana, Kansas, Louisiana, Massachusetts, Minnesota, Missouri, Nebraska, Nevada, North Carolina, Ohio, Oklahoma, Utah, and Wisconsin. *See* ARIZ. REV. STAT. ANN. §§ 10-1211 to -1217 (1987); FLA. STAT. § 607.109 (1987); HAW. REV. STAT. §§ 416-171 to -172 (1985); Idaho, IDAHO CODE §§ 30-1601 to -1604 (1988); IND. CODE ANN. § 23-1-42 (Burns 1987); *Legislative Briefs*, 20 Sec. Reg. & L. Rep. (BNA) 694 (May 6, 1988) (discussing Kansas bill); *Legislative Briefs*, 20 Sec. Reg. & L. Rep. (BNA) 743 (May 20, 1988) (discussing another Kansas bill); LA. REV. STAT. ANN. §§ 12:135-:140.2 (West 1988); MASS. GEN. L. ch. 110D, §§ 1-8 (1988); MINN. STAT. ANN. § 302A.671 (West 1987); MO. ANN. STAT. § 351.407 (Vernon 1988); *Legislative Briefs*, 20 Sec. Reg. & L. Rep. (BNA) 694 (May 6, 1988) (discussing Nebraska bill); NEV. REV. STAT. ANN. §§ 78.3765-.3793 (Michie 1988); N.C. GEN. STAT. §§ 55-90 to -98(1987); OHIO REV. CODE ANN. § 1701.831 (Anderson 1985); OKLA. STAT. tit. 18, §§ 1145-1156 (1988); 1987 Or. Laws 820; PA. STAT. ANN. tit. 15, § 1910 (Purdon 1988); UTAH CODE ANN. §§ 61-6-1 to -6-12 (1988); WIS. STAT. ANN. § 180.25(9)(a) (West 1987). Several state legislatures are currently considering similar legislation, including California, Illinois, Michigan, New Hampshire, and Virginia. *See* Special Report, *supra* note 3, at 60 (general discussion of recent state legislation). *See also* Pamepinto & Heard, *New State Regulation of Corporate Takeovers*, Nat'l L.J., Sep. 21, 1987, at 26; Pinto, *Takeover Statutes: The Dormant Commerce Clause and State Corporate Law*, 41 U. MIAMI L. REV. 473, 473-83 (1987); Note, *The Constitutionality of Second Generation Takeover Statutes*, 73 VA. L. REV. 203, 207-11 (1987); Romano, *The Political Economy of Takeover Statutes*, 73 VA. L. REV. 111, 148-69 (1987). Professor Romano's article contains a thoughtful comparison of the effect of the various types of takeover statutes. Using a decision tree analysis, she concludes that a bidder's preference schedule for antitakeover statutes will have the following order: control share acquisition, fair price, supermajority, redemption. She does not, however, separately analyze business combination acts.

In early 1987, the Delaware Corporate Law Section of the Delaware Bar, the committee largely responsible for drafting amendments to the Delaware Corporate Code, considered and rejected a control share statute as ineffective. Black, *supra* note 17, at 18, col. 4. *See infra* text at note 22 (discussing different approaches to control share statutes). The NASAA has adopted the Model Control Share Act. *See NASAA Adopts Model Control Share Act, Modeled After Indiana Antitakeover Law*, 20 Sec. Reg. & L. Rep. 691, 708 (May 6, 1988).

21. A fair price statute normally requires that a shareholder triggering the statute cannot effect a back-end merger unless the merger consideration for disinterested shareholders meets certain price criteria or unless two-thirds of the disinterested shareholders vote for the merger. The price criteria are set to eliminate front-end loading in acquisition programs, that is, the triggering shareholders must pay the back-end shareholders at least at much as the price he paid to acquire his initial controlling block of stock. States that have enacted fair price statutes include Connecticut, Florida, Georgia, Illinois, Kentucky, Louisiana, Maryland, Michigan, Mississippi, North Carolina, Pennsylvania, Virginia, Washington, and Wisconsin. CONN. GEN. STAT. §§ 33-374a to -374c (1987); FLA. STAT. § 607.108 (1987); GA. CODE ANN. §§ 14-2-232 to -234 (1987); ILL. ANN. STAT. ch. 32, para. 7.85 (Smith-

statutes have tightened considerably the terms of the basic models, and the Delaware statute may compare favorably with some of the more restrictive of these modifications.[22] Moreover, Delaware has not layered or stockpiled its takeover legislation.[23] Most of the states with business combination acts annex them to or cumulate them with other forms of takeover legislation.[24]

Before proceeding with a breakdown and discussion of the nature of the compromise, consider that the effect of the new statute is easily overdramatized. Because Delaware is the corporate home of 56% of the Fortune 500 firms and 45% of the firms listed on the

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Hurd 1988); KY. REV. STAT. ANN. §§ 271A.396-.398 (Michie/Bobbs-Merrill 1986); LA. REV. STAT. ANN. §§ 12:132-:134 (West 1988); MD. CORPS. & ASS'NS CODE ANN. §§ 3-601 to 603 (1987); MICH. COMP. LAWS ANN. §§ 450.1775-.1784 (West 1987); MISS. CODE ANN. §§ 79-25 to -27 (1987); N.C. GEN. STAT. §§ 55-75 to -79 (1987); VA. CODE ANN. §§ 13.1-726 to -728 (1988); WASH. REV. CODE ANN. § 23A.08.425 (1987); WIS. STAT. ANN. § 180.725(3)(a) (West 1987). In sum, if the price criteria are not set unreasonably high, a fair price statute could, in theory, allow back-end mergers that do not have the approval of two-thirds of the disinterested shareholders.

22. Considering only the control share acquisition statutes: Two states, Hawaii and North Carolina, have no opt out provision. Five states, Arizona, Hawaii, Minnesota, Wisconsin, and Ohio, require consummation of the acquisition a short time after the shareholder vote. Three states, Arizona, Wisconsin, and Minnesota, require that the acquiring person have definite financing arrangements in place before it requests a shareholder vote. Five states, Arizona, Oklahoma, North Carolina, Massachusetts, and Florida, include, within the coverage of their statutes, non-domiciled corporation with a defined economic nexus to the state. And, creating the most substantial extension, ten states give disinterested shareholders dissenters' appraisal rights in the event of a favorable vote for the acquiror.

23. In contrast, North Carolina, Ohio, and Pennsylvania, for example, have each passed at least three different takeover statutes since 1982. *E.g.*, North Carolina—N.C. GEN. STAT. §§ 55-75 to -98 (1988); Ohio—OHIO REV. CODE ANN. §§ 1701.59(e)(4), 1701.831 (1988); Pennsylvania—PA. STAT. ANN. tit. 15, § 1910 (Purdon 1988).

24. Some states have combined their business combination act with a control share acquisition statute. *See, e.g.*, ARIZ. REV. STAT. ANN. §§ 10-1221 to -1223 (1987); IDAHO CODE §§ 30-1601 to -1614 (1988); IND. CODE ANN. § 23-1-43 (Burns 1988); MINN. STAT. ANN. § 302A.673 (West 1987); MO. ANN. STAT. § 351.459 (Vernon 1988). Others combine their business combination act with a fair price provision. *See, e.g.*, KY. REV. STAT. ANN. §§ 271A.396-.398 (Michie/Bobbs-Merrill 1986); N.Y. BUS. CORP. LAW § 912 (McKinney 1986); WASH. REV. CODE § 23A.50 (1980). Minnesota and Washington have also attached provisions redefining the fiduciary duty of directors in tender offer contests. *See* MINN. STAT. ANN. § 302A.673 (West 1987); WASH. REV. CODE § 23A.50 (1988). Pennsylvania has combined its redemption provision with a business combination act, a fair price provision, and a statutory poison pill, making it one of the most restrictive antitakeover statutes in the country. *See* PA. STAT. ANN. tit. 15, § 1910 (Purdon 1988).

New York stock exchange,[25] any change in the Delaware corporate code affects a substantial number of shareholders. However, the Delaware statute is not the exclusive nor even the definitive law for Delaware corporations concerning the propriety of takeover defenses. Any analysis of the new statute based solely on the terms of the statute itself is a mistake because it fails to consider the effect of the statute in both the context of preexisting and ubiquitous target company takeover defenses[26] and, more importantly, the context of inevitable court evaluations of the behavior of target directors under the statute.[27] In the current environment of shark repellents,[28] poison

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25. Kaletsky, *supra* note 19, at 24. *See generally* Romano, *Law as Product: Some Pieces of the Incorporation Puzzle*, 1 J.L., ECON., & ORG. 225 (1985) (exploring state incorporation competition thesis from an empirical perspective and explaining why Delaware is the leading choice for reincorporation).

26. *See* Lipton, *A Checklist for Defending Against Takeovers*, Nat'l L.J., Sept 21, 1987, at 21, col. 1 (recent outline of firm-specific defensive actions by a recognized master). He notes that "the single most important takeover defense is the poison pill. More than 400 companies had adopted it." *Id.* Mr. Lipton's firm of Wachtell, Lipton, Rosen & Katz is currently promoting a "second generation" poison pill. The new share purchase rights plan contain a "flip-in" (once triggered the rights entitle shareholders to buy, at deep discounts, firm stock) as well as a "flip-over" (once triggered the rights entitle shareholders to a very favorable exchange in the event of a back-end merger). *See* Dynamics Corp. of Am. v. CTS Corp., 637 F. Supp. 406 (N.D. Ill.), *remanded*, 794 F.2d 250 (7th Cir. 1986), *rev'd on other grounds*, 107 S. Ct. 1637 (1987). In an effort to protect the pill from attacks based on shareholder democracy, the plan contains a shareholder vote procedure: If a bidder holding less than 1% of a firm's stock makes an any-or-all offer with financing in place, shareholders can vote to accept the offer (the vote is held from 90 to 120 days after the request) and redeem the rights.

27. *See* 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 (1984) (general discussion of firm-specific defenses and the response of the courts); D. BLOCK, N. BARTON & S. RADIN, THE BUSINESS JUDGMENT RULE (1987); A. FLEISCHER, TENDER OFFERS: DEFENSES, RESPONSES & PLANNING (2d ed. 1983); Leebron, *Games Corporations Play: A Theory of Tender Offers*, 61 N.Y.U. L. REV. 153 (1986); Gordon & Kornhauser, *Takeover Defense Tactics: A Comment on Two Models*, 96 YALE L.J. 295 (1986); Lamb & Turezyn, Revlon *and* Hanson Trust: *Unlocking the Lock-Ups*, 12 DEL. J. CORP. L. 497 (1987); Siegel, *Tender Offer Defensive Tactics: A Proposal for Reform*, 36 HASTINGS L.J. 377 (1985); Harrington, *If it Ain't Broke, Don't Fix it: The Legal Propriety of Defenses Against Hostile Takeover Bids*, 34 SYRACUSE L. REV. 977 (1983); Lipton, *Takeover Bids in the Target's Boardroom; An Update After One Year*, 36 BUS. LAW. 1017 (1981).

28. The term "shark repellents" refers to provisions inserted into the target's articles of incorporations or bylaws in advance of any takeover threat which attempt to deter hostile takeover attempts. A shark repellent can take many forms, including staggered boards, supermajority votes for mergers, and fair price provisions. *See* Gilson, *The Case Against Shark Repellent Amendments: Structural Limitations on the Enabling Concept*, 34 STAN. L. REV. 775 (1982); Lautzenhiser, *State and Federal Regulation of*

pills,[29] lock-ups,[30] repurchase programs,[31] and other defenses, and in light of court evaluations of target board behavior in using such defenses, the statute may have only a minimal effect. Advocates of the importance of thwarting hostile bidders will recognize that the statute, although not strong on its own, can be combined with specific defenses—which target boards had relied on before the statute—to effect marginally better defenses. Those who advocate the importance of encouraging hostile takeovers will rely solely on the courts, as they had before the statute, to police inappropriate and self-serving entrenchment behavior by target boards.

