Note

SELECTIVE STOCK REPURCHASES AFTER *GROBOW*: THE VALIDITY OF GREENMAIL UNDER DELAWARE AND FEDERAL SECURITIES LAWS

I. INTRODUCTION

A corporation's power to deal selectively in its own stock has emerged as a powerful defensive maneuver available to a board of directors to thwart a hostile takeover threat or to sever its relationship with a dissident stockholder.[1] Until recently, the two most common ways a corporation could deal selectively in its own stock were by engaging in an exclusionary self-tender offer for the corporation's shares,[2] or by repurchasing a substantial block of stock from a dissident shareholder, typically at a large premium unavailable to the other shareholders.[3] The former defensive maneuver is commonly referred to as "reverse greenmail," while the latter is called "greenmail."[4] These two defensive tactics, however, have faced substantial criticism from commentators mainly because each repurchase scheme

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1. "Few issues in corporate law or governance have moved from the wings to the center stage of public attention as rapidly as the issue of negotiated stock repurchases . . . ." Macey & McChesney, *A Theoretical Analysis of Corporate Greenmail*, 95 YALE L.J. 13 (1985).

2. A self-tender occurs when a corporation offers to purchase its shares, usually for cash, at a price in excess of the raider's tender price, thereby eliminating the takeover threat. *See* Wander & LeCoque, *Boardroom Jitters: Corporate Control Transactions and Today's Business Judgment Rule*, 42 BUS. LAW. 29, 56-57 (1986). In an exclusionary self-tender offer, a corporation forbids a bidder, who is attempting a hostile takeover, from tendering his shares into the offer. *See, e.g.*, Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985).

3. Greenmail is a term that describes a corporation's repurchase of its own stock from one or a small number of shareholders at a premium above market price, thereby eliminating a raider's potential bid for the target corporation, or severing ties with a shareholder that poses a threat to the future policies of the corporation. *See Unocal*, 493 A.2d at 956 n.13.

4. Selective stock repurchases at a premium from a dissident shareholder are also commonly referred to as "extortion," "goodbye kiss," and "negotiated share repurchases." *See* Macey & McChesney, *supra* note 1, at 13 n.1.

involves the apparent favoring of one group of shareholders over another.[5]

In response to the Delaware Supreme Court's decision in *Unocal Corp. v. Mesa Petroleum Co.*,[6] the SEC amended rule 13e-4[7] and adopted rule 14d-10[8] to prohibit a bidder from commencing a tender offer unless it is open to all shareholders of a particular class of securities, thereby effectively prohibiting an exclusionary self-tender offer as a valid stock repurchase technique.[9] The invalidity of the exclusionary self-tender offer casted doubt upon the validity of other repurchase techniques in which shareholders of the same class of stock are not all treated equally, including the payment of greenmail.[10] In a recent case challenging a corporation's power to discriminate among share-

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5. The validity of the payment of greenmail has recently been the subject of heated debate among commentators. *See, e.g.*, Coffee, *Regulating the Market for Corporate Control: A Critical Assessment of the Tender Offer's Role in Corporate Governance*, 84 COLUM. L. REV. 1145 (1984); Dennis, *Two-Tiered Tender Offers and Greenmail: Is New Legislation Needed?*, 19 GA. L. REV. 281 (1985); Gilson, *Drafting an Effective Greenmail Prohibition*, 88 COLUM. L. REV. 329 (1988); Greene & Junewicz, *A Reappraisal of Current Regulation of Mergers and Acquisitions*, 132 U. PA. L. REV. 647, 732 (1984); Macey & McChesney, *supra* note 1; Matheson & Norbert, *Hostile Share Acquisitions and Corporate Governance: A Framework for Evaluating Antitakeover Activities*, 47 U. PITT. L. REV. 407 (1986); Oesterle, *The Negotiation Model of Tender Offer Defenses and the Delaware Supreme Court*, 72 CORNELL L. REV. 117 (1986).

6. 493 A.2d 946 (Del. 1985). Mesa, headed by T. Boone Pickens, acquired approximately 13% of Unocal's stock and then commenced a two-tier tender offer for Unocal. Specifically, Mesa offered $54 per share for approximately 37% of the shares followed by a "back-end" exchange of subordinated securities reported to be worth $54 for the remaining shares. Finding the Mesa offer coercive and inadequate, the Unocal Board responded by initiating a self-tender offer for 49% of its stock, provided that Mesa completed the first tier of its tender offer. Unocal offered $72 of debt securities for each share tendered, however, this self-tender excluded Mesa from participating. *Id.* at 949-51. The Delaware Supreme Court held that excluding Mesa from the self-tender was reasonable due to the fact that Mesa's tender offer was an inadequate two-tier coercive tender offer. *Id.* at 956.

7. 17 C.F.R. § 240.13e-4(f)(8)(i) (1987).

8. Rule 14d-10 provides, in relevant part: "(a) No bidder shall make a tender offer unless: (1) The tender offer is open to all security holders of the class of securities subject to the tender offer . . . ." 17 C.F.R. § 240.14(d)-10 (1987).

9. In addition to the all-holders rule, the Williams Act now requires that a payment made to a security holder of a particular class of securities pursuant to a tender offer equal the highest consideration paid to other security holders. The Act, however, does not require a tender offer to be open for all outstanding shares of a class, but provides that if a greater number of securities are deposited the actual securities taken up will be divided pro rata, according to the number of securities deposited by each security holder. *See Proposed SEC Rule on Tender Offers by Issuers*, 17 Sec. Reg. & L. Rep. (BNA) 1310 (July 12, 1985).

10. *See infra* notes 81-84 and accompanying text (discussing proposed regulation by the SEC to limit the payment of greenmail).

holders of the same class when repurchasing its stock, *Grobow v. Perot*,[11] the Delaware Supreme Court approved the payment of a "large premium" to GM's largest shareholder, Ross Perot, thereby affirming the validity of a corporation's right to selectively repurchase its shares and pay greenmail under Delaware law.[12]

This comment will first explore the history of selective stock repurchases and greenmail under Delaware law leading up to the Delaware Supreme Court's decision in *Grobow*. Specifically, it will contrast a corporation's broad statutory powers under Delaware law to selectively deal in its own stock with the case law, which has imposed judicial restrictions that have limited a corporation's power to repurchase its stock. Next, this comment will discuss the decision in *Grobow*. In addition, a case involving the same selective repurchase as *Grobow*, but brought under federal securities and Delaware laws, *In re General Motors Class E Securities Litigation*,[13] will be analyzed. Finally, this comment will evaluate the rationale underlying the opinions of the courts in these cases and explore the status of greenmail after these two decisions.

II. BACKGROUND

A. *Statutory Authority*

Under Delaware General Corporate Law, a board of directors has broad power to deal in its own outstanding stock.[14] Section 160, however, does impose some restrictions on repurchases; for instance, a corporation may not repurchase its own shares when its capital is impaired or when such a repurchase would cause its capital to be impaired.[15] Additionally, this section prohibits a corporation from repurchasing any shares which are redeemable at its option for more

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11. 539 A.2d 180 (Del. 1988), *aff'g*, 526 A.2d 914 (Del. Ch. 1987).

12. *Id.* at 191.

13. 694 F. Supp. 1119 (D. Del. 1988).

14. Section 160 provides, in relevant part, that a "corporation may purchase, redeem, receive, take or otherwise acquire, own and hold, sell, lend, exchange, transfer or otherwise dispose of, pledge, use and otherwise deal in and with its own shares . . . ." DEL. CODE ANN. tit. 8, § 160(a) (1983).

15. *See* DEL. CODE ANN. tit. 8, § 160(a)(1) (1983). *See, e.g.*, Schwartz v. Greene, 163 A.2d 614 (1960) (corporation can repurchase its shares provided it does not impair its capital); *In re* International Radiator Co., 92 A. 255 (Del. Ch. 1914) (corporation cannot repurchase its shares if repurchase inhibits corporation's ability to pay its debts); *accord* Alcott v. Hyman, 208 A.2d 501 (Del. 1965).

than the price at which they may be redeemed.[16] Although Delaware General Corporate Law does not expressly restrict a corporation from paying a premium for a dissident's shares, section 160 must be read in conjunction with prior case law, which creates judicial restrictions, in addition to the express statutory restrictions, on a corporation's power to repurchase its stock.[17] Absent a showing that a corporation's repurchase violated a statutory or judicially imposed restriction, the business judgment rule will protect a board of directors' decision to deal in its own stock.[18]

B. Primary Purpose Test

1. Burden of Proof

The most significant judicially imposed restriction on a board of directors' power to repurchase its own stock is the primary purpose test. Under this judicial test, if a court finds that a "board has acted solely or primarily because of the desire to perpetuate themselves in office, the use of corporate funds for such purposes" will be deemed improper.[19] Essentially, this test encompasses a question of good faith.[20] Therefore, the primary purpose test is often dispositive on

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16. *See* DEL. CODE ANN. tit. 8, § 160(a)(2) (1983).

17. *See* 2 E. FOLK, R. WARD & E. WELCH, FOLK ON THE DELAWARE GENERAL CORPORATE LAW § 160.2, at 294 (2d ed. 1988).

18. *See* Aronson v. Lewis, 473 A.2d 805 (Del. 1984). The business judgment rule "is a presumption that in making a business decision the director of a corporation acted on an informed basis, in good faith and in the honest belief that the action was in the best interest of the company." *Id.* at 812 (citation omitted). If this presumption is not rebutted, a board's decision will not be disturbed by the court. *Id. See, e.g.*, Cheff v. Mathes, 199 A.2d 548, 555 (Del. 1964) ("[T]he directors will not be penalized for an honest mistake of judgment, if the judgment appeared reasonable at the time the decision was made."); *accord* Alcott v. Hyman, 184 A.2d 90 (Del. Ch. 1962), *aff'd*, 208 A.2d 501 (Del. 1965).

19. *Cheff*, 199 A.2d at 554. *Accord* Johnson v. Trueblood, 629 F.2d 287 (3d Cir. 1980) (applying Delaware law); Polk v. Good, 507 A.2d 531 (Del. 1986); Bennett v. Propp, 187 A.2d 405 (Del. 1962); Kaplan v. Goldsamt, 380 A.2d 556 (Del. Ch. 1977); Petty v. Pentech Papers, Inc., 347 A.2d 140 (Del. Ch. 1975); Kors v. Carey, 158 A.2d 136 (Del. Ch. 1960); Potter v. Sanitary Co. of Am., 194 A. 87 (Del. Ch. 1937).

20. Lowenstein, *Pruning Deadwood in Hostile Takeovers: A Proposal for Legislation*, 83 COLUM. L. REV. 249, 314 (1983) (primary purpose test is a good faith test). *See also Johnson*, 629 F.2d at 292-93 (discussing good faith element of primary purpose test).

which party bears the burden of proof and the requisite level of bad faith a court requires in order to satisfy the burden.[21]

Initially, a board of directors was presumed to act in good faith in buying back its corporate shares. This decision could be overturned only by a conclusive showing by the plaintiffs of fraud or some other misconduct.[22] This standard, however, was later modified in a leading Delaware case, *Kors v. Carey*.[23] In *Kors*, the court stated that even though the plaintiffs did not have to show conclusive evidence, the plaintiffs still had the burden of showing fraud or an abuse of discretion on the part of the directors.[24] This standard was criticized by many commentators because it was thought that if the plaintiffs bear the burden of establishing the personal motives of a board of directors, almost any stock repurchases can be justified.[25] The *Kors* doctrine, however, in which the plaintiffs bear the burden as to the board of directors' motives, was short lived.

