THE USE OF SUPERMAJORITY VOTING RULES IN CORPORATE AMERICA: MAJORITY RULE, CORPORATE LEGITIMACY, AND MINORITY SHAREHOLDER PROTECTION

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The use of voting decision rules in corporate America has suffered from the same confusion of competing interests that has permeated the debate in the political arena.[1] In both the Constitution and the corporate

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[1]In the early part of this century, when the concept of simple majority rule gained adherents sympathetic to the progressive movement, analogies between corporate and political voting became popular. *See, e.g.*, John W. Burgess, *Private Corporations from the Point of View of Political Science*, 13 POL. SCI. Q. 201, 205 (1898).

> [W]hen the government confers upon a number of persons, forming a corporate body, the power to do business by the will of a quorum and majority of them, sound political science requires the government to insure that the majority shall not so abuse this power as to deprive the individuals who happen to constitute the minority of any of their civil or political rights, as guaranteed to them by the constitution and laws of the country.

Id. Additionally, the contractualist analogy to constitutional law has also been noted. *See* MELVIN A. EISENBERG, THE STRUCTURE OF THE CORPORATION 16 (1976) (stating that corporate law can be seen as "constitutional" in that it regulates "the manner in which the corporate institution is constituted").

Other works have broadly reviewed the intersection of voting rules and corporate law as being informed by "majority rule" concepts borrowed from democratic theory. *See generally* Earl Latham, *The Body Politic of the Corporation, in* THE CORPORATION IN MODERN SOCIETY 218 (Edward S. Mason ed., 1966) (comparing corporations to "systems of private government"). More recently, however, such analogies are often used to support anticorporitiste rhetoric. *See* William W. Bratton, Jr., *The New Economic Theory of the Firm: Critical Perspectives from History*, 41 STAN. L. REV. 1471 (1989).

> Anti-managerialists demonstrated the firm's public nature by analogizing managerial power to governmental power. Like government, large corporations took actions important to those outside of the organization. Like government authorities, managers exercised their power by means of a rationalized system of control and administration. Like the government, the "public" firm was a "political" entity. Political theories respecting government, such as interest group pluralism, therefore should be applied to

charter, the "natural"[2] desire to let the majority rule through a "fair," one person-one vote system[3] has been criticized by those who view majoritarianism as an anathema to the protection of fundamental minority rights.[4] Whether as citizens or shareholders, the inherent conflict between protecting the rights of the minority while allowing the democratic majority to rule has been used to justify implementation of voting decision rules, such as the supermajority or unanimity.[5] However, invocation of such rules most often occurs over the objections of those who contend that "true" democracy requires a one person-one vote system.[6]

Throughout the history of American corporate law, this debate has been framed by two questions. First, when is it "legitimate" for a

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it.

Id. at 1497 (citations omitted).

[2]This article will occasionally place certain words in quotations to indicate that such designated word is often found embedded in the rhetoric and arguments over corporate theory and majority rule, but that the author does not necessarily concede to the words literal meaning within the text.

[3]*See generally* Neal Riemer, *The Case for Bare Majority Rule*, 62 ETHICS 16, 16-17 (1951) (defending majoritarianism and opining that such rule "more closely approximates the ethical ideal" of democracy).

[4]*Id.* at 23 & n.17 (noting the oft-stated argument that the majority must be restrained to protect and stabilize minority rights).

[5]Under a simple majority rule, 50% plus one vote is needed to conclude a decision. A supermajority rule requires some number greater than 50% plus one. Under this definition, a unanimity rule would be an extreme form of supermajority rule. Generally, a supermajority rule reduces externalities among voters but increases the cost of decision making. *See* JAMES M. BUCHANAN & GORDON TULLOCK, THE CALCULUS OF CONSENT 211 (1962). Most of the literature on voting is in the field of political science and has focused on the question of whether there are any voting rules, other than unanimity, which will assure stable decisions in any environment where vote trading is possible. *See* PETER C. ORDESHOOK, GAME THEORY AND POLITICAL THEORY: AN INTRODUCTION 378-81 (1986); Andrew Caplin & Barry Nalebuff, *On 64% Majority Rule*, 56 Econometrica 787 (1988); Norman Schofield et al., *The Core and the Stability of Group Choice in Spatial Voting Games*, 82 AM. POL. SCI. REV. 195 (1988). Aside from this political science perspective, additional work on voting intersects with financial theory. *See generally* Lucian A. Bebchuk, *Takeover Bids Below the Expected Value of Minority Shares*, 24 J. FIN. & QUANTITATIVE ANALYSIS 171 (1989) (discussing necessary share values for successful takeover bids and implications of such on the free rider problem); Douglas H. Blair *et al.*, *Unbundling the Voting Rights and Profit Claims of Common Shares*, 97 J. POL. ECON. 420 (1989) (testing the marketability of voting rights, separate from their corresponding share, within a hostile takeover model); Milton Harris & Artur Raviv, *Corporate Governance: Voting Rights and Majority Rules*, 20 J. FIN. ECON. 203 (1988) (analyzing the "optimality" of voting rights assignments as well as the simple majority rule).