In sum, the addition of the Delaware statute does not greatly affect the nature of the Delaware courts' responsibility for policing choices made by target directors who are self-interested in the outcome of a hostile tender offer.[32] While the statute may affect the attitude of the courts on takeover defenses in general, predicting the parameters of the statute's influence is difficult. For example, the courts could view with more *suspicion* defenses that go beyond the statute

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Shark Repellent Provisions: How Much is Needed?, 11 N. KY. L. REV. 481 (1984); Comment, *Corporate Takeover Battles—Shark Repellent Charter and Bylaw Provisions that Deter Hostile Tender Offers or Other Acquisitions—A Comprehensive Examination*, 27 HOW. L.J. 1683 (1984).

29. A poison pill defense involves the issuance of rights to target shareholders that enable the target shareholders to purchase either stock of the target or stock of the acquiror at a favorable rate in the event of a merger or consolidation. There are, however, an infinite variety of poison pills designed to deter different types of hostile acquisitions, with new pills emerging all the time. *See* M. LIPTON, T. MIRUIS & R. BROWNSTEIN, TAKEOVER DEFENSES AND DIRECTOR LIABILITIES 95-126 (M. Lipton ed. 1986) (discussing the current poison pill environment); Dawson, Pence & Stone, *Poison Pill Defensive Measures*, 42 BUS. LAW. 423 (1987) (same).

30. A lock-up in a hostile takeover battle is a grant to a favored bidder, by the target, of the right to purchase assets of the target company if the disfavored bidder takes control. *See generally* Finkelstein, *Lock-ups in Contested Takeovers*, 17 REV. SEC. REG. (Standard & Poors) 866 (1984); Lamb & Turezyn, *supra* note 25, at 501; Note, *Lock-Up Options: Toward a State Law Standard*, 96 HARV. L. REV. 1068 (1983) (discussing lock-ups in depth).

31. Repurchase programs are tactics used by target management that allow the target company to repurchase large quantities of its own stock in competition with the tender offeror, either through market transactions or by a tender offer for its own stock. *See* Bradley & Rosenzweig, *Defensive Stock Repurchases*, 99 HARV. L. REV. 1378 (1986); Atkins, Lyons & Feder, *Stock Repurchases in Tender Offers*, 17 REV. SEC. REG. (Standard & Poors) 787 (1984).

32. *See, e.g.*, Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1986) (applying the enhanced duty rule of Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985)); Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985) (creating a threshold test, the burden of proof being on the directors, before the protection of the business judgment rule is granted).

(i.e., the legislature believes the statutory defense is strong enough). Alternatively, the courts could view with more *favor* those same defenses (i.e., the legislature believes that defenses in general are legitimate and has established only a default system that firms are encouraged to reject or supplement on their own).[33] Ultimately, it will be the Delaware courts that will define the power of the Delaware statute. Refrain, then, from judging the effect of the statute based on the next section of this article, which outlines the statute's basic design. Instead, defer judgment until the succeeding section, which describes the role of specific target company defenses and the approach of the Delaware courts to target board behavior.

II. THE BASIC DESIGN AND INTENT OF THE STATUTE: CHILL BOOTSTRAPPERS?

A. *The Mechanics of the Delaware Act*

The Delaware statute, at its core, prohibits an entity (an "interested shareholder") that has acquired a specified stock position in a publicly-traded Delaware corporation—15% or more of the voting stock—from engaging in any business combination with the corporation for a "cooling-off" period of three years.[34] There are several ways to avoid triggering the cooling-off period as well as several ways to terminate prematurely ("thaw") a running cooling-off period.[35] The first category, potential exclusions from the operation of

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33. In Moran v. Household Int'l Inc., 500 A.2d 1346, 1352-53 (Del. 1985), the appellants argued that the original § 203, a mild section requiring disclosure by bidders, implied that all other impediments to tender offers were inappropriate. The court responded by stating that "[s]uch a contention is a *non sequitur*. The desire to have little state regulation of tender offers cannot be said to also indicate a desire to also have little private regulation." *Id.* at 1353.

34. *See* DEL. CODE ANN. tit. 8, § 203 (1988).

35. Associate Professor Kenneth Koford, testifying against the bill before the Delaware legislature and reacting, perhaps, on behalf of all the nonlawyers trying to understand this unusual legislation, had this to say about the proposal:

> The goal of such a rule is to scare would-be takeover artists: They have to leap over, not a barrier, but a kind of alligator pit, to get full operational control of the firm. If they end up in the alligator pit—with less than 85% of the stock—they will get devoured and will lose a lot of money as their firm falls apart . . . . So they [Bar Association] put six ladders in the alligator pit—ways to get out . . . Gil Sparks says they aren't too hard—you'd only lose maybe an arm or a leg usually, before you got out of the pit and could operate the firm to maximize value . . . . Why write a law in this crazy way?

Testimony of Kenneth Koford, before Joint Hearing of the Delaware Senate and House Judiciary Committees, Jan. 21, 1988.

the basic prohibition, includes the following scenarios: first, an acquisition in one transaction of over 85% of the target's voting stock, excluding stock held by director/officers and most employee stock plans[36]; second, an election to opt out of the statute by a director resolution passed within ninety days of the statute's effective date; and third, an election to opt out by an amendment to the certificate of incorporation[37] or to the bylaws effective for stock acquisitions that take place twelve months subsequent.[38] The second category, potential ways to thaw the running of a cooling-off period, includes two possibilities: first, approval by the board and by a vote by two-thirds of the outstanding stock held by those other than the acquiror;[39] and, second, the approval (or lack of disapproval), by a majority of

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36. DEL. CODE ANN. tit. 8, § 203(a)(2) (1988). Assume, for example, that 10% of the stock is owned by director-officers. To meet the 85% cap, a bidder must buy 76.5% of the stock, calculated as 85% of 90%. If one also assumes that 10% of the stock is held by groups of people that will not tender (directors who are not officers and vice versa, and unresponsive shareholders), then the bidder must acquire 94.6% of all the available stock. As explained by E. Norman Veasey, this calculation can be somewhat complex. Exclusions from the denominator will require examination of a number of issues including: the broad definition of ownership in DEL. CODE ANN. tit. 8, § 203(c)(8) (1988) for the officer-directors, the types of securities, beneficial holdings, trusts and contractual arrangements of the officer-directors, and the specific provisions of a firm's various employee stock plans. For the numerator one must also consult the definition of ownership in DEL. CODE ANN. tit. 8, § 203(c)(8) (1988) for the bidder. *See* Veasey, *Supermajorities and the New Delaware Takeover Law*, 3 Corporate Counsel Weekly (BNA) 8 (Mar. 2, 1988).

The original draft of the bill contained a 90% cap and a 10% threshold trigger. *See* Barret, *supra* note 19, at 41, cols. 3-6; *Compromise Near in Delaware*, N.Y. Times, Dec. 21, 1987, at D2, col. 9.

37. DEL. CODE ANN. tit. 8, § 203(b)(1) (1988). Of course, an amendment to the certificate of incorporation can be done only if the board of directors first adopts a resolution referring the matter to the shareholders. *See* DEL. CODE ANN. tit. 8, § 242(b)(1) (1974).

38. Under Delaware law, shareholders may amend the bylaws without prior action by the board. *See* DEL. CODE ANN. tit. 8, § 109(a) (1974).

There are other less important exemptions. A 15% acquiror can avoid the cooling-off period altogether by making the 15% acquisition and a business combination proposal only after the announcement (and before the consummation) of a business combination between the firm and a third party who is not an interested stockholder or who became an interested stockholder with the approval of disinterested directors. *See* DEL. CODE ANN. tit. 8, § 203(b)(6) (1988). Two authors note that this is an "inadvertent loophole." *See* SMITH & FURLOW, *supra* note 17, at 47. In the author's view, the exception is consistent with the purpose of the overall exemption for competitive offers. The competitor provision is more important in thawing a running moratorium than in avoiding it altogether. *See* note 40 *infra*. Another exemption of minor significance allows a firm to opt-out in its original certificate of incorporation. DEL. CODE ANN. tit. 8, § 203(b)(1) (1988).

39. DEL. CODE ANN. tit. 8, § 203(a)(3) (1988).

the directors who took office before anyone had acquired 15% of the firm's stock, of a business combination between the firm and a third party (including a management buyout group).[40]

A comparison of the Delaware statute with its New York parent demonstrates the moderation of the Delaware provision. In New York, although the triggering acquisition amount is 20% the cooling-off period is potentially indefinite.[41] A majority of disinterested shareholders (excluding the 20% owner but including the inside managers) must vote to allow a business combination with an interested shareholder but can do so only *after* the expiration of an initial five year moratorium.[42] Absent such a vote, interested shareholders can effect business combinations with a target only if they pay a statutorily defined "fair price" in the transaction.[43] The fair price is the greater of the following: (1) the highest price per share paid by the interested shareholder for firm shares after he becomes a 5% owner and within either five years of the start of the business combination or five years before the interested shareholder becomes a 20% owner, (2) the market value of the stock on the announcement date of the business combination, or (3) the market value of the stock on the date the acquiree becomes a 20% owner.[44] Moreover, the holders of all outstanding shares of stock are entitled to receive compensation.[45] The essence of the New York statute, then, is the fair price release rather than a vote of disinterested shareholders. New York's opt-out provision is also more onerous, with an eighteen month waiting period for charter amendments.[46]

Delaware's penchant for caution in takeover legislation is not new. In 1976, Delaware passed its first takeover statute, regulating

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40. *Id.* § 203(b)(6). The third party must be a disinterested stockholder or an interested shareholder who has the approval of disinterested directors. Thus, a *hostile* takeover bid will not thaw the moratorium for competitors. The competitive bid exemption is one of the most complicated provisions of the statute and creates some extraordinary difficulties in application as director lineage becomes a critical factor.

41. N.Y. BUS. CORP. LAW § 912(a)10(A), (b) & (c) (McKinney 1986).

42. *Id.* § 912(c)(2). Moreover, the New York statute's definition of "business combinations" is much broader, including liquidations, *id.* § 912(a)(5)(D), and large dividend distributions. *Id.* § 912(a)(5)(B).

43. *Id.* § 912(c)(3).

44. *Id.* § 912(c)(3)(A).

45. Booth, *The Promise of State Takeover Statutes*, 7 MICH. L. REV. 1635 (1988).

46. *Id.* § 912(d)(3).

tender offers by, among other things, requiring pre-offer notice.[47] Compared to other first generation takeover statutes that typically allowed state officials to rule on the fairness of tender offers for resident corporations,[48] Delaware's provision was quite mild. In this tradition, the first draft of the Delaware business combination act came as a surprise.[49] The original draft was tough. The cooling-off period was triggered by an acquisition of a mere 10% of the outstanding voting stock, the percentage of voting stock that had to be acquired to avoid the period was 90% with no exclusions for insider holdings, an opt-out bylaw amendment was not effective for eighteen months, boards could unilaterally opt out within forty days of the statute's effective date, and a majority of the disinterested shareholder vote could waive the period *only* if an interested shareholder owned 90% of the outstanding stock.[50]

In response to public comments on the original draft,[51] the Council of the Corporation Law Section reduced substantially the

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47. The statute was also codified at § 203. *See* DEL. CODE ANN. tit. 8, § 203 (1986). The old § 203 was subsequently repealed effective July 1, 1987. *See* DEL. CODE ANN. tit. 8, § 203 (Supp. 1987).

48. *See, e.g.*, Edgar v. MITE Corp., 457 U.S. 625 (1982) (invalidating the Illinois statute that allowed the determination of fairness to be made by the Secretary of State). *See generally* Hazen, *State Anti-Takeover Legislation: The Second and Third Generations*, 23 WAKE FOREST L. REV. 77 (1988); Sargent, *On the Validity of State Takeover Regulation: State Responses to* MITE *and* Kidwell, 42 OHIO ST. L.J. 689 (1981) (discussing the development of state anti-takeover statutes).