Two years following the *Kors* decision, the Delaware Supreme Court in *Bennett v. Propp*[26] noted the inherent danger and conflict of interest a board faces with the repurchase of shares in a hostile takeover climate.[27] Therefore, the court placed the burden on the defendant directors to justify that such a repurchase was "one pri-

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21. *See* Lowenstein, *supra* note 20, at 314 (suggesting that defendant directors are skilled enough to create a record that will show good faith, even though entrenchment may be the primary purpose for the repurchase); Oesterle, *supra* note 5, at 134 ("[S]ome observers may feel that courts may not be equipped to discern selfish behavior by target managers."). Other commentators suggest that the primary purpose test should be eliminated because true motives are impossible to ascertain. *See, e.g.*, Macey & McChesney, *supra* note 1, at 59 n.168. *See also* Gilson, *A Structural Approach to Corporations: The Case Against Defensive Tactics in Tender Offers*, 33 STAN. L. REV. 819, 821-31 (1981) (discussing courts' approaches to board's conflict of interest).

22. *See* Bankers Sec. Corp. v. Kresge Dep't Stores, Inc., 54 F. Supp. 378 (D. Del. 1944).

23. 158 A.2d 136 (Del. Ch. 1960).

24. *Id.* at 141. The court merely stated that the plaintiffs had "failed to carry the burden of proving any misconduct or abuse of discretion" on the part of the directors.

25. *See, e.g.*, Dennis, *supra* note 5, at 306-07. "Application of the 'sole or primary motive' test . . . shows that virtually all share repurchases in Delaware should be legal. In almost all takeover situations, management will have some policy difference with the raider or be able to claim a disruption of employee morale." *Id.*

26. 187 A.2d 405 (Del. 1962).

27. *Id.* at 409.

marily in the corporate interest."[28] This standard was later articulated in perhaps the most frequently cited Delaware case on the issue of selective stock repurchases, *Cheff v. Mathes*.[29] In *Cheff*, the defendants tried to establish their burden of the primary purpose test by claiming that the stock repurchases were motivated by a perceived danger to the corporation because of the stock ownership of Mr. Maremont.[30] The court stated that the issue was whether or not the defendant board of directors "satisfied the burden of proof of showing reasonable grounds to believe a danger to corporate policy and effectiveness existed by the presence of the Maremont stock ownership."[31] The court stated that this burden is satisfied by a showing of good faith and reasonable investigation.[32]

The standard adopted in *Cheff*, was later applied in a 1977 case, *Kaplan v. Goldsamt*,[33] even though no takeover threat existed at the time of the repurchase. In *Kaplan*, the court held that the repurchase of 550,000 shares of stock at a premium from a board member who was at odds with the remainder of the board was proper under the primary purpose test.[34] Further, the court declined to adopt a rule which would make all repurchases at a premium in a nonhostile climate per se improper.[35]

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28. *Id.* The often quoted language of Chief Justice Sutherland described the conflict as follows:

> We must bear in mind the inherent danger in the purchase of shares with corporate funds to remove a threat to corporate policy when a threat to control is involved. The directors are of necessity confronted with a conflict of interest, and an objective decision is difficult. Hence, in our opinion, the burden should be on the directors to justify such a purchase as one primarily in the corporate interest.

Id. (citations omitted).

29. 199 A.2d 548 (Del. 1964).

30. *Id.* at 556. Mr. Maremont had a history of either participating in or attempting to liquidate several corporations. *Id.*

31. *Id.* at 555.

32. *Id.*

33. 380 A.2d 556 (Del. Ch. 1977).

34. *Id.* at 560. The court stated:

> [*Cheff* and *Kors*] stand for the proposition that the use of corporate funds to acquire the shares of a dissident stockholder faction is a proper exercise of business judgment where it is done to eliminate what appears to be a clear threat to the future business or the existing, successful business policy of a company and is not accomplished for the sole or primary purpose of perpetuating the control of management.

Id. at 569.

35. *Id.* at 569.

Even though it was well established under Delaware law that in the context of a selective stock repurchase that the defendant managers shared the burden of proving good faith, it was unclear whether the same would hold true for other types of antitakeover defenses, where there was also an inherent conflict of interest present, such as in an exclusionary tender offer. In 1985, the Supreme Court of Delaware in *Unocal Corp. v. Mesa Petroleum Co.*[36] laid down a uniform standard to examine defensive manuevers designed to thwart a hostile takeover. In *Unocal*, the court adopted a two-prong test which a defendant board of directors must satisfy before the defensive action may come within the protection of the business judgment rule.[37] The court adopted the *Cheff* standard as the first prong of the test.[38] Under this prong the defendant directors must show that they had reasonable grounds for believing that a danger to corporate policy and effectiveness existed because of another's stock ownership.[39] The court stated that this burden could be satisfied by showing good faith and reasonable investigation.[40] Moreover, this burden is materially enhanced when a board of directors is composed of a majority of independent directors.[41] The second prong of the *Unocal* test is essentially a balancing test which examines whether the defensive measure employed by a board is reasonable in relation to the threat posed.[42] This analysis entails the examination of the type of takeover bid, the defensive measure employed, and its effect on the corporate enterprise, including the impact on constituents other than the shareholder.[43] In *Unocal*, the court held that the exclusionary self-tender

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36. 493 A.2d 946 (Del. 1985).

37. *Id.* at 955-56. *See supra* note 18 (discussing business judgment rule).

38. *Unocal*, 493 A.2d at 955.

39. *Id.*

40. *Id.*

41. *See generally* Pease, *Outside Directors: Their Importance to the Corporation and Protection From Liability*, 12 DEL. J. CORP. L. 25, 28-30 (1987) (discussing independent or outside directors and noting the legal advantages of outside directors).

42. *Unocal*, 493 A.2d at 955.

43. *Id. See generally* Lipton & Brownstein, *Takeover Responses and Directors' Responsibilities: An Update*, 40 BUS. LAW. 1403 (1985). Some commentators have suggested that under this language almost any defensive measure will be valid. *See, e.g.*, Oesterle, *supra* note 5, at 144 ("If, as the Delaware Supreme Court noted in *Unocal*, target managers may protect the interests of employees, localities, or 'long term investors,' then target directors have unlimited justification for blocking bids."). *But see* Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 182-83 (Del. 1986) (suggesting that a board may consider other constituencies only if they are reasonably related to benefits accruing to the shareholders).

offer employed by the defendant directors was reasonable because of the inadequacy and coercive nature of the plaintiff's tender offer.[44]

The *Unocal* two-prong test was later applied in a 1986 case, *Polk v. Good*.[45] In *Polk*, the court examined the validity of a corporation's selective repurchase at a premium--greenmail--from a shareholder who allegedly posed a threat to the defendant corporation.[46] Thus, in *Unocal*, the *Cheff* standard was modified by adding a second prong to the board's initial burden before the board is entitled to the protection of the business judgment rule.[47] To say that the initial burden is on the defendant board, however, does not end the inquiry. Of greater significance is how a board of directors satisfies this burden.[48] This is best understood by analyzing the prior case law in Delaware.

2. The Delaware Case Law

The first major case interpreting the primary purpose test in conjunction with a selective stock repurchase was *Kors v. Carey*.[49] In *Kors*, the plaintiff alleged that the board of directors' decision to repurchase its stock was improper for two reasons. First, plaintiff contended that the stock repurchase by Lehn & Fink of United Whelan's 62,500 shares was for the sole purpose of securing corporate control.[50] Second, it was alleged that the price of the stock repurchase was at a premium--greenmail--and, therefore, constituted a waste of corporate assets.[51] The court held that the corporation's selective repurchase was valid under Delaware law even though the court found the reason the defendant board decided to repurchase its shares was to preserve "management policy and independence and an established relationship with customers . . . ."[52] The court, in carving

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44. *Unocal*, 493 A.2d at 956. *See supra* notes 6-8 and accompanying text (discussing specific facts and holding in *Unocal*).

45. 507 A.2d 531 (Del. 1986).

46. *Id.* at 537. *See infra* notes 69-74 and accompanying text (discussing impact of *Polk* decision).

47. *See infra* note 68 and accompanying text (discussing impact of *Unocal* standard).

48. *See infra* notes 53-67 and accompanying text (discussing proposition that initial burden lacks teeth).

49. 158 A.2d 136 (Del. Ch. 1960).

50. *Id.* at 140.

51. *Id.* The plaintiff contended that the price paid for the 60,200 shares of stock was per share approximately 10% in excess of the market value. *Id.* at 138.

52. *Id.* at 139.

an exception into the primary purpose test, concluded that the repurchase was proper because United Whelan posed a "clear threat to the future" business of Lehn & Fink.[53] The threat posed was by a competing firm's majority stockholder, Charles Green, who had a well-documented history of liquidating corporations. This threat, coupled with the potential harm to Lehn & Fink, was enough to carry the day for the defendants.[54]

The primary purpose test was further eroded in the 1962 Delaware Supreme Court case, *Bennett v. Propp*.[55] In *Bennett*, Sadacca, the chairman of the board of defendant Noma, without conferring with or obtaining the authority of the board except for one director, Ward, bought over one-fourth of the total shares of Noma on the open market using corporate funds.[56] The court distinguished *Kors* and held that Sadacca's decision to repurchase Noma's stock was not in response to a serious threat to Noma's welfare, but rather done primarily to preserve the control of the corporation in himself and his colleagues.[57] Furthermore, the argument that Little was a

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53. *Id.* at 141. The court stated that "directors, while bound to deal with stockholders as a class with scrupulous honesty, may in the exercise of their honest business judgment adopt a valid method of eliminating what appears to them a clear threat to the future of their business by any lawful means." *Id.* (citation omitted). *See generally* FOLK, WARD & WELCH, *supra* note 17, at 298-301 (discussing exceptions to primary purpose test).

54. *Kors*, 158 A.2d at 141. The court stated:

> [T]here is no doubt in my mind but that the business methods of Charles Green, which stress liquidity, the spending of substantial sums for aggressive promotional schemes, and a readiness to sacrifice an established mode of doing business for quick profits, presented a threat of a possible future business course which was entirely at odds with Lehn & Fink traditions.

Id.

55. 187 A.2d 405 (Del. 1962).

56. *Id.* at 407.

57. *Id.* at 408-09. The court distinguished the present case from *Kors*. Sadacca's main defense to this suit was that Noma's welfare was in danger due to a threat from a Mr. Little, Textron, Inc., chief executive officer. Noma, prior to the suit, had a 51% interest in American Screw Company. At an American Screw Company stockholder meeting, a vote was held on a proposal to sell its assets to Little's company. Sadacca opposed this vigorously and the proposal did not pass. Shortly thereafter, Little wrote a letter to Sadacca claiming that he intended to ask the Textron Board to make an offer to purchase slightly over 50% of Noma on a first-come, first-served basis. Sadacca showed this letter to only one other director, Ward, and then decided to buy shares of Noma because Sadacca claimed that Little intended to acquire American Screw by coming through the back door of Noma. The court held that the letter posed no immediate threat but was a tacit used by little to try to induce Sadacca and the other directors to sell out their interest to

threat to the corporation because of his reputation as a liquidator of corporations was not persuasive.[58] Sadacca and Ward were held liable under the primary purpose test, but an exception was adopted for the remainder of the board who had no knowledge of the transaction until three days after Sadacca purchased the shares.[59]

Noma's assets at the time of the purchase were inadequate for such a repurchase and all banks contacted refused to loan money to finance the purchase. Since the money was due on Monday, much of Saturday's board meeting focused on raising the requisite $3 million to cover the purchase and not the legality of the purchase.[60] The board, looking out for the interest of the stockholders, procured a loan out of fear that the corporate reputation would be hurt at a time when the company owed money to several creditors.[61] Therefore, the emergency situation, combined with the fact that the board did not have prior knowledge of the transaction, led the court to hold that their decision to approve the repurchase was not a breach of their fiduciary duties, even though their decision might not have been the best under the circumstances.[62] Thus, a defendant board of directors will not be held liable for a corporate repurchase, even though this action was motivated primarily to entrench themselves in office, if the board did not have prior knowledge of the repurchase and the board was forced to approve the transaction due to the urgency of the situation.