49. The first draft was circulated publicly in November of 1987 by the Council of the Corporation Law Section of the Delaware State Bar Association, after which the Council received over 150 letters of comment. *See Business and the Law: Compromise Near in Delaware*, N.Y. Times, Dec. 21, 1987, at D2, col. 1.

50. *See* Memorandum to Corporation Law Section Membership, from Council of the Corporation Law Section, "Proposed Business Combination Legislation and Section Meeting—December 11, 1987," Nov. 19, 1987.

51. The principal reason for the modifications were apparently three letters from a Commissioner of the Securities and Exchange Commission, Joseph Grundfest. *See* Memorandum to Members of the Corporate Law Section, from A. Gilchrist Sparks, III, "Proposed Section 203," December 31, 1987. Although the Council made changes responding to several of Grundfest's recommendations, in the end they failed to appease him. Editorial, Wall St. J., Dec. 31, 1987, at 6, col. 1. *See also* Statement of Joseph Grundfest before the House Judiciary Committee of the Delaware State Legislature concerning Delaware's proposed antitakeover legislation, Jan. 20, 1988: "Delaware should not adopt an antitakeover law at all." *Id.*

SEC Commissioners, Chairman David Ruder and Commissioner Cox, as well as Federal Trade Commissioners, Daniel Oliver, and Commissioner Terry Calvani also opposed the first draft: "Corporate law should remain neutral in contest for corporate control . . . ." Interestingly, the State Board of Pension Trustees for the State of Delaware refused to take a position on the matter, even given the harsh

proposal's protections, creating the existing statute. In supporting letters from the more influential members of the bar and in the testimony of the Bar Association's representative before the Delaware legislature, one finds repeated references to the word "compromise."[52] Even so, there were votes against the final draft, both by members of the Council and by members of the Corporate Law Section.[53] Such negative votes are unprecedented in the many years of the Section's control over the content of the Delaware corporate code.[54] Moreover, when the Bar Association's proposal was presented

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effect of the initial draft, but Delaware's largest bank, Wilmington Trust, was not so reluctant: "We urge you to scrap the proposed measure or to consider substantial modification." Several other institutional investors also wrote to oppose the early draft. *See* Sontag, *A Takeover Law Grows in Delaware*, Nat'l L.J., Apr. 11, 1988, at 1, 19 & 20.

One of the more ardent lobbying efforts came from Professor Michael C. Jensen, of both the Harvard Business School and the William E. Simon School of Business at the University of Rochester. *See* Letter from Michael C. Jensen to David B. Brown (Dec. 8, 1987). Delaware's legislation puts his views in conflict. He writes:

> I have long been an admirer and defender of the Delaware Corporate Law and one of those who fought mightily against the thesis of those who argue that Delaware is engaged in a "race for the bottom." The Delaware Antitakeover Proposal causes me great concern because I am convinced that this law will do enormous damage to corporate American and to the shareholders of Delaware corporations.

Id.

Reminding me of an anxious parent attempting to dissuade a beloved child from an improvident and yet inevitable choice, he makes a tough argument. He states first that, in his view, the market crash of October 19, 1987 was caused, in large part, by an improvident anti-raider tax bill, and attributes the stock declines in the first week of December of 1987 to publicity concerning the new Delaware law (a draft of § 203 was circulated publicly in the third week of November). He concludes by noting that if Delaware adopts the proposal, it will add "considerably to the pressures for Federal chartering." Letter from Michael C. Jensen to David B. Brown (Dec. 8, 1987).

52. "[Section 203] is the product of a series of compromises which both preceded and followed the nationwide circulation in late November for comment to attorneys, academics, corporations, pension funds, federal officials and others of an earlier draft . . . ." *Testimony of A. Gilchrist Sparks, III, Chairman, Corporation Law Section, Delaware State Bar Association, before the Joint Hearing of the Delaware Senate and House Judiciary Committees, Jan. 20, 1988, reprinted in* SMITH & FURLOW, *supra* note 17, at 297.

53. *See generally* Sontag, *supra* note 51, at 19. The vote on the final draft was 14 to 1 in the Council and 101-24 in the Corporate Law Section. *See also* SMITH & FURLOW, *supra* note 17, at 10.

54. *See generally* Seligman, *A Brief History of Delaware's General Corporation Law of 1899*, 1 DEL. J. CORP. L. 249, 280-82 (1976) (discussing Corporation Law Section of Delaware and its control over drafting of corporate statutes).

to the Delaware legislature, a second novel event took place; a competing bill appeared in the Delaware legislature, Senate Bill No. 311, requiring stockholders to agree to opt in by charter amendment rather than permitting them to opt out.[55]

The previously unthinkable became possible: Would there be a floor fight on a proposal by the Corporation Law Section of the Delaware Bar Association to amend the Delaware Corporate Code? National lobbying groups focused their attention (and presumably their cash) on Dover.[56] After two days of testimony on January 20 and 21, however, order was quietly restored. The Bar Association proposal passed 39-0 in the House on January 26, and 19-1, one member abstaining, in the Senate on January 28.[57] Looking at the content of the debate, the final vote is not difficult to understand. In the two days of testimony, one of the lead-off speakers was Michael E. Harkins, the Delaware Secretary of State.[58] He reminded the legislators that corporate franchise tax and fees produced over $170 million in revenue, representing 17% of the state's total income. After a polemic discussion on the merits of takeovers, and some curiously pointed jabs at members of the Delaware bar who had opposed the measure in bar meetings,[59] he ended with his trump card:

> I distributed to each of you the correspondence I have received from over 170 corporations, all of whom have paid a maximum franchise tax of $130,000. Each of them supports this statute and at least a half a dozen have stated that they would have to look seriously at the question of changing their Delaware incorporation [if the statute is not adopted].

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55. SMITH & FURLOW, *supra* note 17, at 10, 15-16 (discussing the opt-in/opt-out debate).

56. *See infra* note 60. *See also* Gilligan, *Wall Street Look Adds New Wrinkle to Dover Regulars*, The Morning News, Jan. 21, 1988, at 1, col. 5.

57. SMITH & FURLOW, *supra* note 17, at 10. Ironically, the House passed the bill the same day that T. Boone Pickens spoke on the floor of the Senate. *Cf. id.* at 10 n.28 (discussing who spoke for and against the legislation).

58. *See Statement of Secretary of State, Michael E. Harkins, Testimony Before the Delaware House and Senate Judiciary Committees, Jan. 20, 1988, reprinted in* SMITH & FURLOW, *supra* note 17, at 257-59.

59. "Those [lawyers in the bar] who rejected [the] compromise and who argue that you should not act are not here to give you first hand, on the public record, their views—that silence is deafening." *Id.* at 258.

Is this a prudent risk?

I believe not.[60]

Testimony in opposition to the bill came from an Associate Professor of Economics at the University of Delaware, who spoke for ten members of the economics and finance faculty; from an SEC Commissioner;[61] from T. Boone Pickens' lobby group, the United Shareholders Association;[62] from a Washington, D.C. attorney; from other academics; and from several institutional investors.[63] This testimony, however, proved to be mere formality, for once Mr. Harkins had made his pitch, other testimony became superfluous.[64]

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60. *Id.* at 259.

Mr. Harkins was followed by representatives of Delaware corporations, including Boeing Company, ConAgra Inc., Hercules Inc., E.I. du Pont de Nemours and Company, Household International, General Motors Corporation, and General Mills, Inc., each of whom pushed for immediate passage.

Statements of support also came from labor unions. *Cf.* SMITH & FURLOW, *supra* note 17, at 10 n.28 (discussing who spoke for and against the legislation). Labor unions such as the Delaware State CAP Council of the UAW, the Independent Federation of Flight Attendants, and the Chemical & Atomic Workers Local #8-898 argued that the gains to some raiders come at the expense of their members. The representative from the Independent Federation of Flight Attendants gave a very impassioned account of the effect of Carl Icahn's purchase of TWA. Mr. Icahn extracted large wage concessions from TWA employees that the old management had been unwilling or unable to demand. Some have argued that the wage concessions were overdue because the labor contracts in issue related back to the days when the airline industry was regulated and could no longer be afforded in a competitive, deregulated market. *See* SMITH & FURLOW, *supra* note 17, at 271-75. Moreover, recent studies have shown that takeovers do not systematically disadvantage labor. *See* Jarrell, Brickley, & Netter, *The Market for Corporate Control: The Empirical Evidence Since 1980*, 2 J. ECON. PERSP. 49, 57 (1988).

What is somewhat puzzling, however, is the success of the labor unions in amending the Bar Association proposal to prohibit impairment of labor contracts in business combinations approved pursuant to the statute. Labor unions do not pay franchise taxes and fees in Delaware. Presumably, either managers view the prohibition as adding additional disincentive to potential bidders or union locals have a substantial influence in state elections. The prohibition raises numerous troubling questions: Does it prohibit even a willing union (over the dissent of a minority faction) from renegotiating an existing contract with a new owner? If so, the provision could drive a salvageable firm into bankruptcy. How does it affect the new owner's sales of operating divisions and other substantial firm assets?

61. *See* Sontag, *supra* note 51, at 20.

62. *Id.*

63. *Id.* Fidelity Investments, the nation's largest financial services company, five public employee pension funds, and Institutional Shareholder Services, representing a group of eight institutional investors, all weighed in against the proposal. *See* SMITH & FURLOW, *supra* note 17, at 293.

64. The opt-in provision was defeated because A. Gilchrist Sparks III, chair-

B. *The State's Misplaced Concern with Bootstrappers (AKA Raiders)*

The drafters of the Delaware statute designed the three year cooling-off period primarily to block heavily leveraged acquisitions that depend on the assets of the target for repayment of the acquisition financing[65]—so-called "bootstrap" or "bust up" acquisitions.[66] Bootstrap acquisitions have always incurred the wrath of target boards because such acquisitions allow the raider to buy the company with its own assets. With bootstrap acquisitions, the relative size of the target and the acquiring firm becomes much less significant. A large asset base no longer protects against a takeover, because small bidders with short-term financing based on the asset liquidity of a target can purchase very large firms. Managers of large firms, who at one time only worried about intercorporate politics, must now also worry about raids. Moreover, it is argued that bootstrappers, once they gain control, generally make more severe changes in the operating structure of the target. For example, they are quicker to fire personnel, negotiate wage concessions, sell divisions, close or move plants, refocus assets on cash generating operations, and, in the most despised scenario, sell all the firm's assets, in what is known as the bust-up takeover.[67]

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man of the Delaware State Bar Association, Corporation Law Section, argued that corporations under an opt-in provision "would be much more likely to pursue a reincorporation merger out of Delaware which requires the same vote than it would to some state with opt-out legislation already in place." Adoption of an opt-in provision would draw attention to the firm, he argued, and act as an invitation to "every raider to check out the proponent's vulnerability." SMITH & FURLOW, *supra* note 17, at 299.

65. A report by the Council states that the primary purpose of the statute is to prevent front-end loaded, bust-up takeovers. According to the report, "The statute prevents [two-tier takeovers] which on several occasions [have] been found to be coercive by the Delaware Supreme Court, and which have been specifically identified by the U.S. Supreme Court in the *CTS* decision as a problem to be dealt with by states." *The Proposed Delaware Takeover Statute: A Report to the General Assembly*, *reprinted in* SMITH & FURLOW, *supra* note 17, at 244.

66. *Delaware May Staunch Leveraged Takeovers*, *supra* note 16, at 47; Barret, *supra* note 17, at 41, col. 4. The propriety of "bust-up" takeovers has been the subject of intense debate among commentators. *See, e.g.*, H. BENJAMIN, LEVERAGED BUYOUTS (1982) (discussing bust-up takeovers).

67. An outspoken proponent of this view is Senator William Proxmire, chairman of the Senate Banking Committee. "To service debt, especially the expensive, pervasive debt that accompanies hostile takeovers, companies must retrench research and development as well as terminate otherwise productive workers." *See* Proxmire, *The M & A 'Game' is Not a Productive Enterprise*, Nat'l L.J., Nov. 9, 1987, at 21, 22, col. 1. He is joined by Representative John Dingell, chairman of the House

The motivation for this radical restructuring by raiders has historically been their need to immediately service the substantial short-term, high interest rate debt incurred in purchasing control of the target.[68] Consider a skeleton example of a typical leveraged deal, popular in the early eighties: A small partnership of investors, with a reputation for success in takeovers, forms a shell corporation. The shell gathers cash (a war chest) by selling high interest, short-term, unsecured debt with a promise to repay the debt through a sale of the assets acquired in a future takeover. With this cash, the shell makes a cash tender offer for 51% control of a publicly traded company.[69] After control of the board passes, the new board effects a "back-end" merger between the shell and the publicly traded company, exchanging the shares of the minority shareholders for preferred stock or debt in the residual firm.[70] A properly structured merger of a publicly held corporation avoids giving the minority shareholders any appraisal rights.[71] The acquiror uses control of the assets of the target to pay off the short-term debt: it applies all cash and cash equivalents directly to the debt; it sells sluggish operating divisions to generate cash; and it streamlines the remaining business operations to maximize immediate and substantial cash flow.

If the shell were prevented from consummating a merger, or its economic equivalent (for example, a special asset sale or a re-

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Energy and Commerce Oversight and Investigations Subcommittee. According to Dingell, "target corporations are 'liquidating jobs, assuming usurious debt load[s], devastating their research and development budgets, and foregoing long-term planning.' " *Dingell Says Hostile Takeovers Drain Targets to Enrich Wall Street*, 3 Corporate Counsel Weekly (BNA) 3 (Feb. 17, 1988). Dingell has no love for the role of investment bankers: "saying 'quick buck artists, . . . out for maximum fees in stripping the values of target companies[, who] have no long-term interest in the economy or of the American working people.' " *Id.* Interestingly, however, Representative Dingell has expressed concern about business combination acts. *See Sanford Urges States to Lobby Against Preemption of Their Takeover Statutes*, 19 Sec. Reg. & L. Rep. (BNA) 1882 (Dec. 11, 1987).

68. H. SHERMAN & R. SCHRAGER, JUNK BONDS AND TENDER OFFER FINANCING 406 (IRRC's Corp. Governance Serv. Jan. 1987).

69. *See, e.g.*, Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 956 (Del. 1985) (describing a typical two-tier offer).

70. *Id.*

71. Delaware's appraisal statute does not give appraisal rights to shareholders of a firm listed on a national securities exchange or shareholders of a firm held by more than 2,000 shareholders if the exchanged securities are stock in the surviving corporation or shares of stock in another corporation listed on a national securities exchange or held by more than 2,000 shareholders. DEL. CODE ANN. tit. 8, § 262 (1987). *Cf.* DEL. CODE ANN. tit. 8, § 262 (1987) (exception in appraisal statute for publicly traded companies).

capitalization), then the shell could claim only 51% of the cash potential of the target through dividends or their equivalents.[72] Because the acquiror can apply 100% of the cash generated by the target to service the debt, lenders are encouraged to lend more cash to the acquiror at better rates than they would if the acquiror could apply only 51% of the cash potential in the target to any acquisition financing. The drafters of the Delaware statute, by effecting a statutory prohibition on back-end mergers and all their economic equivalents, hoped to stop most bootstrap acquisitions that do not have the blessing of existing management.[73]

In theory, the statute does not affect those bidders that have sufficient capital or long-term borrowing capacity to purchase targets as longer term investments. Firms with strong balance sheets and plenty of cash need not force the target to generate cash to meet immediate and severe short-term interest obligations. These firms are comfortable with a three year cooling-off period because they do not need 100% control of the target's assets to service otherwise unserviceable debt; they have sufficient external resources to service a substantial amount of the acquisition financing and are content with pro rata distributions of the acquired firm's cash.

Why are firms with strong balance sheets the preferred purchasers? First, and foremost, it is believed that there are fewer of them. "Buying firms" must be extremely large to be able to invest their own assets in an acquisition for a longer term, especially where the risks and costs of an acquisition may not compare favorably with other investment opportunities. Indeed, with the exception of Bendix's unsuccessful raid on Martin Marietta,[74] blue chip corporations have not until recently made hostile bids on other corporations, preferring friendly acquisitions instead.[75] Moreover, the number of

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72. Moreover, the shell may have to pay some income tax on the dividend, unless the two firms file consolidated returns (usually the parent can do so if it owns 80% of the subsidiary). For firms that cannot file a consolidated return, an 80% dividend exclusion is available for dividends received by one firm from another, but 20% is taxed.

73. *See* M. GOLDMAN & E. MCNALLY, THE PROPOSED DELAWARE TAKEOVER STATUTE: A REPORT TO THE DELAWARE GENERAL ASSEMBLY, *reprinted in* SMITH & FURLOW, *supra* note 17, at 241, 254-56.

74. Bendix Corp. v. Martin Marietta Corp., 547 F. Supp. 522 (D. Md. 1982).

75. An investment banking professor at the Harvard Business School explains that "corporations typically haven't had the stomach or time or emotional energy to buy a company and strip it down the way raiders do." *GE Bid May Spur New*

acquisitions by operating corporations, as opposed to the number of acquisitions run by the flashier raiders like Irwin Jacobs, Asher Edelman, and T. Boone Pickens, has, at least in past years, been very small.

Second, well-heeled firms, *it is presumed*, will effect less radical changes in the target's operating structure because they look for longer term and more stable investments. For the blue chip firms, the most likely targets are healthy firms that can be bought and run "as is." Hence, junior personnel are less likely to be fired, factories are less likely to be closed, and the like. It is much better, as the theory goes, to be acquired by General Electric than by a bootstrapper. In the current market, however, both beliefs may be no more than wishful thinking.

Since the stock market plunge on October 19, 1987, leveraged buyout firms have been quiet[76] and corporate buyers with strong balance sheets have moved to fill the void.[77] Moreover, the new corporate buyers have learned from the raiders and seem just as anxious to divest newly acquired assets as their little brothers.[78] In

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Wave of Blue Chip Raiders, INVESTMENT DEALERS' DIGEST, Mar. 14, 1988, at 19. However, the conventional wisdom is slowly beginning to change as established companies enter the takeover fray.

76. The stock market crash affected raiders in a variety of ways. Many typically ran their own stock portfolios and lost substantial equity. Moreover, the market in high-yield below-investment-grade bonds (junk bonds) was disoriented and may have suffered permanent damage. Congress also changed the tax laws, eliminating "mirrors" that had allowed raiders to minimize taxes when they effected distributions of appreciated property in the target. *See Back in Action: Companies Take Over the Takeover Game from Flashy Raiders*, Wall St. J., Jan. 25, 1988, at 1 & 18, cols. 6 & 3.

77. General Electric recently startled the investment community when it made an unsolicited $423 million bid for Roper Corporation. Experts in the mergers and acquisition market are speculating as to whether the bid may encourage other blue chip corporations to make hostile bids. One joked that "we could see a new group of raiders—the Fortune 500." *GE Bid*, *supra* note 75, at 18. Another mentioned that he has a number of blue chip clients who are considering hostile deals. *Id.* at 8-9. Even if the blue chippers stay reluctant, there can be no doubt that corporate buyers are back in the takeover market. *See Back in Action*, *supra* note 76, at 1, col. 6. The first three weeks of 1988 witnessed a surge of corporate takeover bids, many of them hostile—Neoax, Inc.'s bid for IU International Corp., Prime Computer, Inc.'s bid for Computervision, Inc., Emhart Corp.'s bid for Stanadyne, and American Brands bid for E-II Holdings. *Id.*

78. *See* Dobrzynski, *A New Strain of Merger Mania*, BUS. WEEK, Mar. 21, 1988, at 24.

> In the old days, a company bought a company to keep it. Now, following the trend to focus on a few businesses, CEOs are copying bust-up artists,

sum, Delaware may find that it has dealt only with yesterday's buyers.

What is troubling about the drafter's concern over bootstrappers, however, is that bootstrappers may provide the best curative for lazy, inept, or self-interested managers.[79] Raiders search for, seize

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> who buy companies to break them up and resell the units at a profit. "You're not just buying a company to hold it and merge it anymore. . . . You're looking at it as a mosaic—there are some pieces to keep if they fit and some pieces to be spun off to get more value."

Id.

Recent examples abound: Neoax will buy IU International Corporation by selling two-thirds of IU's businesses. *Id.* Campeau, bidding for Federated Department Stores, sold two Federated units and several of its own units to third parties, contingent upon the success of its bid. *May Stores Agrees to Buy From Campeau 2 Federated Chains if Takeover Succeeds*, Wall St. J., Mar. 7, 1988, at 4, col. 2. (Campeau ultimately succeeded in purchasing Federated. *Federated President Quits in Anticipation of Campeau Control*, Wall St. J., May 4, 1988, at 30, col. 3).

79. Critics of takeovers question whether hostile control changes produce net gains to society. *See* Lipton, *supra* note 18, at 6-7 (discussing dangerous implications of short-term investment strategy). In the capital markets, there is substantial data showing that takeovers produce net gains. In hostile takeovers, stock price gains provide the market's estimate of the increase in returns likely to result from takeover activity, and empirical evidence gathered on the question suggests that takeovers produce huge gains to target shareholders and marginal or, in the 1980's, insignificant gains to the shareholders of acquirors. *See* Jarrell, Brickley & Netter, *supra* note 60, at 51-54; Jensen & Ruback, *The Market for Corporate Control: The Evidence*, 11 J. FIN. ECON. 5 (1983); Grundfest & Black, *Stock Market Profits from Takeover Activity Between 1981 and 1986: $167 Billion is a Lot of Money*, Securities and Exchange Commission News Release, Sept. 28, 1987. *But see* Weidenbaum & Voght, *Takeovers and Stockholders: Winners and Losers*, Booklet No. 83, Center for the Study of American Business (Dec. 1987) (acquiring stockholders often lose during takeovers); Scherer, *Corporate Takeovers: The Efficiency Arguments*, 2 J. ECON. PERSP. 69 (1988) (acquiring firms experience long-term negative abnormal returns after takeovers and operating performance of acquired companies does not improve after takeovers); Stein, *Takeover Threats and Managerial Myopia*, 96 J. OF POL. ECON. 61, 76 (1988) (questioning the value of stock price-event studies); Lipton, *supra* note 18, at 27 (gains experienced by target shareholders may be short-term). In the Grundfest & Black study, they estimated that between 1981 and 1986 shareholder wealth increased due to takeovers by a minimum of $167 billion measured in nominal dollars and $184 billion measured in constant 1987 dollars. They also concluded that, on average, bondholders and preferred stock holders do not suffer losses in takeovers. Moreover, the evidence on stock premiums paid in tender offers probably significantly understates the total gains. In most cases, speculation about potential tender offers, based on Schedule 13D filings for example, causes significant run-ups in the stock price of targets well before the tender offer itself. *See, e.g.*, Mikkelson & Ruback, *An Empirical Analysis of the Interfirm Equity Investment Process*, 14 J. OF FIN. ECON. 523 (1985) (significant price reactions accompany a Schedule 13D filing, with the highest returns occurring when the filer disclosed a possibility of a future acquisition). There is also strong evidence that gains produced in acquisitions do not come from a bidder who takes

upon, and profit from opportunities to enhance the operation of publicly held companies; they are less concerned with so-called synergy gains and seek gains from major changes in the target firm itself.[80] The best opportunities for bootstrappers, then, are firms that are languishing because of lazy, inept, or corrupt management. If

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advantage of the market's undervaluing of a target firm. When target firms resist takeovers and remain independent, it has been shown that their stock prices return to pre-offer prices within two years. Jarrell, Brickley & Netter, *supra* note 60, at 55. *See also* Bhagat, Brickley & Loewenstein, *The Pricing Effects of Interfirm Cash Tender Offers*, 42 J. OF FIN. 965 (1987) (tender offer announcement increases in target stock are too large to be explained by market undervaluation of the target firm).