The teeth of the primary purpose test were further eroded in *Kaplan v. Goldsamt*.[63] In *Kaplan*, the court of chancery applied the primary purpose test to Medicorp's repurchase of 550,000 shares from the founder and former member of the board of directors of

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Little. Therefore, Sadacca's purchases were made primarily to preserve control of the corporation. *Id.* at 406-09.

58. *Id.* at 409.

59. *Id.* at 410.

60. *Id.* at 409-10.

61. *Id.* at 410.

62. *Id.* Chief Justice Sutherland concluded:

> In our view, the pressure of the time excused them from such efforts [exploring other methods]. They may not have made the best decision; we cannot say. Perhaps a telephone call to the brokers might have given time for negotiation; on the other hand it might well have precipitated serious litigation Monday morning. Upon the whole, we think that the directors cannot be blamed for deciding to take up the stock in the interest of protecting the corporation from dangerous litigation.

Id.

63. 380 A.2d 556 (Del. Ch. 1977).

the defendant corporation in a nonhostile takeover context.[64] Rather, the threat, if there was one at all, was to the future success of Medicorp's business policy since Goldsamt and the remaining members of the defendant board had "irreconcilable" differences concerning the future direction of Medicorp.[65] The court held that the payment of greenmail to Goldsamt was valid because it was done to eliminate a threat to the future business policy of Medicorp and was not initiated for the primary purpose of perpetuating control in the defendant board of directors.[66] Moreover, the court held that "the fact that a price paid is in excess of market [greenmail] does not necessarily make the transaction improper."[67] Therefore, the threat posed does not have to be immediate, as in *Kors* and *Cheff*, to be analyzed under the primary purpose test; however, the fact that the repurchase was not implemented to thwart a raider's bid certainly lessens, if not eliminates completely, the presumption of self-interest and entrenchment.

Finally, the payment of greenmail was analyzed for the first time under the enhanced scrutiny of the *Unocal*[68] test in *Polk v.*

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64. *Id.* at 560. Even though the dissident stockholder, Goldsamt, threatened a proxy fight to gain control of the corporation and to impose his business views on management, it was conceded at trial that Goldsamt never pursued this threat. Furthermore, the defendant board never considered Goldsamt's remarks as serious, but rather thought they were made out of anger. *Id.* Moreover, the fact that the repurchase was from a director of Medicorp did not alter the analysis. *Id. See, e.g.*, Frantz Manufacturing Co. v. EAC Indus., 501 A.2d 401, 408 (Del. 1985).

65. *Goldsamt*, 380 A.2d at 560. It was Goldsamt's opinion that the market price of Medicorp's stock was too low and, therefore, he suggested that Medicorp use all its possible cash and surplus to buy as much stock as legally possible. The other directors, however, believed that if Medicorp went in his direction it could possibly lead toward liquidation. It appears that the situation became so heated between Goldsamt and Medicorp that at one board meeting Goldsamt referred to the rest of the board as "idiots." Furthermore, the board had to change the site of its board meetings "so as to avoid any adverse consequences on management's morale that Goldsamt's unrestrained airing of his views might have." *Id.*

66. *Id.* at 569. Vice-Chancellor Brown stated:

> [T]hat the use of corporate funds to acquire the shares of a dissident stockholder faction is a proper exercise of business judgment where it is done to eliminate what appears to be a clear threat to the future business or the existing, successful business policy of a company and is not accomplished for the sole or primary purpose of perpetuating the control of management.

Id.

67. *Id.*

68. *See supra* notes 38-42 and accompanying text (discussing *Unocal* standard). In *Unocal*, the Delaware Supreme Court added a second prong to the primary

Good.[69] In *Polk*, the defendant board repurchased the Bass group's 9.9% interest in Texaco at a 3% premium above the market price, based on a rumor that the Bass group was to join forces with Pennzoil and attempt to break up Texaco.[70] The court held that the defendant board satisfied its initial burden under the two-prong test of *Unocal* and thus the repurchase was entitled to the protection of the business judgment rule.[71] Specifically, the first prong of the test—reasonable grounds for believing a danger to corporate policy existed—was held to be satisfied since the board, in approving the selective repurchase, exercised good faith and performed a reasonable investigation.[72] Moreover, the court held that the board's burden under this initial prong was materially enhanced since the selective repurchase was approved by a board comprised of a majority of outside directors, aided with legal advice rendered by legal counsel and an investment banker.[73] Next, the court held that the second prong was satisfied—the defensive measure must be reasonable in relation to the threat posed—because "[t]he payment of a premium of approximately 3% over market seems reasonable in relation to the immediate disruptive effect and the potential long-term threat which the Bass group posed."[74]

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purpose test for all takeover defenses. This new standard was perhaps stimulated by the fact that the primary purpose test was not an adequate test for measuring director self-interest. In *Unocal*, the court described the potential conflict that a board faces during a takeover attempt as "the omnipresent specter that a board may be acting primarily in its own interests, rather than those of the corporation and its shareholders . . . ." *Unocal*, 493 A.2d at 954.

69. 507 A.2d 531 (Del. 1986).

70. *Id.* at 533. These rumors came from the financial press at a time when Texaco acquired Getty Oil Company for a price of over $10 billion. The Bass group at this time suggested a joint venture with Texaco, however, Texaco management saw this proposal as nothing more than an avenue for the Bass group to receive a higher return for its stock. Texaco, believing that rejection of the offer might trigger a hostile move by Bass, classified the group as an immediate threat to the corporation. However, the Bass group remained publicly supportive of the present Texaco management. *Id.* at 533-34.

71. *Id.* at 537.

72. *Id.*

73. *Id.* Justice Moore, speaking for the court, stated:

> Here, the presence of the 10 outside directors on the Texaco board, coupled with the advice rendered by the investment banker and legal counsel, constitute a *prima facie* showing of good faith and reasonable investigation. With 10 of the 13 directors being independent, the plaintiffs thus bore a heavy burden of overcoming the presumptions thus attaching to the board's decisions.

Id. (citations omitted). *See* Pease, *supra* note 41, at 38-40 (discussing the effect of an independent board on the *Polk* decision).

74. *Polk*, 507 A.2d at 537.

Thus, while the courts have placed the initial burden on the defendant directors, due to inherent conflict of interest posed by a takeover threat, corporate selective stock repurchases and the payment of greenmail continue to be effective defensive maneuvers for a board of directors under Delaware law.

III. AN ANALYSIS OF GREENMAIL

The payment of greenmail has generally been disapproved by commentators and the courts; however, it remains a valid defensive maneuver mainly because it is an effective method for management to rid itself of a dissident stockholder.[75] There are three principal arguments for the prohibition of the payment of greenmail. First, a corporate repurchase of stock from one shareholder or a small group of shareholders at a premium—greenmail—denies all shareholders in the same class of stock equal treatment.[76] The argument is that since a corporation's selective repurchase or discriminatory self-tender offer are similar to other types of corporate distributions, such as dividends, discrimination among shareholders is not proper.[77] Second, it is argued that a board of directors pays greenmail only in order to entrench themselves in office, in violation of the primary purpose test.[78] In other words, critics of greenmail suggest that in an active

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75. *See* Wander & LeCoque, *supra* note 2, at 60 ("Despite their antagonism toward greenmail, some courts appear to recognize that the only practical solution for a corporation seeking to maximize long-term value is to pay the greenmail or risk being forced into a takeover situation at a time that is disadvantageous to the shareholders."). Delaware courts have openly expressed their displeasure with the threat of greenmail. *See Unocal*, 493 A.2d at 956. The court held that the exclusionary self-tender offer was reasonable in relation to the threat posed primarily because of the raider's "grossly inadequate two-tier coercive tender offer coupled with the threat of greenmail." *Id.*

76. *See* Oesterle, *supra* note 5, at 143 ("Most criticism of exclusionary exchange offers derives from the belief that all shareholders in a single class merit equal treatment, regardless of whether the particular discrimination in issue ultimately serves the target shareholders' interests."). *Id. See also* Brudney, *Equal Treatment of Shareholders in Corporate Distributions and Reorganizations*, 71 CALIF. L. REV. 1072, 1108 (1983) (discussing limits on the repurchases); Macey & McChesney, *supra* note 1, at 48-50. *See generally* Westen, *The Empty Idea of Equality*, 95 HARV. L. REV. 537 (1982) (discussing shareholder equality).

77. The Model Business Corporation Act has classified a corporate distribution as "in the form of a declaration or payment of a dividend; a purchase, redemption, or other acquisition of shares; a distribution of indebtness; or otherwise." MODEL BUS. CORP. ACT ANN. § 1.40(6) (3d ed. 1985).

78. This is perhaps the most popular argument used by stockholders in trying to hold a stock repurchase invalid. *See, e.g.*, *Cheff*, 199 A.2d at 556; *Bennett*, 187 A.2d at 408; *Kors*, 158 A.2d at 140.

market environment shareholders would all be in a better position if ineffective management were replaced, instead of retained in office through a selective repurchase.[79] Finally, critics of greenmail have suggested that the cost of greenmail is passed on to the shareholder due to a decline in the value of the company's stock after a stock repurchase.[80]

Perhaps stimulated by the commentators, the Securities and Exchange Commission (SEC) has recommended to Congress that the practice of paying greenmail be substantially limited.[81] As a result, legislation has been introduced in both the House of Representatives[82] and the Senate[83] that would effectively amend the Securities and Exchange Act of 1934. Specifically, this legislation contains provisions that would prohibit a corporation from repurchasing its stock at a premium from a shareholder who has held over three percent of the outstanding shares for less than two years, unless the offer is made to all shareholders of the same class of stock, or a majority of shareholders have approved the repurchase.[84]

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79. Some commentators have suggested that a board's reaction to a pending takeover should be passive. *See generally* Easterbrook & Fischel, *Takeover Bids, Defensive Tactics, and Shareholders' Welfare*, 36 BUS. LAW. 1733 (1981) (advocating passive response to tender offers). *But see* Herzel, Schmidt & Davis, *Why Corporate Directors Have a Right to Resist Tender Offers*, 3 CORP. L. REV. 107 (1980).

80. *See* R. GILSON, THE LAW AND FINANCE OF CORPORATE ACQUISITIONS 736-37 (1986) (discussing studies on the stock market's reaction to the payment of greenmail). According to Gilson, the first studies indicated that the stock markets initially reacted negatively to a board's decision to pay greenmail. *See, id.* at 736 (citing Bradley & Wakeman, *The Wealth Effects of Targeted Share Repurchases*, 11 J. FIN. ECON. 301, 308-12 (1983) (for the three days following the announcement of the payment of greenmail, stock prices fell 5.5% for a repurchase designed to thwart a takeover bid and 2.85% for all repurchases); Dann & DeAngelo, *Standstill Agreements Privately Negotiated Stock Purchases, and the Market for Corporate Control*, 11 J. FIN. ECON. 275, 294 (1983) (down 2.37% for all repurchases)). However, studies do exist indicating that greenmail may not harm a target's shareholders. *See id.* (citing duties done by Holderness and Sheehan and by Mikkelson and Ruback).

81. The SEC has concluded that the payment of greenmail is unfair to nonrecipient shareholders and results in a decline in the price of the corporation's stock. *See SEC Staff Says Greenmail Payments Depress Price of Target's Stock*, 16 Sec. Reg. & L. Rep. (BNA) 1579, 1585 (Oct. 5, 1984).