A second criticism is that takeover pressure leads managers to sacrifice long-term interests (research and development, for example) in order to boost short-term cash flow—managerial myopia. *Cf.* Lipton, *supra* note 18, at 23-24 (discussing management's change of focus). One study found, however, that firms with high research and development expenditures are not more vulnerable to takeovers and that stock prices respond positively to announcements of increases in research and development. OFFICE OF THE CHIEF ECONOMIST, SECURITIES AND EXCHANGE COMMISSION, INSTITUTIONAL OWNERSHIP, TENDER OFFERS AND LONG-TERM INVESTMENT (Apr. 19, 1985) (study also found that increased institutional investments are not positively associated with increased takeover frequency or with reduced research and development expenditures). *But see* Stein, *supra*, at 76-77 (questioning the value of the SEC study). Professor Jensen concludes that "There is much evidence inconsistent with the myopic markets view and no evidence that indicates it is true." Jensen, *Takeovers: Their Causes and Consequences*, 2 J. ECON. PERSP. 21, 26 (1988).

A third criticism is that takeovers produce too much corporate debt. *See Borrowing Binge: Takeover Trend Helps Push Source Corporate Debt and Defaults Upward*, Wall St. J., Mar. 15, 1988, at 1, col. 6; Lipton, *supra* note 18, at 20-23. But in 1986, high yield debt represented less than one dollar of every twelve used to finance acquisitions. *See The Growth of Junk Bonds*, MERGER & ACQUISITIONS, May-June 1987, at 16. With the junk bond market in disarray after the October 19, 1987 crash, the figure ought to be lower at present. Moreover, Professor Jensen argues that debt-equity ratios of nonfinancial corporations are not at record levels, and actually declined in 1985. Jensen, *supra*, at 38-39.

A fourth criticism may be the most telling. Assuming that hostile takeovers benefit the capital markets, there is still substantial disagreement over whether there is a less costly way to displace inefficient managers. *See Brookings Revisits Corporate Takeovers*, Tax Notes 1230 (Sept. 28, 1987). Lawyers and investment bankers take huge fees, and takeovers can generate substantial dislocation costs, the threat of which may also destabilize existing economic relationships. But shareholders have been reluctant to give managers the power to protect, at their personal whim, nonshareholder constituencies.

80. Synergy gains are created by mixing the operations of two independent companies so that the value of the combined company exceeds the sum of the two. Raiders are concerned with synergy gains, however, when they take control of a firm with an intent to change its operations and makes it more attractive to third party merger partners. *See generally* Andre, *Tender Offers for Control: A Critical Analysis and Proposals for Reform*, 12 DEL. J. CORP. L. 865, 874 (1987) (discussing synergistic gains theory).

the cost to the firm of such conduct is substantial, then bootstrappers and their backers can turn a handsome profit by buying the firm and restructuring its operations.

Studies of hostile takeovers indicate that such bootstrap takeovers often occur in industries on the decline or in industries suffering other sharp business changes where managers fail to shrink operations rapidly enough or fail to make other necessary adjustments rapidly enough.[81] The problem of sluggish management is most severe, perhaps, when a firm in a declining industry continues to generate substantial cash flows; the managers hold and reinvest the cash in inefficient programs rather than paying it out to shareholders who can make better use of it.[82] In the oil industry, for example, managers were continuing costly explorations for additional oil reserves despite a declining market for oil.[83] In the airline industry, managers were slow to adjust to the demands of deregulation; they failed to readjust union wage scales that had reached excessive levels under regulation.[84] The forest products, food, and broadcasting industries are additional examples of industries with excess capacity and substantial cash flows.[85] In all these industries, existing managers, perhaps due to inertia or to a desire to protect personal turf or nonshareholder constituencies, maintained full-scale traditional operations for too long in the face of substantial changes in business climate.

The disciplining effect of hostile takeovers in these industries, once they appeared, was dramatic. Not only were those firms actually acquired in these industries radically restructured, but other firms in the industry that were not the subjects of takeovers also swiftly undertook major restructurings.[86] It appears that incumbent managers who worry about bootstrappers are more likely to effect appropriate changes in their firm's operations to keep firm share prices high, offering less of a temptation to potential purchasers. It should be no surprise, then, that those industries most affected by the threats of bootstrappers contain firms that, on their own, have engaged in some of the more radical restructurings as of late. T. Boone Pickens, for

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81. *See, e.g.*, Shleifer & Vishny, *Value Maximization and the Acquisition Process*, 2 J. OF ECON. PERSP. 7, 11-12 (1988); Jensen, *supra* note 79, at 23-28, 32-36.

82. *See* Jensen, *supra* note 79, at 34.

83. *Id.* at 32-34.

84. *Id.* at 23-24.

85. *Id.* at 35-36.

86. *Id.* at 27.

example, can be credited with "shaping up" the entire oil industry.[87] In sum, it may be the bootstrappers that provide the strongest incentive for incumbent managers to keep agency costs down. If so, the drafters of the Delaware provision have done shareholders a serious disservice by styling their statute to discriminate against bootstrappers.

C. *The Statute's Poor Fit as a Solution to the Shareholder Coercion Problem*

In response to the argument above, however, the drafters of the Delaware statute argue that the statute does not discriminate against all bootstrappers but only against bootstrappers that take advantage of the collective action problem suffered by shareholders in responding to tender offers.[88] Some bidders, they argue, will stampede shareholders into tendering control of the firm for bargain prices and then follow up with a squeeze-out of the back-end minority shareholders at even worse prices.[89]

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87. *Raiders Sober the Oil Industry: Big-Spending Era May End*, N.Y. Times, Jan. 11, 1985, at D1, col. 3. Professor Michael Jensen has estimated that the restructurings of Phillips, Unocal and Arco have created total gains to shareholders of $6.6 billion by reducing continuing investments in negative net present value projects. Jensen, *The Takeover Controversy: Analysis and Evidence*, 1986 MIDLAND CORP. FIN. J. 6.

88. *See* Brudney & Chirelstein, *Fair Shares in Corporate Mergers and Takeovers*, 88 HARV. L. REV. 297, 304 (1974). In *CTS*, the Court recognized officially that tender offerors can take advantage of target shareholders' inability to mount a collective response. The Court referred to the collective action problem three times in the opinion: (1) in answer to the argument that the Indiana statute is preempted by the Williams Act; (2) in answer to the argument that the statute violates the commerce clause; and (3) in answer to the policy argument that the Indiana Act would limit the number of tender offers for Indiana companies. *CTS*, 107 S. Ct. at 1646, 1651, 1652. This language was repeatedly cited in the debates on the Delaware statute. *See* Memorandum from Edward McNally and Stephen E. Jenkins to Members of the Corporation Law Section, "The Proposed Delaware Business Combination Statute" (Dec. 30, 1987).

89. *See* Goldman & McNally, Members of the Council of the Corporation Law Section of the Delaware State Bar Association, *The Proposed Delaware Takeover Statute: A Report to the General Assembly*, *reprinted in* SMITH & FURLOW, *supra* note 17, at 241, 242 (presenting hypothetical to illustrate coercive problems which the statute purports to address). The collective action problem is created when a bidder threatens all target shareholders with the prospect that those who tender will be better off than those who do not. Absent a collective response providing that no shareholders will tender unless the price is raised, each shareholder's best response is to tender immediately, even if she believes that a "give" exists in the bidders' price. The primary example of this problem is the two-tier tender offer, which begins with an initial front-end offer for a percentage of the target's shares, and then concludes

The Delaware statute provides two curative mechanisms. First, the statute encourages any bidder to deal at arms length with the existing board in negotiating a friendly acquisition rather than to attempt a hostile tender offer.[90] If a bidder pursues a two-step acquisition, servicing its financing with the firm's assets and offering to pay a substantial number of the firm's shareholders with securities rather than with cash in the acquisition, the board can protect all the firm's shareholders by negotiating on their behalf, thus eliminating the collective action problem. Presumably the board can maximize both the front-end cash price and the back-end exchange price with its unified representation of the shareholders' interest. Second, the statute, by requiring a two-thirds vote of disinterested shareholders for back-end mergers,[91] forces an interested shareholder to pay honest prices in order to entice shareholders into voting for any back-end business combination.

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with a back-end cash-out of the remaining shareholders—often at a lower price than that offered at the front-end of the transaction. *See generally* Bebchuk, *The Pressure to Tender: An Analysis and a Proposed Remedy*, 12 DEL. J. CORP. L. 911, 917-31 (1987) (discussing "The Distorted Choice Problem"). Partial tender offers are usually the vehicle for the most coercive offers (in a pure partial tender offer, the bidder does not announce any intention to effect a subsequent merger and does not execute a cash-out merger following the successful partial offer), but even any-or-all tender offers have coercive potential. *See generally* Oesterle, *The Negotiation Model of Tender Offer Defenses and the Delaware Supreme Court*, 72 CORNELL L. REV. 117 (1986) [hereinafter Oesterle, *Negotiation Model*] (evaluating the position of the Delaware Supreme Court in 1986 and discussing the theory that target managers should be viewed as negotiating agents for target shareholders); Oesterle, *Target Managers as Negotiating Agents for Target Shareholders in Tender Offers: A Reply to the Passivity Thesis*, 71 CORNELL L. REV. 53, 60-63 (1985) [hereinafter Oesterle, *Negotiating Agents*] (discussing defensive tactics and the coercive effect of two-tiered tender offers).

Several commentators have written on the coercive effects of tender offers and the "prisoner's dilemma." *See Two-Tier Tender Offer Pricing and Non-Tender Offer Purchase Programs Advance Notice of Possible Commission Action*, SEC Exchange Act Rel. No. 21079 (June 21, 1984), [1984 Transfer Binder] Fed. Sec. L. Rep. (CCH) § 83,637, at 86,916; Bebchuk, *Toward Undistorted Choice and Equal Treatment in Corporate Takeovers*, 98 HARV. L. REV. 1693 (1985); Bradley & Rosenzweig, *Defensive Stock Repurchases*, 99 HARV. L. REV. 1377, 1412-13 (1986); Lowenstein, *Pruning Deadwood in Hostile Takeovers: A Proposal for Legislation*, 83 COLUM. L. REV. 249, 307-09 (1983); Carney, *Shareholder Coordination Costs, Shark Repellents, and Takeout Mergers: The Case Against Fiduciary Duties*, 1983 AM. BAR FOUND. RES. J. 341, 349-50; Dennis, *Two-Tiered Tender Offers and Greenmail: Is New Legislation Needed?*, 19 GA. L. REV. 281, 319-31 (1985); Mirvis, *Two-Tier Pricing: Some Appraisal and "Entire Fairness" Valuation Issues*, 38 BUS. LAW. 485 (1983).

90. DEL. CODE ANN. tit. 8, § 203(a)(1) (1988).

91. *Id.* § 203(a)(3).

The legitimacy of this alternate justification depends upon an assessment of the seriousness of the shareholders' collective action problem.[92] If the collective action problem is oversold and overcorrected, then the statute, in essence, merely deters legitimate, highly-leveraged takeovers. Here, shareholders, as well as employees and taxpayers, who do not want the companies closed, lose and the managers of potential targets gain. Those who argue against the significance of the shareholder coercion argument make two points. First, they doubt the coercive power of two-tier tender offers and in support cite an SEC study which found that, on average, fewer shareholders tender for two-tier than for any-and-all tender offers.[93] The study further found that the average total premiums received by shareholders in the two types of offers differ only insignificantly.[94] From these data, the coercive argument opponents assert that two-tier tender offers cannot be overly coercive. If such tender offers are coercive, they argue the tender offers induce a significantly larger percent of shareholders to tender and should induce tenders at lower average premiums when compared to any-and-all tender offers. Second, they argue that since two-tier tender offers are now rare,[95] concern over them should be minimized. If the argument that most hostile tender offers are not, in fact, coercive is valid, then the Delaware statute loses much of its legitimate underpinnings.

There are, however, two plausible rebuttals to data supporting the position that tender offers are not coercive, each suggesting that

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92. *See generally* Booth, *supra* note 45 (argument that control share acts are a legitimate answer to collective action problem).

93. Comment & Jarrell, *Two-Tier and Negotiated Tender Offers, the Imprisonment of the Free-riding Shareholder*, 19 J. FIN. ECON. 283 (1987) (an article based upon a 1985 memorandum of the OFFICE OF THE CHIEF ECONOMIST, SECURITIES AND EXCHANGE COMMISSION, THE ECONOMICS OF ANY-OR-ALL, PARTIAL AND TWO-TIER TENDER OFFERS (Apr. 19, 1985)). Blended premiums in two-tier tender offers resulted in a median premium paid of 54.5%; in any-or-all offers, the median premium equaled 51.8%. *Id.* at 298. Furthermore, in over two-thirds of the successful two-tier offers, less than a 20% difference existed between the premiums offered in the front and back ends. *Id.* at 300-01.

94. *Id.* at 294-301.

95. *See* Grundfest, *Two-Tier Bids Are Now a Defensive Technique*, Nat'l L.J., Nov. 9, 1987, at 26. Grundfest documents a dramatic decline in the use of two-tier tender offers. In 1982-83, the high water mark for the use of this device, there were 35 two-tier bids, accounting for about 20% of tender offers. In 1985-86, however, there were only 11 two-tier bids (excluding management buyouts), which accounted for only 3% of all tender offers. Indeed, in the same period, the number of two-tier tender offers by issuers (either in defensive hostile bids or as part of management buyouts) exceeded the number of such bids by outsiders. In the first five months of 1987, there were no two-tier bids. *Id.* at 26-27.

shareholder coercion in tender offers is real. The first rebuttal rests on the possibility that the collective action problem is not unique to two-tier tender offers, but may also be found in any-and-all tender offers.[96] Those who assume that any-and-all tender offers are not coercive (and who use them as a basis for comparison with two-tier tender offers or suggest that the absence of two-tier tender offers nullifies the problem), underestimate the basic power of the shareholder collective action problem. Because shareholders must decide to tender individually, any time the tender offer price is higher than the present value of the potential back-end price (discounted for risk due to uncertainty), shareholders may be forced to individually tender when, as a group, they would most likely refuse to tender and hold out for a higher price.[97] This scenario can occur with any-and-all tender offers as well as with two-tier tender offers. Thus, the prevalence of any-and-all tender offers is not necessarily synonymous with the elimination of the collective action problem.[98]

A second rebuttal focuses on the reasons both for the equivalence of two-tier offers to any-and-all offers in premiums paid and for the diminishing role of two-tier tender offers. The studies may only

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96. An any-and-all offer states that the bidder will buy any-or-all tendered shares of the target firm, as long as enough shares are tendered to insure control. *SEC Request for Comments on Two-Tier Tender Offers*, 16 Sec. Reg. & L. Rep. (BNA) 1124 (June 29, 1984).

97. *See* Lipton, *Takeover Bids in the Target's Boardroom*, 35 BUS. LAW. 101, 113-14 (1979). *See also* Note, *Shareholder Rights Plans—Do They Render Shareholders Defenseless Against Their Own Management?*, 12 DEL. J. CORP. L. 991, 999 (1987) ("Although shareholders are aware that a forthcoming any-and-all offer could yield a higher premium . . . the individual shareholder lacks the collective power, as well as the time, to bargain with the hostile bidder." (citation omitted)).

98. The any-and-all tender offer does have one significant difference from the two-tier tender offer, but the difference does not eliminate, nor necessarily even reduce its coercive effect. All tendering shareholders in any-and-all tender offers completely escape from the firm, and avoid holding minority shares once the tender offer has been consummated. In two-tier tender offers that are oversubscribed, as most are, tendering shareholders cannot escape holding minority shares once the tender offer has been executed. Theoretically an any-and-all tender offer can attract and pay off all of a firm's existing shareholders. This has significant appeal to many who perceive any-and-all tender offers as inherently fair—anyone who wants out can get out at the tender offer price. Yet an any-and-all tender offer that attracts 100% of the shares may have done so by convincing each tendering shareholder that the consequences of not tendering are so severe that it would be foolish to refuse to tender, holding out in the hopes that at least 51% of the other shareholders will join you in holding out for a higher but reasonable price. Ultimately, however, the question of the intensity and frequency of shareholder coercion in any-and-all offers is an empirical question and there is currently no sound data.

reflect that target firms have learned to take care of themselves and blunt the problem. Arguably, two-tier tender offers occur less frequently because firms have blocked them with a variety of firm specific defenses, principally shark repellent amendments to corporate charters.[99] Board-out supermajority amendments, for example, may operate very similarly to the Delaware statute; any back-end merger must be approved by a supermajority of voters, with the size of the required vote dependent upon whether the bidder can vote (if the bidder can vote its shares, the percent of votes required for approval can be very high—as high as 80%). The very popular fair price amendment that requires a bidder to pay the front-end tender offer price to minority shareholders who lose their stock in a back-end merger also significantly reduces a bidder's incentive to use a two-tier offer instead of an any-and-all offer.[100] The existence of a state antitakeover statute does not affect the equivalence of premiums paid in various types of tender offers.[101]

This is not to say that firms also have no defenses to any-and-all tender offers; rather, the argument is that a firm's specific defenses are crafted to make bargain offers more costly, without regard to type. The data then may simply reflect the ability of firms to deal with the problems of two-tier offers with firm-specific defenses.[102]

The follow-up from the critics is, however, that they have just shown that state legislation is unnecessary; firms should be left to

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99. *See* Grundfest, *supra* note 95, at 26. "Corporations and shareholders can defend themselves against outsiders' two-tier tender offers by adopting fair-price amendments to corporate charters. Moreover 'lollipop' plans can provide managements with an effective defense against two-tier bids, even if the corporation has no fair-price provision in place." *Id.* (citiation omitted). Lollipops, also known as back-end poison pills, are rights that, when triggered by a tender offer, give shareholders the right to tender to the firm, at a set price, any shares not taken in the tender offer. *Id.* at 28 n.15. *See also Revlon*, 506 A.2d at 180-81 (mechanics of a back-end poison pill).

100. N.Y. BUS. CORP. LAW § 912(c)(3)(D) (McKinney 1986). *See* Jarrell & Poulsen, *Shark Repellents and Stock Prices, the Effects of Antitakeover Amendments Since 1980*, 19 J. OF FIN. ECON. 127 (1987). Fair price amendments are the most popular of the shark repellent amendments. Jarrell and Poulsen report that 487 firms adopted fair price amendments between 1979 and 1985, with 90% of the adoptions coming after 1983. Moreover, the adoption of these amendments could not be correlated with statistically significant decreases in stock prices, as was the case with all the other types of shark repellent amendments they had studied. *See id.*

101. Grundfest, *supra* note 95, at 27. *See generally* Comment & Jarrell, *supra* note 93 (study of premiums paid in different takeover situations).

102. *See* Grundfest, *supra* note 95, at 27-28.

fend for themselves.[103] The drafters of the Delaware statute can argue in response that the statute is a legislative legitimization of these amendments and serves a valuable function by eliminating firm by firm expenses of charter amendments and, more importantly, by reducing the potential uncertainties associated with an unstable judicial climate. State courts (and federal courts interpreting state law) have failed to rule with any uniformity concerning target company defenses; invalidations of defenses seemingly occur almost randomly, and with disastrous consequences to the defending firm.[104] In light of the uncertain legality of these devices,[105] it should come as no

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103. *See* Letter from SEC Commissioner Charles C. Cox to the Council of the Corporation Law Section of the Delaware State Bar Association (Dec. 10, 1987), *reprinted in* SMITH & FURLOW, *supra* note 17, at 157, 158; Letter from SEC Commissioner Joseph A. Grundfest to David B. Brown, Secretary, Council of the Corporation Law Section of the Delaware State Bar Association (Dec. 10, 1987), *reprinted in* SMITH & FURLOW, *supra* note 17, at 161, 165-67; Letter from FTC Chairman Daniel Oliver and Commissioner Terry Calvani to David R. Brown, Secretary, Council of the Corporation Law Section of the Delaware State Bar Association (Dec. 10, 1987), *reprinted in* SMITH & FURLOW, *supra* note 17, at 201, 210.

104. There are numerous examples of cross-jurisdictional disputes concerning the validity of target board-adopted takeover defenses. For example, jurisdictions differ in their view on the propriety of greenmail. *Compare* Polk v. Good, 507 A.2d 531 (Del. 1986) (upholding greenmail payments as within the business judgment of directors) *with* Heckmann v. Ahmanson, 168 Cal. App. 3d 119, 214 Cal. Rptr. 177 (1985) (greenmail payments unlawful); jurisdictions also differ in their view on the propriety of discriminatory self tender offer and poison pill plans. *Compare* Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985) (upholding discriminatory self-tender) *with* Amalgamated Sugar Co. v. NL Indus., Inc., 644 F. Supp. 1229 (S.D.N.Y. 1986) (holding "flip-in" plan *ultra vires*) and Bank of N.Y. Co. v. Irving Bank Corp., 528 N.Y.S.2d 482 (N.Y. Sup. Ct. 1988) (same), *New York Court Enjoins Enforcement of Discriminatory Flip-in Provision*, 20 Sec. Reg. & L. Rep. (BNA) 1275 (Aug. 12, 1988). In Delaware, a factually intensive analysis has created opposite results in arguably similar cases. For an example of this phenomenon in Delaware, *compare* Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1986) *with* Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985). Compare also the various lower court opinions in the *CTS* case discussing the validity of a poison pill plan. In *CTS*, the same facts lead to widely varying results, as the progression of opinions point out. The district court enjoined the initial poison pill plan but upheld a revision, the Seventh Circuit remanded, the district court again upheld the plan, the Seventh Circuit reversed. *See* Dynamics Corp. of Am. v. CTS Corp., 637 F. Supp. 406 (N.D. Ill.), *aff'd*, 794 F.2d 250 (7th Cir.), *rev'd*, 107 S. Ct. 1637 (1987).

105. The courts' indecisiveness reflects perhaps the lack of consensus in the academic community. *See* Easterbrook & Fischel, *The Proper Role of a Target's Management in Responding to a Tender Offer*, 94 HARV. L. REV. 1161 (1981); Gilson, *A Structural Approach to Corporations: The Case Against Defensive Tactics in Tender Offers*, 33 STAN. L. REV. 819 (1981); Black & Smith, *Antitakeover Charter Provisions: Defending*

surprise that firms have lobbied state legislatures and asked that their privately created devices be, in essence, legitimized by statute.[106] Indeed, some state statutes do no more than empower firms specifically to adopt popular private defenses.[107]

The overriding problem with an argument based on shareholder coercion, however, is that even if believed, the rebuttal does not support the current form of the Delaware statute. The Delaware statute is both too narrow and too broad. It is too narrow because once one recognizes the potential for coercive power in any-and-all tender offers, one establishes not only the need for a statute effecting a defense to two-tier tender offers but also the need for a statute effecting a defense to other tender offers that have coercive potential. Such tender offers include partial tenders that are not followed by a back-end merger and any-and-all tender offers that either are not followed by a back-end merger or are successful in meeting the statute's 85% rule (and can be followed by a back-end merger).