82. H.R. 5693, 98th Cong., 2d Sess. (1984).

83. S. 2851, 98th Cong., 2d Sess.

84. H.R. 5693, 98th Cong., 2d Sess. (1984); S. 2851, 98th Cong., 2d Sess. In addition, recent legislation has been proposed in the Senate which would limit the time period a greenmailer is required to hold the stock. *See* S. 1323, 100th Cong., 1st Sess. (1987) (six month); S. 1324, 100th Cong., 1st Sess. (1987) (one year). A small minority of states have adopted legislation which has limited the practice of greenmail. *See, e.g.*, ARIZ. REV. STAT. ANN. § 10-1204 (Supp. 1987);

Despite these attempts to pass anti-greenmail legislation, greenmail remains an effective defensive tactic available to a board of directors under Delaware law. Moreover, some commentators suggest that greenmail serves a legitimate function under certain circumstances and that the arguments advanced by the critics of greenmail are simply not true.[85]

First, it is noted that the entrenchment of management theory is not applicable to greenmail because the payment of greenmail, unlike any other type of defensive measure, sends a message to the marketplace that the particular corporation is undervalued, which encourages other raiders to take a position in the corporation.[86] Thus, the more a firm pays in greenmail, the more the assets of a firm drop and the more the price of the stock drops.[87] This might lead to management's ouster by the stockholders instead of a potential raider. Additionally, greenmail encourages tender offers because it reduces the cost to potential raiders.[88] The potential raider will be more willing to take a chance with a firm knowing that, if the bid fails, his position can be liquidated at a profit. Therefore, while it is often argued that the primary purpose behind greenmail is entrenchment in office, the converse may often be true.

Second, it is suggested that the payment of greenmail is unfair because it discriminates among shareholders of the same class of stock. Advocates of greenmail, however, suggest that this unequal treatment is justified. The argument is that a firm, when it pays greenmail, is paying for information developed by the greenmailer that the firm is undervalued and, therefore, the greenmailer is being paid for this valuable information.[89] Thus, the premium paid for the

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MINN. STAT. ANN. § 302A.55 subdivision 3 (West 1987); NEV. REV. STAT. ANN. ch. 463.512-.516 (Michie 1987); N.Y. BUS. CORP. LAW § 313(c) (McKinney 1986); WIS. STAT. ANN. § 180.725(5) (West 1987). *See* Gilson, *supra* note 5, at 331-36 (discussing the various state statutes).

85. *See generally* Macey & McChesney, *supra* note 1 (arguing that the payment of greenmail is valid when it benefits the shareholders).

86. *See* Macey & McChesney, *supra* note 1, at 41 ("Paying greenmail is doomed to fail as other greenmailers will come along and demand similar payments."); Wander & LeCoque, *supra* note 2, at 59 ("[T]he buying off of one greenmailer brings on another.").

87. *See supra* note 80 (discussing economic studies on greenmail).

88. Dennis, *supra* note 5, at 332 ("In the aggregate then, greenmail reduces the cost to bidders. A reduction in cost should result in more bids and potential bids.").

89. Even though many courts do not advance this argument in justifying the payment of greenmail, commentators suggest this is a valid reason for discriminating

stock is essentially compensation for services supplied and discrimination becomes justified.[90]

Finally, there is evidence suggesting that the payment of greenmail results in a net gain in the price of stock.[91] Moreover, the Delaware courts have often justified the payment of a premium on the theory that a substantial block of stock should sell at a higher price due to the control factor.[92]

With the Delaware courts applying the heightened scrutiny of the *Unocal* test to analyze antitakeover defensive measures coupled with the SEC's overruling of the exclusionary self-tender offer as a valid takeover defense, the validity of greenmail in the future was unclear. Therefore, the decision in *Grobow* was anxiously awaited, especially since the repurchase agreement involved a unique hush-mail clause.[93] Moreover, to add to the impact of this case the same repurchase was challenged at the federal level and involved challenges to the premium under both the Securities and Exchange Act and Delaware law. Together these two decisions paint an excellent picture of the status of greenmail under present law.

IV. *GROBOW V. PEROT*

In *Grobow*, a consolidated derivative shareholder suit was brought on behalf of General Motors (GM) challenging the repurchase of GM's stock from its largest shareholder and member of the GM Board, H. Ross Perot (Perot).[94] The complaint alleged, in pertinent

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against stockholders:

> The greenmailer is *not* "equal" to other shareholders in the same class, as she alone has developed information beneficial to the firm. It is hardly unfair to pay her for that information—indeed, it would be unfair not to do so. Moreover, other shareholders benefit from the greenmail sequence anyway in the increase of the price of their shares, an increase less likely to occur if the greenmailer is forced to share her gains.

Macey & McChesney, *supra* note 1, at 49-50.

90. Macey and McChesney have suggested that the payment of greenmail be broken down into two components. The first part is the payment for the stock, and second for value of producing valuable information to the firm. *Id.* at 50.

91. *See supra* note 80 (discussing economic studies on greenmail).

92. *See, e.g.*, *Cheff*, 199 A.2d at 555 ("However, as conceded by all parties, a substantial block of stock will normally sell at a higher price than that prevailing on the open market, the increment being attributed to a 'control premium'."). *But see* Coffee, *supra* note 5, at 1292-93 (greenmail unfairly distributes the control premium on a non-pro rata basis); Dennis, *supra* note 5, at 333 (control premium argument is not appropriate because control does not shift).

93. *See infra* note 95 and accompanying text (discussing the hush-mail clause).

94. *Grobow*, 539 A.2d at 184.

part, that: (i) GM defendant directors breached their fiduciary duties of loyalty and due care to GM and its subsidiary, Electronic Data Systems (EDS), by paying an excess price for Perot's and his three top associates' GM class E stock; (ii) the repurchase lacked a valid business purpose because the repurchase agreement included not only the payment for Perot's resignation, but also payment for his future silence;[95] and (iii) the primary purpose of the repurchase was to entrench the board members of GM in office and to save them from future public embarrassment.[96] Specifically, the suit was filed against GM, EDS, GM's directors, Perot, and three of Perot's EDS associates.[97]

The defendants all filed a motion to dismiss the suit for failing to comply with Delaware Court of Chancery Rule 23.1.[98] Since the plaintiffs failed to make a pre-suit demand upon the board, their complaint had to allege a demand futility claim in accordance with *Aronson v. Lewis*[99] and rule 23.1.[100] Specifically, the court stated that the issue was whether the complaint alleged with particularity, facts creating "'a reasonable doubt that the directors' action was entitled

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95. *Id.* at 185. The payment made to Perot for his future silence was later classified as hush-mail. According to the court, this term "is assumed by this Court to combine the terms 'green mail' and 'hush money' to connote a variation on an unlawful and secret payment to assure silence." *Id.* at 185 n.3.

96. *Id.* at 185.

97. *Id.*

98. *Id.* Delaware Chancery Court Rule 23.1 provides, in pertinent part:

> In a derivative action brought by 1 or more shareholders or members to enforce a right of a corporation or of an unincorporated association, the corporation or association having failed to enforce a right which may properly be asserted by it, the complaint shall allege that the plaintiff was a shareholder or member at the time of the transaction of which he complains or that his share or membership thereafter devolved on him by operation of law. The complaint shall also allege with particularity the efforts, if any, made by the plaintiff to obtain the action he desires from the directors or comparable authority and the reasons for his failure to obtain the action or for not making the effort. The action shall not be dismissed or compromised without the approval of the Court . . . .

DEL. CH. CT. R. 23.1 (1987).

99. 473 A.2d 805 (Del. 1984). *See generally* Block & Prussin, *Termination of Derivative Suits Against Directors on Business Judgment Grounds: From* Zapata *to* Aronson, 39 BUS. LAW. 1503 (1984) (discussing demand futility claim as articulated in *Aronson*); Pease, Aronson v. Lewis: *When Demand is Excused and Delaware's Business Judgment Rule*, 9 DEL. J. CORP. L. 39 (1984) (providing further analysis of *Aronson*'s two-step demand futility test).

100. *Grobow*, 539 A.2d at 186.

to the protection of the business judgment rule.'"[101] The court of chancery, applying a higher "judicial finding" instead of a reasonable doubt standard, held that the plaintiffs failed to establish a demand futile case under rule 23.1 and thus granted summary judgment.[102] The Supreme Court of Delaware affirmed the lower court's decision under the reasonable doubt standard, finding the higher standard used by the lower court to be harmless error.[103] In dismissing the plaintiffs' case, the court implicitly advanced the legitimacy of greenmail by approving of the repurchase of Perot's stock under facts that do not justify the payment of greenmail.[104]

A. *Background Facts*

In 1984, GM acquired 100% of Electronic Data Systems' (EDS) stock and thus EDS became a wholly-owned subsidiary of GM.[105] According to the conditions of the merger, Perot, the founder of EDS, was elected to GM's Board of Directors, and each EDS shareholder was provided with the choice of receiving cash for their stock or a combination of stock, plus a percentage of GM's newly issued class E stock and a nontransferable contingent note.[106] Perot chose the latter option, thus becoming GM's largest shareholder.[107] In addition, he remained the chairman of EDS.[108]

Initially, the merger proved to be beneficial and successful to both corporations.[109] The marriage, however, did not last long as management differences developed by mid-1986 between Perot and

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101. *Id.* (quoting *Aronson*, 473 A.2d at 808). In *Aronson*, the court established a two-prong test in which demand will be considered futile, and thus excused. Demand will be excused when the plaintiff alleged with particularized facts that would create a "reasonable doubt that: (1) the directors are disinterested and independent and (2) the challenged transaction was otherwise the product of a valid business judgment." *Aronson*, 473 A.2d at 814.

102. Grobow v. Perot, 526 A.2d 914, 921 (Del. Ch. 1987).

103. *Grobow*, 539 A.2d at 187.

104. *See infra* notes 213-23 and accompanying text.

105. *Grobow*, 539 A.2d at 184.

106. *Grobow*, 526 A.2d at 918. Under the terms of the merger, EDS shareholders were given the option of receiving either $44 in cash for their EDS stock or receiving $35.20 in cash, plus .2 of a share of GM class E stock, and a nontransferable contingent note maturing in 1991. *Id.*

107. *Grobow*, 539 A.2d at 184. Perot held .8% of GM's voting stock. *Id.*

108. *Id.*

109. *Grobow*, 526 A.2d at 918. EDS was able to offer GM a wide variety of computer systems and soon GM represented 75% of all of EDS' total revenues. *Id.*

the officers and directors of GM over the way in which GM was managing EDS.[110] Perot publicly criticized GM's management and ultimately demanded that GM allow him to run EDS the way he deemed fit or that GM, in the alternative, buy out his interest.[111] As a method for eliminating Perot, GM and AT & T discussed the possibility of buying EDS from GM; however, these negotiations never passed the rudimentary stages.[112]

In the late fall of 1986, Perot offered to sell his interest in GM at what Perot characterized as "a giant premium."[113] After an agreement was reached between the two parties, GM formed a special committee to review the terms and in late November of 1986, the committee recommended that GM approve the repurchase agreement.[114] The next day, the GM Board of Directors comprised of a majority of outside directors and excluding Perot, approved the repurchase of Perot's stock.[115] According to the terms of the repurchase agreement, Perot and three top EDS associates sold their entire interest in GM for $724.8 million.[116] In return, Perot also agreed to several covenants: (1) resign from the GM Board and as chairman

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110. *Grobow*, 539 A.2d at 184.

111. *Grobow*, 526 A.2d at 918. The court stated that Perot was quoted in the *Wall Street Journal* as saying, "'Until you nuke the old GM system, you'll never tap the full potential of your people'; and 'GM cannot become a world-class and cost-competitive company simply by throwing technology and money at its problems.'" *Id.* (quoting Grobow's complaint)

112. *Id.*

113. *Id.* This giant payment is the greenmail aspect of the case.

114. *Id.* The committee was comprised of three GM board members headed by an outside director. Since the plaintiffs' complaint failed to specify whether the other two committee directors were members of management or outside directors, the court assumed the three were all outside directors. *Id.*

Moreover, a board of directors is allowed to reasonably rely on a report of a committee under Delaware law:

> A member of the board of directors, or a member of any committee designated by the board of directors, shall, in the performance of his duties, be fully protected in relying in good faith upon the records of the corporation and upon such information, opinions, reports or statements presented to the corporation by any of the corporation's officers or employees, or committees of the board of directors, or by any other person as to matters the member reasonably believes are within such other person's professional or expert competence and who has been selected with reasonable care by or on behalf of the corporation.