Self-Help for Takeover Targets, 36 WASH. & LEE L. REV. 699 (1979); Hochman & Folger, *Deflecting Takeovers: Charter and By-Law Techniques*, 34 BUS. LAW. 537 (1979); Bebchuk, *The Case for Facilitating Competing Tender Offers: A Reply and Extension*, 35 STAN. L. REV. 23 (1982).

106. *See generally* Romano, *supra* note 20, at 123, 137. The major difficulty with each of these privately implemented solutions to the collective action problem is the serious uncertainty as to whether any given device will pass muster in any given court on any given day, either in general or on the specific facts of any one takeover. *See* Fogg, *"Poison Pills" Proliferate Despite Conflicting Rulings*, N.Y.L.J., Oct. 14, 1986, at 25, col. 3. The problem is most severe for the pure shareholder voting or board approval provisions that create contingencies so onerous that they are designed to never become manifest. *See* Oesterle, *Negotiation Model*, *supra* note 89, at 133-35. Courts often do not understand the purpose of these provisions and dwell on what would happen *if* the conditions did vest. The uncertainty created by the decisions on these poison pill or "scorched earth" plans has been manifested by a bidder's practice of triggering the plans and then going to court to seek relief. *See, e.g.*, Amalgamated Sugar Co. v. NL Indus. Inc., 644 F. Supp. 1229 (S.D.N.Y. 1986); Hanson Trust PLC v. ML SCM Acquisition, Inc., 781 F.2d. 264 (2d Cir. 1986) (litigation arising from the implementation of defensive tactics pursuant to a hostile takeover bid). Thus far, the bidders have been successful, but if a future court should uphold one of these plans, both the bidder and target may find themselves financially hamstrung, with the public shareholders being the ultimate losers. In my view, this is one of the reasons that fair price amendments and other solutions designed to give front-end tender offer prices to non-tendering shareholders are so popular: It is easier to convince a judge that the plans are legitimate (it may also be easier to convince shareholders to vote for an amendment so attractively named: How can one disagree with the proposition that he should get a "fair price"?).

107. *E.g.*, Hawaii H.B. No. 2961, *Legislative Briefs*, 20 Sec. Reg. & L. Rep. (BNA) 1222 (July 29, 1988).

Thus, the statute seems incomplete. If eliminating shareholder coercion is the primary purpose behind the Delaware act, then why are so many potential cases of shareholder coercion left unaddressed? Is the real purpose of the statute to deter bootstrappers? Or have the drafters decided (and this is not evident from the written record) that only some tender offers present a serious collective action problem?

The statute is too broad because it applies to non-tender offer acquisitions that do not themselves create a coercion problem. The shareholder collective action problem depends upon a public announcement of a tender offer price and the plight of those who refuse to tender. The private acquisition of a 15% interest does not create shareholder coercion. Granted, some very large scale market acquisition programs that are publicly known—street sweeps[108]—can operate substantially the same as public tender offers, presenting serious line-drawing problems,[109] but many of the acquisitions included in the Delaware statute seem to fall outside even the most liberal definition of the collective action problem. Why are these acquisitions included if they do not involve shareholder coercion? At best, it can be argued that such acquisitions better enable bidders to later mount coercive tender offers. But why not create a statute that acts directly on the coercive event? One is left with the deep suspicion that the drafters, in making the statute overbroad, intended to deter some unwanted stock acquisitions simply to protect incumbent managers from ouster. It is in this context that the statute shows its least attractive side.[110]

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108. A street sweep occurs when a potential buyer enters the market in order to acquire the shares needed to carry out the purchase of the target company. *See* Ivanhoe Partners v. Newmont Mining Corp., 533 A.2d 585 (Del. Ch.), *aff'd*, 535 A.2d 1334 (Del. 1987).

109. *Id.* at 604-05 (rejecting the claim of several institutional investors that a street sweep was coercive). *See generally* Oesterle, *Street Sweep Takeovers* (to be published in upcoming 1989 DUKE L.J.).

110. In a letter to the Council of the Corporation Law Section of the Delaware Bar Association, SEC Commissioner Grundfest analogized the 85% threshold for statutory exemption to a political election. In arguing for a lower threshold, he stated:

> In the political arena, a candidate who wins an election with 65 percent of the vote can claim victory by landslide. A 75 percent victory signals a political dynasty. An 85 percent threshold, if accomplished, would probably instigate a voting fraud investigation unless the opposition was particularly hapless. I would argue that a 75 percent threshold is more than adequate

A solution that is more appropriate to the generic collective action problem is an approval system that attaches to the acquisition itself rather than to what an acquiror can do once an acquisition has been effected. Once a particular kind of acquisition is identified as creating a collective action problem, the acquisition could be conditioned on a system that provides a unified shareholders' response. Professor Bebchuk has suggested that a ballot be attached to all tender offer responses, enabling shareholders to vote "no" and still tender.[111] Ohio has passed a statute that has a somewhat similar effect, and Indiana's Control Share Acquisition statute is a distant but recognizable cousin.[112] As an alternative, an independent agent could be created, analogous to a bond indenture trustee for bondholders, who is empowered to negotiate tender offer prices on behalf of shareholders.[113]

In any event, the Delaware statute is, at best, a crude solution to the shareholders' collective action problem and, at worst, uses the collective action problem as a camouflage for other less compelling justifications. In sum, one can argue, with substantial basis in the history and mechanics of the statute, that the drafters of the Delaware statute were not interested in the shareholder coercion problem but rather in thwarting highly leveraged offers because of a belief, which may be outdated, that such offers are the most common form of hostile takeovers and that they lead to more drastic restructuring of target firms if they are successful.

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to assure that a bidder's offer is fair and reasonable.

Letter from SEC Commissioner Joseph A. Grundfest to E. Norman Veasey (Dec. 31, 1987), *reprinted in* SMITH & FURLOW, *supra* note 17, at 195, 198.

111. *See* Bebchuk, *supra* note 89, at 931-32.

112. Ohio has the oldest and the most straightforward of the state control share statutes. Ohio prevents the acquisition of control shares without a favorable vote of disinterested shareholders, while the Indiana statute prevents those holding control shares from voting them without a favorable vote of disinterested shareholders. Under the Indiana statute, the target does, however, have the right to redeem control shares that have not been allowed to vote. The aberrant form of the Indiana statute was an effort to find a home in the language of a Sixth Circuit opinion that had declared the Ohio statute unconstitutional in Fleet Aerospace Corp. v. Holderman, 796 F.2d 135 (6th Cir. 1986), *vacated*, 107 S.Ct. 1949 (1987). Arguably at the heart of the opinion was language denouncing prohibitions on the act of purchase. *See also* Icahn v. Blunt, Fed. Sec. L. Rep. (CCH) ¶ 92,096 (W.D. Mo. June 24, 1985) (invalidating a Missouri statute modeled after the Ohio statute). The drafters felt that they could deflect much of the fire of these two courts if they did not stop purchases per se, but only controlled the rights of the shares so purchased. This is presumably closer to the traditional function of state corporate codes. *See generally* Booth, *supra* note 45.

113. *See* Oesterle, *Negotiating Agents*, *supra* note 89, at 157.

III. THE EFFECT OF THE STATUTE: MORE PILLS AND STANDSTILLS

A. *Will It Negatively Affect Stock Prices?*

The passage of the Delaware statute will stimulate studies of the effect of the statute on share prices; any analysis of the shareholders' interests should, in the end, be determined by a replication of results in any such studies with justifiable methodologies. Pending the publication of studies on the statute, some inferences can be made from existing studies on other state statutes. These inferences, however, are highly speculative and are based on studies that are not without their own problems. The overriding problem with all the studies to date is that they measure periods before *CTS*, when most observers, including most of the federal courts that had addressed the matter, thought that *Edgar v. MITE Corp.*[114] had effectively declared all second generation state statutes to be unconstitutional.[115] One would expect, therefore, no significant effect on stock prices from state legislation. Indeed, the negative effect of such legislation, if any, would be reflected in stock prices on the date that the *CTS* decision was announced rather than on the date the statutes were passed (or first announced).[116]

The studies are discussed here in the order of the similarity of each state statute studied to the Delaware statute. Laurence Schu-

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114. Edgar v. MITE Corp., 457 U.S. 624 (1982) (holding Illinois statute unconstitutional under the commerce clause).

115. *See* Fleet Aerospace Corp. v. Holderman, 796 F.2d 135 (6th Cir. 1986), *vacated*, 107 S. Ct. 1949 (1987) (Ohio statute); Dynamics Corp. of Am. v. CTS Corp., 794 F.2d 250 (7th Cir. 1986), *rev'd*, 107 S. Ct. 1637 (1987) (Indiana statute); Mesa Petroleum Co. v. Cities Serv. Co., 715 F.2d 1425 (10th Cir. 1983) (Oklahoma statute); Telvest v. Bradshaw, 697 F.2d 576 (4th Cir. 1983) (Virginia statute); Martin Marietta Corp. v. Bendix Corp., 690 F.2d 558 (6th Cir. 1982) (Michigan statute); Terry v. Yamashita, 643 F. Supp. 161 (D. Haw. 1986) (Hawaiian statute); APL Ltd. Partnership v. Van Dusen Air, Inc., 622 F. Supp. 1216 (D. Minn. 1985) (Minnesota statute); Icahn v. Blunt, Fed. Sec. L. Rep (CCH) ¶ 92,096, at 91,484 (W.D. Mo. 1985) (Missouri statute). *But see* Cardiff Acquisitions Inc. v. Hatch, 751 F.2d 906, *reh'g denied*, 751 F.2d 917 (8th Cir. 1984) (Minnesota disclosure statute is constitutional).

For the sake of clarity, the classifications "first," "second," and "third" generation are mere time references to the promulgation of the statutes pursuant to the Supreme Court decisions in *MITE* and *CTS* (first generation statutes predate *MITE*, while third generation statutes are modeled after *CTS*).

116. Research of the effect of the *CTS* decision on stock prices is underway. *E.g.*, Woodward, *How Much Indiana's Anti-Takeover Law Cost Shareholders*, Wall St. J., May 5, 1988, at 32, col. 3 (Indiana statute cost shareholders of Indiana companies 6% of the stock value). *But see* Quirin, Letter to the Editor, *Indiana's Anti-Takeover Law*, Wall St. J., May 24, 1988, at 39, col. 1 (disputing conclusions of Woodward article).

mann, studying the parent of the Delaware statute—the New York statute—found negative stock price reactions to various announcements relating to the passage of the New York law.[117] The extent of the losses was slight, however, measuring less than 1%. The New Jersey Office of Economic Policy studied New Jersey's five year business combination statute—the New Jersey Shareholder Protection Act—in preparation for a recommendation on whether the statute, enacted in August of 1986, should be allowed to expire.[118] The report found that the statute will "adversely affect shareholders."[119] However, a second study on the impact of the New Jersey Act, conducted by Donald G. Margotta & Swaminathan Badrinath found no significant impact on stock prices.[120] A study, conducted by Professor Roberta Romano, of Connecticut's Fair Price Statute law, Pennsylvania's Redemption Rights statute, and Missouri's Control Share Acquisition statute also found no significant effect on stock prices.[121]

The largest negative effect on stock prices, a 2% loss, was discovered in a study by the Securities and Exchange Commission.[122] This study focused on a recent Ohio statute that redefined the fiduciary responsibilities of target directors in takeovers (allowing consideration of "long-term as well as short-term interests of the corporation") and that legitimized, for one year, poison pill plans. What is particularly surprising about the study is that neither of the two amendments, on their face, seem very significant. The amend-

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117. L. SCHUMANN, BUREAU OF ECONOMICS STAFF REPORT TO THE FEDERAL TRADE COMMISSION, State Regulation of Takeovers and Shareholder Wealth: THE EFFECTS OF NEW YORK'S 1985 TAKEOVER STATUTES (Mar. 1987). He calculated that the decline represented a capital loss to shareholders of New York corporations of just under $1.2 billion.