DEL. CODE ANN. tit. 8, § 141(e) (Supp. 1988).

115. *Grobow*, 526 A.2d at 919.

116. *Id.* The plaintiffs alleged that the price per share of the repurchase ($61.90) was over double the market price of the GM class E stock the day prior to the repurchase agreement ($31.375). *Grobow*, 539 A.2d at 185 n.4.

of EDS; (2) stop publicly criticizing GM's management and upon breach Perot agreed to pay GM $7.5 million in liquidated damages; (3) not to purchase GM stock (standstill agreement) and not to wage a proxy fight against the GM Board for a five year period; and (4) not to compete with EDS for three years or hire its executives for eighteen months.[117] Perot told the GM Board that he would put his share of the cash from the repurchase in escrow until December 15, 1986, in order to give the GM Board an opportunity to review its decision.[118] The Perot repurchase was widely criticized by analysts and by members of GM's management because of the size of the premium, the hush-mail provision, and the timing of the repurchase since GM was experiencing financial difficulties and implementing a cost cutting plan.[119] Therefore, it was clear that there would be subsequent litigation on this matter.

B. The Trial Court Decision

The plaintiffs listed several reasons why making a demand to the GM Board was futile and, therefore, should be excused under *Aronson*.[120] The chancery court erroneously stated that for the plaintiff to survive demand futility, it must plead with particularity facts that would support a "judicial finding, based on applicable legal principles, of director interest, director nonindependence, or transactional nonprotection under the business judgment rule."[121]

First, the court held that the plaintiffs failed to carry their burden under the first prong of the *Aronson* standard by showing director interest or nonindependence.[122] The plaintiffs attempted to prove director interest through a theory that the repurchase was adopted

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117. *Id.* at 184-85.

118. *Grobow*, 526 A.2d at 919.

119. *Grobow*, 539 A.2d at 185.

120. *Grobow*, 526 A.2d at 920. Among the plaintiffs' allegations that demand was futile were the following: (1) the GM Board was incapable of exercising proper business judgment because the primary purpose of the repurchase was to halt Perot's public criticism and protect the board's reputation; (2) the repurchase was to eliminate any future takeover attempt by Perot and thus served to entrench the GM Board; (3) the GM Board was controlled by GM's management; (4) GM's directors would be required to bring an action against themselves; (5) the GM Board already publicly stated that they would not cancel the repurchase; (6) the repurchase terms were so outrageous on its face that it was impossible for the agreement to be a product of an independent business judgment. *Id.* at 920 n.8.

121. *Id.* at 921.

122. *Id.* at 925.

to quiet Perot's public criticism of the GM Board, thereby securing their positions with GM.[123] The court, in holding that the plaintiffs failed to sufficiently allege self-interest, distinguished several cases relied on by the plaintiffs because in the present case, the GM directors did not receive any personal benefit from the repurchase, such as "enhanced voting power, 'blocking power,' or any other direct, tangible control-related benefit that would have facilitated their self-entrenchment."[124] Additionally, since the GM Board was under no specific threat from Perot, plaintiffs failed to prove that the repurchase was "for the sole or primary motive of entrenchment."[125] Second, the court held that the plaintiffs failed to carry their burden that GM directors lacked independence because they were dominated by GM management which was seeking to entrench itself.[126] The plaintiffs failed to allege facts in the complaint to overcome the presumption that a board of directors comprised of a majority of outside directors acted independently.[127]

Next, the court held that the plaintiffs did not meet their burden of establishing a reasonable doubt that the repurchase agreement was not a valid exercise of the GM Board's business judgment under the second prong of *Aronson*.[128] Plaintiffs claimed that the GM Board breached their fiduciary duty of procedural due care (informed decision) and substantive due care (repurchase terms) owed to them.[129]

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123. *Id.* at 921.

124. *Id.* at 922-23. *See generally* Good v. Texaco, Inc., No. 7501 (Del. Ch. May 14, 1984) (alleged self-interest established where directors were given the power to vote shares acquired in a stock repurchase), *reprinted in* 9 DEL. J. CORP. L. 461 (1984). In *Good*, the plaintiffs alleged director self-interest sufficient to excuse demand because before Texaco's repurchase the board collectively owned .3% of its outstanding shares. Following the repurchase, however, the board could jointly vote approximately 5% of Texaco's outstanding shares. Therefore, the board personally benefitted because of the corporate repurchase through blocking power. *Id.* at 7-8, 11, *reprinted in* 9 DEL. J. CORP. L. at 467, 469. *See also* Moran v. Household Int'l Inc., 490 A.2d 1059 (Del. Ch. 1985), *aff'd on other grounds*, 500 A.2d 1346 (Del. 1985) (demand futility established where board adopted a stock rights dividend plan as a takeover deterrent). Similarly, in *Moran*, the plaintiffs were excused from making demand due to self-interest on the part of the defendant board. The rights plan adopted by the board effectively deterred all takeover attempts because of its alienation of shares and, therefore, the plaintiffs sufficiently pled that this action was for entrenchment purposes. *Id.* at 1071.

125. *Grobow*, 526 A.2d at 923. *See supra* notes 19-21 and accompanying text (discussing primary purpose test).

126. *Grobow*, 516 A.2d at 924.

127. *Id.*

128. *Id.* at 928.

129. *Id.* at 925.

First, the court found that there were arm's-length negotiations between Perot and GM and that the complaint actually contradicted the allegation that GM agreed to all of Perot's demands.[130] Additionally, the court was impressed by the fact that a special committee scrutinized the terms of the agreement and reported its analysis to the board before the vote on the repurchase.[131] More importantly, the court held that the repurchase terms were not a waste of corporate assets and, therefore, a valid exercise of business judgment.[132] The court found that the payment of greenmail to a dissident shareholder has repeatedly been upheld under Delaware law.[133] Moreover, the court found that the terms of the agreement, including the hush-mail provision, were not unfair.[134] The court relied heavily on the covenants that Perot agreed to and the fact that the repurchase was to eliminate a source of policy dispute over how EDS should be managed.[135] Therefore, the plaintiffs failed to meet their burden that the transaction "was so inadequate that no person of ordinary sound business judgment would deem it worth that which the corporation paid."[136]

C. *The Supreme Court Decision*

On appeal, the supreme court held that the lower court's application of a "'judicial finding'" standard for demand futility was

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130. *Id.* at 925-26. The court said that "the complaint contradicts the suggestion that GM supinely acceded to all of Perot's demands; despite such demands, Perot ultimately agreed not to hire away top EDS employees or to start up a competing company." *Id.* at 926.

131. *Id.* at 926. The court found that plaintiffs' claim of breach of substantive due care failed to allege that the committee failed to consult with legal or financial advisors before recommending approval to the board of directors of GM. *Id. See supra* note 114 (discussing board's statutory right to rely on a report from a committee).

132. *Grobow*, 526 A.2d at 927, 928.

133. *Id.* at 927. The court stated that

> [p]utting that provision momentarily to one side [hush-mail], the buy-back transaction appears indistinguishable from other repurchases by a corporation; at a premium over market, of its own stock held by a single dissident shareholder or shareholder group at odds with management that have repeatedly been upheld as valid exercises of business judgment.

Id. This comment, however, will suggest that the facts are distinguishable from the prior case law and thus this case marks an extension in the validity of greenmail. *See infra* note 214 and accompanying text.

134. *Grobow*, 526 A.2d at 928.

135. *Id.*

136. *Id.* (citations omitted).

erroneous.[137] However, the supreme court, in an opinion authored by Justice Horsey, affirmed the decision finding that the plaintiffs had failed to allege facts that created a reasonable doubt of director interest or nonindependence and that the repurchase was not protected by the business judgment rule and, thus, the lower court's higher standard was harmless error.[138]

Initially, the court interpreted the test under *Aronson* in which demand can be excused as futile.[139] The supreme court stated that for the plaintiffs to satisfy the first prong of the *Aronson* test, they must "plead particularized facts demonstrating either a financial interest or entrenchment" by the GM directors.[140] Under the first prong, the plaintiffs attempted to raise a reasonable doubt of director disinterest based on an entrenchment theory under the second prong of *Unocal*.[141] The court held that the enhanced duty of care under *Unocal*, however, was not applicable to the present case because there was not a sufficient "outside threat to corporate policy of GM" to trigger the inherent presumption of director self-interest found in a corporate control context.[142] Moreover, the court found that since Perot owned only .8% of GM's voting stock, plaintiffs failed to prove that the repurchase was motivated primarily by and related to the directors' retaining their positions with GM.[143] The supreme court's decision to distinguish *Unocal* is an important one because without this enhanced duty, the plaintiffs were not able to survive the demand excused test under the first prong of *Aronson*.[144]

After concluding that plaintiffs failed to create a reasonable doubt as to the financial interest or entrenchment on the part of the GM

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137. *Grobow*, 539 A.2d at 187.

138. *Id.* at 192.

139. *Id.* at 187.

140. *Id.* at 188.

141. *Id. See supra* notes 37-47 and accompanying text (discussing *Unocal* standard).

142. *Grobow*, 539 A.2d at 188.

143. *Id.* at 188-89. The court found:

> Plaintiffs merely argue that Perot's public criticism of GM management could cause the directors embarrassment sufficient to lead to their removal from office. Such allegations are tenuous at best and are too speculative to raise a reasonable doubt of director disinterest. Speculation on motives for undertaking corporate action are wholly insufficient to establish a case of demand excusal.

Id. Cf. Sinclair Oil Corp. v. Levin, 280 A.2d 717, 722 (Del. 1971) (requiring facts regarding improper motive to be well-pled and not merely conclusory).

144. *Grobow*, 539 A.2d at 188. *See supra* notes 124-28 and accompanying text.

Board of Directors, the court next addressed the issue of whether the plaintiffs raised a reasonable doubt that the directors exercised proper business judgment in approving the repurchase agreement.[145] In determining if the GM directors exercised proper business judgment, the court noted the fiduciary duty of due care that the directors owe the shareholders.[146] Specifically, the court broke down this fiduciary duty of care into two parts: (1) substantive due care (the terms of the repurchase), and (2) procedural due care (the decision by the board was an informed one).[147]

At the outset, the court, in examining the substantive due care aspect of the repurchase, agreed with the lower court's conclusion that the repurchase, apart from the hush-mail provision, must be viewed as any other repurchase from a dissident stockholder.[148] The court, citing *Polk*, stated the applicable law in Delaware as absent "evidence of fraud or unfairness, a corporation's repurchase of its capital stock at premium over market from a dissident shareholder is entitled to the protection of the business judgment rule."[149] The court, concluding that there was no fraud involved in the transaction, held that the plaintiffs, at most, alleged a claim of corporate waste.[150] Therefore, the plaintiffs were faced with the burden of proving that the consideration the corporation received from the repurchase was "so inadequate in value that no person of ordinary, sound business judgment" would deem it adequate.[151]

Plaintiffs tried to meet this burden by alleging that the price paid for Perot's stock was double the market price, and the hush-mail provision was the motivating reason for this substantial premium, thereby constituting an improper business purpose.[152] The

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145. *Grobow*, 539 A.2d at 189.

146. A board of directors owes fiduciary duties of loyalty and due care to the corporation, which includes its shareholders; in *Grobow*, the court did not look at the duty of loyalty because the plaintiffs did not claim a breach of this duty. *See generally* Smith v. Van Gorkom, 488 A.2d 858, 872-73 (Del. 1985) (director has a duty to exercise an informed business judgment, and this duty is considered a duty of care as opposed to a duty of loyalty).

147. *Grobow*, 539 A.2d at 189. In *Smith*, the board of directors breached their fiduciary duty of care by failing to make an informed decision. *Smith*, 488 A.2d at 878.

148. *Grobow*, 539 A.2d at 189.

149. *Id.*

150. *Id.*

151. *Id.* (quoting Saxe v. Brady, 184 A.2d 602, 610 (Del. Ch. 1962)).

152. *Id.* The plaintiffs alleged that the total repurchase price of $61.90 per share was nearly double the market price of the stock on the day before the repurchase. *Id.* at 185 n.4.

court held, however, that the plaintiffs failed to create a reasonable doubt with particularized facts that the repurchaser is not entitled to the protection of the business judgment rule for several reasons.[153] First, the plaintiffs failed to prove that the board's payment of greenmail was to buy Perot's silence rather than to buy his interest out and remove him from the GM Board.[154] The court was impressed by the fact that the plaintiffs actually alleged in their complaint that the repurchase was aimed at ridding itself of the principal policy dispute between EDS and GM and thus served a legitimate business purpose.[155] Moreover, the court found that the liquidated damage clause (Perot would pay $7.5 million if he breached a covenant of the repurchase agreement) strengthened the commitment to the agreement and thus added to the sound business purpose of the agreement.[156]

Second, the court found that the so-called hush-mail aspect of the agreement was not a waste of corporate assets.[157] In analyzing the hush-mail aspect of the repurchase agreement, the court concluded that "[i]n addition to regaining control over the management affairs of EDS, GM also secured, through the complex repurchase agreement, significant covenants from Perot, of which the hush-mail provision was but one of many features and multiple considerations of the repurchase."[158] Thus, the court concluded that "aside from whatever consideration could be attributed to buying Perot's silence," the price paid for the repurchase was reasonable considering the covenants GM received from Perot in turn.[159] Moreover, the court concluded that plaintiffs' argument that the giant premium constituted corporate waste was flawed because plaintiffs failed to place a

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153. *Id.* at 190.

154. *Id.* at 189-90.

155. *Id.* at 190. The court stated:

> To the contrary, plaintiffs themselves state in their complaints as amended several legitimate business purposes for the GM Board's decision to sever its relationship with Perot: (1) the Board's determination that it would be in GM's best interest to retain control over its wholly-owned subsidiary, EDS; and (2) the decision to rid itself of the principal cause of the growing internal policy dispute over EDS' management and direction.

Id.

156. *Id.* The court stated that failure to anticipate a breach could be a costly oversight. *Id.* (citing E. FARNSWORTH, CONTRACTS § 12.18, at 896 (1982)).

157. *Id.*

158. *Id.*

159. *Id. See supra* text accompanying note 117 (discussing various covenants in repurchase agreement).

dollar figure on the particular promises made by Perot.[160] Therefore, the repurchase agreement was affirmed on substantive due care grounds.[161]

Next, the court addressed the procedural due care element of the repurchase agreement.[162] Plaintiffs alleged that the GM directors breached this duty, thereby failing to reach an informed decision for two reasons: (1) there were no arm's-length negotiations between the GM Board and Perot, and (2) the GM Board failed to engage in proper deliberation before approving the repurchase terms.[163] The court stated that the plaintiffs must allege well-plead facts that support a reasonable conclusion that the GM Board acted with "gross negligence" in negotiating the terms of the repurchase.[164] Additionally, the court stated that a decision by a board of directors, comprised of a majority of disinterested and independent directors, raises a presumption that the business judgment rule applies.[165]

First, the court noted that the complaint itself alleged that the repurchase agreement was pursuant to "'give and take' negotiations and was conducted at arms length [sic]."[166] Specifically, it was expressly conceded that Perot did not receive all of his original demands.[167] Second, the court found that the decision was not rushed,

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160. *Grobow*, 539 A.2d at 190. The court did not accept the plaintiffs' allegation that the total repurchase price of $31.371 per share was double the market price of the stock ($61.90) the day before the repurchase:

> The formula plaintiffs use to establish the existence of a "giant premium" is ambiguous, making the allegation conclusory. The total repurchase price includes not only the price paid for the class E stock, but also the price paid for the contingent notes and the value of the tax compensation. Ambiguity is caused when these items are factored in, especially the contingent note discounts. For example, in their complaints, plaintiffs appear to discount the contingent notes by $16.20, reflecting the present value ($62.50-$46.30). The GM directors, however, discount the notes by $6.00. This disparity appears to be due to plaintiffs' use of a base figure of $46.30, which is $16.20 less than that used by the defendants. The plaintiffs fail to explain this disparity with particularity, thus failing to satisfy their burden under *Aronson*.

Id. at 188 n.7.

161. *Id.* at 190.

162. *Id.*

163. *Id.*

164. *Id. See generally Van Gorkom*, 488 A.2d at 873 (standard of care applicable to director's duty of care based upon concept of gross negligence).

165. *Grobow*, 539 A.2d at 190 (citing *Polk*, 507 A.2d at 537); *Unocal*, 493 A.2d at 955.

166. *Grobow*, 539 A.2d at 191.

167. *Id. See supra* notes 116-17 (discussing the terms of the repurchase agreement).

but rather the GM Board had been considering a buyout for several weeks.[168] Furthermore, the court found that plaintiffs did not allege that the committee and the GM Board had failed to consider the views of experts such as investment bankers, lawyers, and accountants or to consider all relevant facts and the terms of the repurchase before approving it.[169] Thus, the court held that "the repurchase of dissident Perot's interests can only be viewed legally as representing an exercise of business judgment by the General Motors Board with which a court may not interfere."[170]

D. *The District Court Decision*

In a case challenging the same repurchase, *In re General Motors Class E Stock Buyout Securities Litigation*,[171] plaintiffs brought a class and derivative suit against GM claiming that the stock repurchase violated federal securities and Delaware laws.[172] The case involved the same set of facts except, unlike *Grobow*, the plaintiffs made a demand on the board of directors and thus the state law claims were not dismissed due to *res judicata*.[173] *General Motors* is an important case because it analyzed two different techniques used to challenge the payment of greenmail challenged under securities law in addition to a typical claim of breach of fiduciary duty of care or loyalty.

First, plaintiffs alleged that the GM directors and Perot failed to disclose material information concerning the repurchase, in violation of section 10(b) of the Securities Exchange Act of 1934 and

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168. *Grobow*, 539 A.2d at 191.
169. *Id.*
170. *Id.*
171. 694 F. Supp. 1119 (D. Del. 1988).
172. *Id.* at 1122.
173. The District Court for the State of Delaware, in an opinion authored by Chief Judge Murray Schwartz, stated:

> The *Grobow* plaintiffs had not made a demand. The Delaware Supreme Court was concerned with the issue of whether there were sufficient facts alleged to excuse a demand. . . . This Court has before it a demand refused question to which the reasonable doubt standard does not apply. It follows the issue before the Supreme Court was not the same as before this Court. *Grobow* does not have res judicata effect on this action.

Id. at 1132 (citation omitted). *See* Zapata Corp. v. Maldonado, 430 A.2d 779, 784 n.10 (Del. 1981) ("[W]hen stockholders, after making demand and having their suit rejected, attack the board's decision as improper, the board's decision falls under the 'business judgment' rule and will be respected if the requirements of the rule are met."). *See also supra* note 99 and accompanying text (discussing authority for the demand futility claim under Delaware law).

SEC Rule 10b-5.[174] Plaintiffs brought a class claim on behalf of all shareholders who bought General Motors class E stock between the summer of 1986 (the date that the GM management decided that EDS' autonomy from GM must end, Perot's relationship with GM must end, and Perot's silence must be purchased) and December 1 (the date of the repurchase) for failing to disclose this information.[175] Specifically, the complaint alleged that GM failed to disclose: (1) GM's decision that EDS' autonomy within GM must end; (2) GM must terminate its association with Perot and buy his silence; (3) GM's negotiations in October 1986 with AT & T trying to sell EDS; (4) the negotiations of Perot's buyout; and (5) failing to disclose the conditions of the November 28, 1986 agreement until December 1, 1986.[176]

Although the court held that the plaintiffs sufficiently stated the materiality of the AT & T/GM negotiations and the buyout negotiations for Perot's stock at a large premium under rule 10b-5, the court nevertheless held that GM had no duty to disclose this information because there were no "allegations of inside trading, rumors or the need to correct inaccurate or misleading information."[177]

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174. Section 10 states, in pertinent part:

> It shall be unlawful for any person, directly or indirectly, by the use of means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—
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> (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

15 U.S.C. § 78j (1982). In addition, fraud is further prohibited in SEC Rule 10b-5, which provides, in relevant part:

> It shall be unlawful for any person . . .
>
> (a) To employ any device, scheme, or artifice to defraud,
>
> (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (c) To engage in any act, practice, or course of business which operates or would operate as fraud or deceit upon any person, in connection with the purchase or sale of any security.

17 C.F.R. § 240.10b-5 (1988).

175. *General Motors*, 694 F. Supp. at 1125-26.

176. *Id.* at 1125.

177. *Id.* at 1129 (footnote omitted). The named plaintiff in this class action, Elliot Dubowski, purchased GM class E stock on November 27, 1986, and

A second way that the plaintiffs challenged the payment of greenmail was by alleging that GM's stock repurchase from Perot and three other EDS officials was a tender offer under section 13(e) of the Securities Exchange Act.[178] If the plaintiffs succeeded in classifying the repurchase as a tender offer under the Williams Act, the repurchase would be invalid under rule 13e-4(b) because of GM's failure to extend the repurchase offer to all class E shareholders.[179] The court held that the repurchase agreement did not come within

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November 20, 1986. *Id.* at 1126. To maintain an action under § 10(b) and rule 10b-5, the plaintiff must allege injuries that resulted from reliance on material misstatements or omissions. Therefore plaintiff's allegations of statements made by GM on November 26, 1988, and failure to disclose the repurchase agreement on November 28, 1986, were dismissed since plaintiff had already purchased his stock. *Id.* at 1126-27. Thus, the court analyzed only three of the plaintiff's claims that arose before November 20, 1986.

Next, the court stated the two-prong test to establish a claim under § 10(b) and rule 10b-5. First, the injury must have resulted from reliance upon a material misstatement or omission. A fact is material when there is "'a substantial likelihood that the disclosure of the omitted fact would have been viewed by a reasonable investor as having significantly altered the 'total mix' of information made available.'" *Id.* (quoting Basic, Inc, v. Levinson, 485 U.S. 224, 224 (1988) (quoting TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976)). This analysis is fact specific and based upon a weighing of the probability that the event will occur and the magnitude of the event in the company's activities. *Id.* at 1127 (citing SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 849 (2d Cir. 1968), *cert. denied sub nom.* Coates v. SEC, 394 U.S. 976 (1960)).

Second, there must be a duty to disclose this material information. *Id.* at 1128. Under rule 10b-5, an insider who trades on material information has a duty to disclose. *Id.* at 1128-29 (citing Chiarella v. United States, 445 U.S. 222, 228 (1980)). Moreover, a corporation may have an affirmative duty to verify rumors or correct inaccurate or misleading information. *Id.* at 1129. *See also* Deuschman v. Beneficial Corp., 841 F.2d 502, 506 (3d Cir. 1988); Roeder v. Alpha Indus., Inc., 814 F.2d 22, 26 (1st Cir. 1987); State Teachers Retirement Bd. v. Flour Corp., 654 F.2d 843, 850 (2d Cir. 1981).

In *General Motors*, the court held that GM management's decision to terminate its relationship with Perot and to end the autonomy with EDS in the summer of 1986 was not a material fact under rule 10b-5 because of the "very low probability as of the summer of 1986 that it would occur." *General Motors*, 694 F. Supp. at 1128. However, the court found that the negotiations between GM and AT & T over the sale of EDS, and the negotiations between GM's general counsel and Perot's attorney concerning GM's repurchase of Perot's stock at a large premium were material because of the magnitude of the impact on EDS and the high probability of the events occurring. *Id.* Ultimately, however, despite these findings of materiality, the court dismissed plaintiffs' claims under § 10(b) and rule 10b-5 because no duty to disclose had been established. *Id.* at 1129.