118. STATE OF NEW JERSEY, OFFICE OF ECONOMIC POLICY, NEW JERSEY SHAREHOLDER PROTECTION ACT: AN ECONOMIC EVALUATION (Aug. 1987).

119. *Id.* at v.

120. *See Study Says N.J. Antitakeover Law Has Little Impact on Stock Prices*, 2 Corporate Counsel Weekly (BNA) 2 (Sept. 30, 1987). The study is commonly cited by those who favor takeover legislation. *E.g.*, Goldman, *supra* note 17, at 38 (citing the study to support proposition of minimum impact on stock prices). *See* Macey, *State Anti-Takeover Legislation and the National Economy*, 1988 WIS. L. REV. 467 (the Margotta & Swaminathan study is methodologically flawed). Professor Margotta, in reviewing the studies of the New York and Ohio statutes, also argues that any negative effect from these studies "was dissipated" with 20 days in New York and within one day in Ohio. *Id.* at 12.

121. Romano, *supra* note 20, at 180-87.

122. OFFICE OF THE CHIEF ECONOMIST, SECURITIES AND EXCHANGE COMMISSION, SHAREHOLDER WEALTH EFFECTS OF OHIO LEGISLATION AFFECTING TAKEOVERS 3 (May 18, 1987).

ment on long-term interests merely supplements a prior amendment that allows directors to consider, in addition to the shareholders' welfare, the effects of a takeover on employees and other non-shareholder groups. The prior amendment actually represents the more dramatic break with traditional doctrine. The significance of a one year validation of poison pills seems largely inconsequential. At the time the amendment was passed, there was no real threat that poison pill plans were going to be declared illegal by the Ohio courts.

What the study does not reveal is that the Ohio act effected yet a third change, a change that may have actually driven the results. Moreover, this part of the law is not specific to takeovers: The act protects directors from monetary liability absent evidence of either a deliberate intent to injure the company or a reckless disregard for its welfare.[123] In passing this portion of the act, Ohio was attempting to limit the liability of directors in order to ease concerns over the "liability crisis"[124] and large increases in insurance rates.[125]

The Ohio study has other significant differences from the previous studies. First, the Ohio study excluded firms with 30% or more of the ownership concentrated in one controlling group; such firms were not excluded in previous studies. Had they been included, the negative effect would not have been as significant. The exclusion makes sense for several reasons. First, one can argue that publicly held companies with substantial inside ownership blocks are not the primary targets of hostile bidders. Second, the SEC argues that the quick passage of the Ohio statute may have facilitated better data on the statute's actual effect because the SEC was better able to isolate the effect of the legislation on stock prices than were most earlier studies. Third, the Ohio provision differed substantially from the other state provisions at that time because, under the dominant interpretations of *Edgar*, it was judged to have the best chance of surviving constitutional challenge.[126] Most second generation statutes at that time were assumed to be unconstitutional.

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123. OHIO REV. CODE ANN. § 1701.01 (Anderson 1986).

124. *See generally* Mallen & Evans, *Surviving the Directors' and Officers' Liability Crisis: Insurance and the Alternatives*, 12 DEL. J. CORP. L. 439 (1987) (discussing difficulties in purchasing directors and officers liability insurance).

125. *See Ohio Legislature Broadens Scope of Business Judgment Rule*, 18 Sec. Reg. & L. Rep. (BNA) 1719 (Nov. 28, 1986).

126. The definition of fiduciary duties for corporate directors and officers is traditionally the province of state corporate codes. By placing the takeover language

Information on the effect of the Delaware statute can also be inferred from studies of the effect on stock prices of board-out, supermajority amendments to articles of incorporation. Supermajority amendments require approval by at least two-thirds (and often up to 80%) of the shareholders for statutory mergers and their economic equivalents.[127] In contrast to the Delaware statute, an acquiror can vote its shares, but if the vote requirement is set high enough, it can effectively require a majority of disinterested shareholders for passage.[128] Typically, the supermajority voting requirements can either be triggered by board action or be waived by the board,[129] thus providing the board with bargaining leverage in dealing with hostile bidders intent on executing a back-end merger. Here the similarities with the Delaware statute are obvious, although the Delaware statute has the three year sunset provision unlike many supermajority provisions that have no similar time limit. Although shareholders must approve the supermajority amendments, they do so routinely.[130]

In a study by Gregg Jarrell and Annette Poulsen of 48 firms with board-out supermajority amendments adopted between 1979 and 1985, the authors found negative cumulative abnormal returns of almost 5% when public release of proxy material occurs.[131] This

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in a section on fiduciary duties, the state was betting that courts would pass on the language rather than face the politically thorny possibility that integral sections of traditional state corporate codes could be unconstitutional.

127. *See* Pound, *The Effects of Antitakeover Amendments on Takeover Activity: Some Direct Evidence*, 30 J.L. & ECON. 353, 354 (1987).

128. Assume an acquiror purchases 51% of the stock; a vote requirement of 83% means that two-thirds of the disinterested shareholders (2/3 of 49%) must support the merger for it to go forward.

129. *Compare* DEL. CODE ANN. tit. 8, § 203(a) & (b) (1988) *with* N.Y. BUS. CORP. LAW § 912 (McKinney 1986).

130. On average, 96% of management sponsored antitakeover proposals are approved by shareholder votes. *See* Jarrell, Brickley & Netter, *supra* note 60, at 59 (data on 1984 adoptions).

131. Jarrell & Poulsen, *supra* note 100, at 141-44. Because of the small sample size, the standard of error from mean was large (t mean = -2.27). The results are in sharp contrast to an earlier study of supermajority and other antitakeover amendments passed from 1960 to 1980. *See* Linn & McConnell, *An Empirical Investigation of the Impact of 'Antitakeover' Amendments on Common Stock Prices*, 11 J. FIN. ECON. 361 (1981). Linn and McConnell found statistically significant, positive abnormal returns, for supermajority amendments (but they did not distinguish between board-out supermajority amendments and pure supermajority amendments). *Id.* A later study of antitakeover amendments by John Pound built on the Jarrell and Poulsen study and assessed whether those amendments with the largest negative effect on stock prices would have had other outcome effects. Pound, *supra* note 127, at 357-67. Pound compared a group of firms with supermajority (no distinction was drawn

effect was more negative than for all the other types of shark repellent amendments studied, and the authors noted that the adoptions of supermajority amendments were declining in relationship to the adoptions of other types of shark repellent amendments.[132] The study also found that institutional holdings were less than half of the average for all publicly registered firms and that insider holdings were about 50% more than average.[133] From this data, the authors concluded that the more harmful supermajority amendments correlated with lower levels of institutional stockholdings and higher levels of insider stockholdings.[134]

The total effect of the existing data is pessimistic. It seems probable that if studies can isolate the effect of the Delaware provision on stock prices of Delaware corporations (which may present a methodological nightmare because the statute was in public discussions for over two months prior to its passage), the studies would show the statute to have a slight but significant negative effect on stock prices of Delaware corporations. Even so demonstrated, the effect may be due less to the statute itself than to the market's assessment of the Delaware courts' reluctance to police adequately manager discretion under the statute.

B. *Does the Statute Stop Leveraged Acquisitions?*

Standing alone, the statute may not present a serious problem for most bidders, even those with predominantly short-term debt

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for board-out provisions) or classified board amendments (the inclusion of these amendments makes the analogy to the Delaware provision even more imprecise) to firms without takeover amendments. The study found that firms with these takeover amendments show that the frequency of takeover attempts is 26% lower when compared to firms that do not have the amendments. Average bid premiums between the two groups of firms differed by only 10%, with the higher bids received by firms with the amendments. Surprisingly, managerial resistance in takeover contests was no more profitable in firms with amendments than in firms without amendments. Moreover, managers in firms with the amendments were twice as likely to resist takeovers. In no cases was control transferred over the final objections of firm managers. Pound's conclusion was that the amendments he had studied have the effect of reducing the frequency of takeover bids while not improving the expected value of shareholder gains in those takeover contests that do occur.

132. The study also considered fair price amendments, which are identical to supermajority amendments except that the acquiror, by paying a defined fair price in the merger, can escape the supermajority vote requirement. *See* Jarrell & Poulsen, *supra* note 100, at 132-33.

133. *Id.* at 148-52.

134. *Id.* at 155.

financing.[135] Increased sophistication in the capital markets has significantly increased the availability of cash. While bidders in the early eighties struggled to accumulate enough cash to buy 51% of a target and pay off back-end shareholders with other securities, bidders now can accumulate cash faster, in greater amounts, and from a wider variety of sources.[136] Investment banker bridge loans, which can run to over a billion dollars, are less than two years old.[137] With more cash, bidders can routinely make any-and-all cash tender offers, rather than two-tier tender offers. It may be common for such any-and-all offers to attract enough stock to meet the 85% cap on the Delaware statute.[138] The statute would, however, dramatically

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135. Martin Lipton, a well-known takeover defense lawyer, says "that it will be a rare situation where a tender offer will not attract 85% of the target's non-management controlled stock." Lipton, *Delaware Law May Boost Use of White Squire Defense*, INVESTMENT DEALERS' DIGEST, Feb. 29, 1988, at 49. *But see* Letter from Commissioner Joseph A. Grundfest to David B. Brown, Secretary, Council of the Corporation Law Section of the Delaware State Bar Association (Dec. 10, 1987), *reprinted in* SMITH & FURLOW, *supra* note 17, at 168 (arguing that 90% threshold figure is practically unattainable and should be lowered to 75% or some other realistic figure).

136. The following comments recently made by players in the mergers and acquisition game illustrate the phenomenon: "The world is awash in cash"; "You can always get cash for a deal"; "It was so easy [to raise $300 million], it was scary"; "What you've got is a structure with lots of money looking around for deals." Dobrzynski, *supra* note 78, at 122, 124-25. The article notes that commercial banks, insurance companies, and pension funds, among others, are "falling all over themselves to put up cash." *Id.* The participants in takeover financing have been unceasingly creative. They have created junk bonds, bridge loans, and now ADRs (American depositary receipts). *See* Dutt, *Increasing Sophistication in ADR Issues Boosts Deals*, INVESTMENT DEALERS' DIGEST, Aug. 10, 1987, at 47. When the Federal Reserve Board issued a new interpretation of margin rules in January of 1986 that restricted the use of debt in takeovers to 50% or less of the purchase price, the financial market did not miss a beat, shifting to high-yield preferred stock—also rated below investment grade—which was converted to debt after the acquisition. Sherman & Schrager, *supra* note 68, at 15.

137. In a recent hostile bid for Federated Department Stores, Inc., First Boston Corporation agreed to extend a bridge loan to the hostile bidder, Campeau, thereby increasing Campeau's takeover arsenal to about $1.3 billion. The bridge loan is significant because it is "one of the few negotiated since the stock market crash last October." McNish, *Campeau to Sell Stake in Firm to Reichmanns*, Wall St. J., Feb. 12, 1988, at 2, col. 2. *See* Lipton, *supra* note 18, at 15-16 (other examples of bridge financing).

138. Data on this point have not yet been specifically gathered. Some inferences are possible from some old studies, which admittedly did not focus on the problem. In a sample of any-and-all tender offers undertaken from 1981 to 1984, the average final bidder holding was an 86% interest. OFFICE OF THE CHIEF ECONOMIST, SECURITIES AND EXCHANGE COMMISSION, THE ECONOMICS OF ANY-OR-ALL, PARTIAL,