178. 15 U.S.C. § 78m(e) (1982).

179. 17 C.F.R. § 240.13e-4(f) (1988). *See supra* notes 6-8 and accompanying text (a tender offer must be open to all members of the same class of stock).

the scope of the Williams Act and, thus, was not a tender offer.[180]

Initially, the court noted that although the term "tender offer" is not defined in the Williams Act, courts have in the past held that privately negotiated transactions, and open market purchases are not tender offers.[181] The court then listed an eight factor test established in *Wellman* to help resolve the issue of whether the repurchase was a tender offer.[182] The court, however, found the test inconclusive and further stated that the *Wellman* standard is not to be used as a "litmus test" to classify a tender offer.[183] Instead, the court found the reasoning in *Hanson Trust* persuasive and, therefore, since the

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180. *General Motors*, 694 F. Supp. at 1131. The purposes of the Williams Act have been articulated in several recent decisions. *See generally* Piper v. Chris-Craft Indus., Inc., 430 U.S. 1 (1977); CTS Corp. v. Dynamics Corp. of Am., 481 U.S. 69 (1987); BNS Inc. v. Koppers Co., 683 F. Supp. 458 (D. Del. 1988).

181. *General Motors*, 694 F. Supp. at 1129. *See* Hanson Trust PLC v. SCM Corp., 774 F.2d 47, 56 (2d Cir. 1985) (citing several cases standing for this proposition); Wellman v. Dickinson, 475 F. Supp. 783, 817-18 (S.D.N.Y. 1979), *aff'd*, 682 F.2d 355 (2d Cir. 1982), *cert. denied sub nom.* Dickinson v. SEC, 460 U.S. 1069 (1983) (listing an eight factor test to determine if a repurchase is a tender offer).

182. *General Motors*, 694 F. Supp. at 1130. The *Wellman* court established an eight part test to identify a tender offer:

> (1) active and widespread solicitation of public shareholders for the shares of an issuer;
> (2) solicitation made for a substantial percentage of the issuer's stock;
> (3) offer to purchase made at a premium over the prevailing market price;
> (4) terms of the offer are firm rather than negotiable;
> (5) offer contingent on the tender of a fixed number of shares, often subject to a fixed maximum number to be purchased;
> (6) offer open only for a limited period of time;
> (7) offeree subjected to pressure to sell his stock;
> . . . .
> [(8)] public announcement of a purchase program concerning the target company precede or accompany rapid accumulation of large amounts of the target company's securities.

Id. at 1130 (citing *Wellman*, 475 F. Supp. at 823-24).

183. *Id.* The court went through each step of the *Wellman* standard. First, the court found there was not active solicitation of public shareholders. Ironically, it was Perot that solicited GM for the repurchase. Second, since the court found there was no solicitation, the court did not consider the question of whether it was a solicitation for a large number of shares. Third, the court found that the repurchase was for a premium over the market price. Fourth, the court found that the terms of the repurchase were not firm, but rather negotiated between Perot and GM. Fifth, the court found that the repurchase was for a fixed number of shares—Perot and his three associates' entire interest. Sixth, the court found nothing in the record that could support the conclusion that the repurchase was open only for a limited time. Seventh, there was no allegation that Perot was under pressure to sell his shares. Eighth, GM made no public announcement of the repurchase. *Id.*

purpose of section 14(d) is to protect the solicitee who lacks adequate information the issue of whether a repurchase is a tender offer is determinative on whether "there will be a substantial risk that solicitees will lack information to make a carefully considered appraisal of the proposal put before them."[184] Therefore, since Perot was well informed as to the value of the class E stock and the repurchase was negotiated by attorneys, the court held that the repurchase by "GM does not come within the scope of transactions and sellers the Williams Act was intended to protect, and is not a tender offer."[185]

In *General Motors*, the plaintiffs advanced other claims under Delaware law[186] not originally litigated in *Grobow*. First, plaintiffs brought a class action on behalf of all shareholders who owned GM stock on December 1, 1986, alleging that GM breached its fiduciary duties and harmed the class by decreasing the value of the stock.[187] However, the court dismissed plaintiffs' claim because under Delaware law "a plaintiff must allege either an injury separate and distinct from that shared by other shareholders or a wrong concerning a contractual right as shareholder."[188] Plaintiffs failed to meet their burden under this test.[189]

Second, plaintiffs brought a derivative claim alleging the price paid for the repurchase was grossly excessive and that the directors breached their fiduciary duties by repurchasing Perot's stock for the primary purpose of entrenching themselves in office.[190] Initially, the district court stated the standard for demand refusal as "[i]f a board's refusal to sue on a derivative claim is protected by the business judgment rule, the plaintiff lacks the authority to pursue a derivative action on the corporation's behalf."[191] Moreover, when demand is refused the burden is on the plaintiff to overcome the presumption of the business judgment rule.[192] However, directors have a duty to

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184. *Id.* (quoting *Hanson Trust*, 774 F.2d at 56).

185. *Id.* at 1131.

186. *See generally* CTS Corp. v. Dynamics Corp. of Am., 481 U.S. 69 (1987) (a corporation is regulated by the law of the state of incorporation).

187. *General Motors*, 694 F. Supp. at 1131.

188. *Id.* (citations omitted).

189. *Id.* at 1132.

190. *Id.* at 1132. *See supra* notes 18-21 and accompanying text (discussing primary purpose test).

191. *General Motors*, 694 F. Supp. at 1133 (citations omitted). *See generally* Zapata Corp. v. Maldonado, 430 A.2d 779 (Del. 1981) (plaintiffs failed to allege director self-interest or fraud). *See supra* notes 123-25 and accompanying text.

192. *General Motors*, 694 F. Supp. at 1133.

inform themselves of all material information prior to making a decision before being afforded the protection of the business judgment rule.[193] The court held that the GM directors did not properly inform themselves prior to refusing demand because "[t]he Complaint alleges that the Board neither reviewed its initial decision to approve the transaction nor made any inquiry in response to the demand letter."[194] Therefore, plaintiffs were allowed to proceed with this portion of its suit.[195]

Finally, the plaintiffs brought a class claim alleging that the GM Board breached their fiduciary duties by failing to extend the repurchase offer made to Perot and his associates to the rest of the class E shareholders.[196] The court stated that the applicable Delaware law was that "[a]bsent an improper purpose, a corporation has the authority to repurchase its shares from a dissident stockholder."[197] Plaintiffs, relying on *Fisher v. Moltz*,[198] claimed that the burden is on the defendant directors to prove corporate purpose.[199] The district court, however, stated that even though the Delaware Supreme Court did not address this issue in *Grobow*, it anticipates that Delaware law "would not impose the burden of proving a proper corporate purpose upon a defendant corporation or its directors if a corporation selec-

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193. *General Motors*, 694 F. Supp. at 1133. *See Aronson*, 473 A.2d at 812 (directors have a duty to inform themselves "of all material information reasonably available to them").

194. *General Motors*, 694 F. Supp. at 1134. Paragraph 77 of the plaintiffs' complaint alleged:

> Prior to rejecting plaintiffs' demand, GM's Board did not review its initial decision to ratify the Perot transaction nor did it constitute a special committee to investigate the matter. Therefore, the Board's rejection of the demand was based upon the same misinformation and uninformed judgment as was the Board's approval of the Perot buyout. The rejection, as was the approval of the Perot transaction, was an uninformed director judgment and did not constitute an independent exercise of business judgment entitled to protection under the law.

Id.

195. *Id.*

196. *Id.* at 1134. The plaintiffs alleged that they were harmed because they were unable to partake in the premium repurchase. *Id.*

197. *Id.*

198. No. 6068 (Del. Ch. Dec. 28, 1979), *reprinted in* 5 DEL. J. CORP. L. 530 (1980). In *Fisher*, the court of chancery held that in examining a corporation's exclusionary tender offer to all but one former employee, the burden of proving a proper corporate purpose is on the defendant corporation. *General Motors*, 694 F. Supp. at 1135.

199. *General Motors*, 694 F. Supp. at 1135.

tively repurchases its shares outside of the tender offer context."[200] Moreover, the court held that even if plaintiffs could overcome this presumption, Delaware law does not require directors to extend a repurchase offer to all shareholders of the same class.[201] Therefore, plaintiffs' class claim was dismissed.

V. EVALUATION

Despite the Delaware Supreme Court's apparent antagonism toward the practice of greenmail,[202] the *Grobow* decision reaffirmed a corporation's right to repurchase its own stock at a premium from a dissident shareholder, absent an improper motive.[203] The decision appears to be in accord with precedent in this area, including the *Kaplan* and *Polk* decisions.[204] At the same time, however, the court is treading on new ground in its decision for several reasons.[205]

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200. *Id.*

201. *Id.* at 1135.

202. *See Unocal*, 493 A.2d at 956.

203. *Grobow*, 539 A.2d at 191.

204. One commentator has suggested that the *Polk* decision provided perhaps the weakest factual situation for the payment of greenmail:

> It is hard to imagine weaker reasons for paying greenmail. First, the court was content to let the Texaco board justify its position by reference to unsubstantiated "rumors." Second, the Bass brothers' willingness to pay a premium for Texaco shares in order to divest Getty Oil from Texaco may have indicated that the Getty Oil acquisition was against the best interests of Texaco shareholders, not the reverse. Finally, the payment of greenmail is best justified either by the existence of valuable inside information or by an attempt to stall one bidder in an effort to attract other higher bidders. Texaco offered neither justification.

Oesterle, *supra* note 5, at 146.

205. One commentator has suggested that a possible way to review the *Grobow* decision is as limiting *Smith v. Van Gorkom*:

> The Delaware court's holding that Grobow's generalized allegations of recklessness were insufficient to create a reasonable doubt that GM's board had acted recklessly (and that demand thus was excused) effectively establishes a new pleading requirement that will make it extremely difficult for shareholders of Delaware companies to maintain derivative suits based on allegations that directors acted recklessly. Shareholders are unlikely to have access to detailed information demonstrating that the directors made decisions recklessly—the very information they must have to satisfy *Grobow*'s pleading requirement. . . . In fact, one could reasonably view *Grobow* as directed at sharply limiting, if not reversing the Delaware court's controversial decision in *Smith v. Van Gorkum* [sic].

Weiss & White, *A Response to Professor Fox*, 76 CALIF. L. REV. 1047, 1057-58 (1988) (footnote omitted). It might be argued, however, that the authors failed to fully consider the facts of these cases.

First, the *Grobow* decision dismissed plaintiffs' challenge of the repurchase at the pre-trial stage for failing to meet the demand excuse requirements under *Aronson*.[206] Under the first prong of the test, the court held that the plaintiffs had failed to plead facts sufficient to excuse demand due to self-interest.[207] Relying on precedent, the court found that plaintiffs' challenge in this regard amounted to a hollow allegation.[208] Moreover, the court held that the enhanced duty of the *Unocal* two-prong test was inapplicable to the present case. Thus, the court held that plaintiffs failed to plead facts that the repurchase was motivated primarily to entrench the GM directors.[209]

This stage of the analysis is important to consider for two reasons. First, the burden of the primary purpose test was placed on the plaintiffs under the first prong of the *Aronson* test.[210] Therefore, it will be difficult if not impossible for plaintiffs to satisfy this burden since lawyers and directors are skilled enough to create a record showing good faith, even though the repurchase was motivated due to entrenchment.[211] Second, if the board of directors does not personally benefit, such as by increasing their voting power, the plaintiffs will face another difficult task proving director self-interest.

Similarly, under the second prong of the *Aronson* test, the court also appears to be treading on new ground.[212] The court's statement in approving the GM repurchase that, "apart from the hush-mail provision, the transaction must be viewed as any other repurchase"[213]

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206. *Grobow*, 539 A.2d at 187.

207. *Grobow*, 539 A.2d at 188.

208. *Id.* Moreover, the court found that plaintiffs' allegation that Perot's public statements could lead to the GM directors' ouster was "too speculative" in nature to meet the first prong under *Aronson*. *Id. Compare supra* note 124 and accompanying text (distinguishing *Polk* and *Moran* in which demand was excused due to director self-interest).

209. *Grobow*, 539 A.2d at 188. The plaintiff alleged that Perot's criticism of the GM Board could lead to their ouster and thus the repurchase was motivated due to entrenchment. However, the court held that this allegation was "tenuous at best and . . . too speculative to raise a reasonable doubt of director disinterest." *Id.*

210. *Id.* In a Delaware case that is factually similar to the present case, *Kaplan v. Goldsamt*, the court placed the burden of the primary purpose test at trial level on the defendant even though there was no hostile takeover threat, but rather a threat to the future policy of the defendant corporation due to dissident shareholder policy views. *See supra* notes 33-35 and accompanying text (discussing *Kaplan*).

211. *See* Lowenstein, *supra* note 20, at 314.

212. *See supra* text accompanying notes 145-70 (discussing whether the plaintiffs alleged a reasonable doubt that the repurchase was an exercise of proper business judgment).

213. *Grobow*, 539 A.2d at 189.

from a dissident shareholder at a premium over the market price, is not persuasive. The cases that the court cited in support of this contention all contain facts that justified the payment of greenmail.[214] Under Delaware law, the courts traditionally have justified the payment of greenmail and the apparent favoring of one shareholder over others in the same class under a control premium theory.[215] In addition, the payment of greenmail is justified and deemed reasonable due to the threat that a greenmailer or dissident shareholder poses to the future success of the corporation.[216] Moreover, commentators suggest that the payment of greenmail is justified because the shareholder in a sense is selling valuable information to the corporation, or that the payment thwarts a prospective tender offer in hopes of attracting a higher bidder.[217] It is hard, however, to square the *Grobow* decision with any of these propositions.

First, the repurchase did not occur during a hostile takeover climate for GM and, therefore, the greenmail payment was not intended to incite higher offers for GM.[218] In fact, the court refused to analyze the GM repurchase under the heightened scrutiny of the second prong of the *Unocal* standard because "there was no outside threat to corporate policy of GM sufficient to raise a *Unocal* issue of whether the directors' response was reasonable to the threat posed."[219] Second, Perot did not offer any valuable information for this repurchase that could justify his unique treatment. Again, it can be argued that the opposite was true since Perot was the backbone

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214. *Id.* All the cases cited by the court involve a different factual setting in which the payment of greenmail is usually justified. *Polk*, 507 A.2d at 531 (an apparent threat of hostile takeover coupled with the Bass group acquiring 8.8% of the stock-control premium); *Cheff*, 199 A.2d at 548 (control premium and threat of liquidation); Edelman v. Phillips Petroleum Co., No. 7899 (Del. Ch. Feb. 12, 1985) (control premium and hostile tender threat), *reprinted in* 10 DEL. J. CORP. L. 835 (1985); Lewis v. Daum, No. 6733 (Del. Ch. May 24, 1984) (threat to future corporate policy and control premium), *reprinted in* 9 DEL. J. CORP. L. 481 (1984); *Kaplan*, 380 A.2d at 569 (threat to corporate control and control premium); *Kors*, 158 A.2d at 141 (control premium and threat to future business of the company).

215. *Bennett*, 187 A.2d at 411.

216. *See, e.g.*, *Polk*, 507 A.2d at 537. The court stated that "[t]he payment of a premium of approximately 3% over market seems reasonable in relation to the immediate disruptive effect and the potential long-term threat which the Bass group posed." *Id. But see* Oesterle, *supra* note 5, at 146 (arguing that the court never explained the long-term threat).

217. *See supra* text accompanying notes 85-92 (discussing the utility of greenmail).

218. *See* Dennis, *supra* note 5, at 311.

219. *Grobow*, 539 A.2d at 188.

of EDS, when he and his three top associates left EDS so did the valuable information. Third, the control premium argument was not advanced as a justification for the repurchase at a premium. In fact, the court stated that Perot "owned only 0.8 percent of GM's voting stock."[220] Finally, the court itself found that part of the premium paid for the stock could be attributed to Perot's silence or the hush-mail provision.[221] Moreover, the payment of greenmail came at a time when GM was in the process of cost cutting due to financial troubles.[222] Thus, even though the Perot repurchase did not advance any arguments behind the payment of greenmail and even though the case, due to its unique facts, cannot be exactly squared with any Delaware precedent the court nonetheless held that the repurchase was entitled to the protection of the business judgment rule.[223]

The *Grobow* decision may be understood in several ways. The approach taken by the court was that the repurchase agreement must be viewed as any other repurchase.[224] As noted earlier, however, this decision is distinguishable because although Perot might have posed a threat to the future policy of GM, the control premium argument under which the Delaware courts have justified discriminatory treatment among shareholders was not advanced by the *Grobow* court. This decision can also be viewed as the Delaware Supreme Court's recognition that the payment of greenmail is a practical way for a board of directors to sever its ties with a dissident shareholder, regardless of whether or not discriminatory treatment among shareholders is justified, absent improper purpose. In *Grobow*, the court held that the primary motive behind the repurchase was not entrenchment and due to the covenants that GM received from Perot in return for the premium paid, the terms of the repurchase agreement were not so inadequate that no person of ordinary business judgment would deem the terms inadequate.[225] While greenmail is generally

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220. *Id.*

221. *Id.* at 190 ("Quite aside from whatever consideration could be attributed to buying Perot's silence" Perot had made valuable concession to the GM Board.).

222. *Id.* at 185.

223. *Id.* at 191.

224. *Id.* at 189.

225. *Id.* Part of the plaintiffs' problem in failing to prove that the payment of the premium resulted in a breach of the directors' fiduciary duty was the plaintiffs' failure to represent the size of the premium. The court stated, "Plaintiffs' effort to quantify the size of the premium paid by GM is flawed . . . by their inability to place a dollar value on the various promises made by Perot, particularly his covenant not to compete with EDS or to attempt to hire away EDS employees." *Id.* at 190.

disliked, even Justice Horsey seems to concede the utility of this practice in his closing:

> Apart from whether the Board of Directors may be subject to criticism for the premium paid Perot and his associates for the repurchase of their entire interest in GM, on the present record the repurchase of dissident Perot's interests can only be viewed legally as representing an exercise of business judgment by the General Motors Board with which a court may not interfere.[226]

VI. THE PRESENT STATUS OF GREENMAIL

The *Grobow* and *General Motors* decisions paint an excellent picture of the present status of greenmail under Delaware and federal securities laws because in each case the plaintiffs advanced several innovative arguments in an attempt to strike down the payment of greenmail. These arguments, however, did not carry the day for the plaintiffs;[227] the courts affirmed the general rule in Delaware that a corporation has the power to repurchase its stock from a dissident shareholder at a premium, absent an improper purpose.[228]

Under present law, the payment of greenmail, unlike many other types of corporate distributions, can discriminate among shareholders of the same class of stock.[229] In *General Motors*, the plaintiffs attempted to extend the equal treatment afforded to shareholders of the same class in the self-tender context to greenmail, by claiming that the greenmail terms must be available to all shareholders of GM class E stock.[230] The district court, however, held that defendant directors do not have a duty to extend the same offer to all shareholders of the same class.[231] Additionally, the plaintiffs claimed that GM's repurchase was, in fact, a tender offer and, therefore, the

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226. *Id.* at 191.

227. In *General Motors*, the plaintiffs were allowed to proceed with their derivative claim of corporate waste and breach of fiduciary duty. *General Motors*, 694 F. Supp. at 1134. This result, however, was due to GM Board's failure to review its initial decision to approve the repurchase after demand was made. Therefore, this decision did not attack the validity of the substantive terms of the repurchase agreement, but rather the board's failure to properly inform themselves prior to refusing demand. *Id.*

228. *Id.* at 1134; *Grobow*, 539 A.2d at 189.

229. *See supra* note 76.

230. *General Motors*, 694 F. Supp. at 1135.

231. *Id.*

directors failed to comply with the Williams Act by not extending the terms to all shareholders.[232] The court dismissed this claim because the legislative history of the Williams Act indicates that privately negotiated and open market purchases of stock do not come within the scope of the Act.[233] Finally, the court held that the defendant directors and Perot had no duty to disclose the repurchase negotiations under section 10(b) of the Securities Exchange Act and rule 10b-5.[234] Therefore, unless new legislation is promulgated, corporations may discriminate among shareholders with the payment of greenmail under Delaware and federal securities laws.

In a nonhostile takeover climate, such as the GM repurchase of Perot's shares, the Supreme Court of Delaware placed the burden on the plaintiffs to plead particularized facts that the business judgment rule is inapplicable and thus excuse demand.[235] Under this analysis, the plaintiffs are charged with the burden of the primary purpose test or proof of the personal motives of the defendant directors.[236] As the court itself conceded, "a heavy burden falls on a plaintiff to avoid pre-suit demand."[237] Therefore, plaintiffs stand a slim chance in claiming demand futility.[238] This is evident from the *Grobow* decision in which the payment of greenmail was affirmed despite the only apparent justification for the premium paid being the fact that GM's future corporate policy might be harmed due to Perot's stock ownership.[239]

Similarly, in the hostile takeover climate, the court has approved of the payment of greenmail as an effective maneuver employed by a board to thwart a possible takeover.[240] While the board must satisfy the initial burden under the two-prong test of *Unocal*, the court's analysis in *Polk* appears to suggest that it will be hard to invalidate a greenmail payment under the business judgment rule.[241]

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232. *Id.* at 1129.

233. *Id. See* 113 CONG. REC. 854, 854-56 (1967) (statement of Senator Williams discussing primary purpose of Williams Act).

234. *General Motors*, 694 F. Supp. at 1129. *See supra* notes 175-77 and accompanying text.

235. *Grobow*, 539 A.2d at 189.

236. *See* Weiss & White, *supra* note 205, at 1058.

237. *Grobow*, 539 A.2d at 190.

238. *See* Weiss & White, *supra* note 205, at 1059.

239. *See supra* notes 85-92 and accompanying test (discussing validity of greenmail).

240. *See, e.g.*, *Polk*, 507 A.2d at 537.

241. *See supra* notes 69-74 and accompanying text (discussing *Polk*).

VII. CONCLUSION

Under Delaware law, a corporation's selective repurchase of its stock is valid under the business judgment rule, absent an improper motive. The *Grobow* decision highlights the problems that a plaintiff will face in trying to prove the requisite motive to survive a failure to make demand upon a board of directors. Even though the court conceded that part of the premium paid for Perot's stock could be attributed to the hush-mail clause, the court held that the repurchase agreement was protected by the business judgment rule because the terms of the repurchase were fair. *Grobow* can best be understood perhaps as the court's recognition that greenmail is a powerful maneuver for a board to rid itself of a dissident shareholder.

The discriminatory treatment of shareholders of the same class of stock was also upheld under securities law in *General Motors*. The court refused to classify a privately negotiated repurchase agreement involving parties familiar with the intrinsic value of stock as a tender offer under the Williams Act. Therefore, the terms of the repurchase did not have to be extended to all shareholders of GM class E stock.

The *Grobow* and *Polk* decisions indicate that the payment of greenmail in both a hostile and nonhostile takeover climate is valid. Although the factual background of both repurchases do not offer traditional justifications for the payment, the court nevertheless held that the repurchase agreements were protected by the business judgment rule and thus solidified the validity of greenmail under Delaware law.

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