[6]*See generally* Jeffrey Kerbel, *An Examination of Nonvoting and Limited Voting Common Shares — Their History, Legality, and Validity*, 15 SEC. REG. L.J. 37, 47 (1987) (noting that the one person-one vote rule resulted from court application of political theory which assumed that "everyone has an equal interest in the running of the corporation").

company to use a majority or supermajority voting rule in making decisions about the management or fate of the company or its major assets? Second, assuming such legitimacy is achieved, what are the effects of the chosen rule on the shareholders, particularly the minority, whose interests are often cited as the base justification for the adoption of a supermajority rule?

This article will discuss each of these questions. The first part of this article will trace the evolution of the corporate legitimacy debate and will analyze, in this context, the decision rule which was adopted as a result of attempts to justify the corporate form. Second, the article will attempt, through empirical analysis, to ascertain whether, in the context of an acquisition or merger, current corporate supermajority voting rules live up to their promised billing as a mechanism for achieving benefits for, and protecting the interests of, the company's shareholders.

I. CORPORATE IDEOLOGY AND THE HISTORY OF SHAREHOLDER DECISION RULES

Historically, American corporate legal scholars have embraced the notion that the decision rules employed by companies should flow directly from the theoretical justification used to legitimize the corporate form itself.[7] From a late twentieth century perspective, the notion of corporate legitimacy may seem idealistic or unimportant.[8] To legal scholars in preceding ages, however, the question was considered highly significant. As such, considerable time was expended attempting to construct logical, coherent theories of the corporation;[9] theories which

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[7]*See generally* Bratton, *supra* note 1, at 1482-501 (stating that "economic practice and theory coexisted in peace").

[8]Modern scholarship generally recognizes that an entity's "existence" precedes any "essence" of theory, making the entire debate over legal legitimacy ultimately indeterminate. *See, e.g.*, JEAN PAUL SARTRE, ESSAYS IN EXISTENTIALISM 35-36 (1965) (noting that "[e]xistence precedes essence," expressing the notion that humans live and only then conceptualize). This concept is equally applicable at the corporate level. *See* Bratton, *supra* note 1, at 1472 (asserting that theories of the corporation "have followed from and responded to economic practice; they have not dominated and determined it"). For example, a leading contemporary methodological individualist concedes that one justification for a position on corporitism could merely be "aesthetic" because "it is always more satisfying to open the black box and see the workings of the mechanism." *See* Jon Elster, *Marxism and Methodological Individualism, in* INDIVIDUALISM: THEORIES AND METHODS 46-47 (Pierre Birnbaum & Jean Leca eds., 1990).

[9]For a historical review of the evolution of corporate theory, see generally Bratton, *supra* note 1, at 1482-501; Morton J. Horwitz, Santa Clara *Revisited: The Development of Corporate Theory*, 88 W. VA. L. REV. 173 (1985).

most often found the concept of voting decision rules occupying a key position in their foundations.[10] Notably, the notion that voting rules lent support to the theory itself was often absent from the debate.[11] Although the existence of this void makes the debate somewhat incomplete from a post-modern perspective,[12] the historical progression of the corporate decision rule is both interesting and instructive, for it reflects a transformation from a strict rule of unanimity to the predominant use of the simple majority, more recently culminating with a popular resurgence of the supermajority rule.[13]

The evolution of the voting decision rule has tracked the development of corporate legal theory which, itself, has undergone four significant transformations[14] since the original corporate entities assumed

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[10]David Millon, *Theories of the Corporation*, 1990 DUKE L.J. 201, 215 (noting the evolution of voting rules within the context of corporate theory).

[11]A situation seemingly no less common today.

[12]Although some corporate legal theorists might still cling tenaciously to theories of natural law or historical or economic determinism, it has become increasingly recognized in the twentieth century that the corporation is merely a subjective construct. *See* ARTHUR K. KUHN, A COMPARATIVE STUDY OF THE LAW OF CORPORATIONS 15 (1912).

> Each particular type of group-form [corporation] which has existed from the earliest commercial periods to the present day was determined by the life of the community in which it was developed and by the particular needs of the time. No type was directly or spontaneously conceived, but each was gradually evolved from some previous form, or was referable to a precedent legal conception.

Id. Today, the very idea of the corporation is questioned. *See* Robert Clark, *In Critical Legal Studies, The West is the Adversary*, WALL ST. J., Feb. 23, 1989, at A16 (discussing the critical legal studies movement which opines for a "communitarian" society in which the distinction between regulation of decision making in the public and private sectors is meaningless). *See generally* Gerald E. Frug, *The Ideology of Bureaucracy in American Law*, 97 HARV. L. REV. 1276 (1984) (arguing from a critical legal studies perspective by concentrating on the shareholders' relationship with the corporation); Thomas L. Hazen, *The Corporate Persona, Contract (and Market) Failure, and Moral Values*, 69 N.C. L. REV. 273, 317-18 (1991) (discussing the need to incorporate critical legal studies and feminist scholarship into the nexus of contracts model of the firm); *see generally* Nigel Purvis, *Critical Legal Studies in Public International Law*, 32 HARV. INT'L L.J. 81 (1991) (discussing the ideological mystification of law); William H. Simon, *Contract Versus Politics in Corporate Doctrine*, *in* THE POLITICS OF LAW 387 (David Kairys ed., 1990) (discussing the stake of other groups, such as employees or the local community, in the corporation).

[13]*See generally* William J. Carney, *Fundamental Corporate Changes, Minority Shareholders, and Business Purposes*, 1980 AM. B. FOUND. RES. J. 69, 79-90 (discussing the evolution of voting rules within the context of fundamental corporate change); Lynne L. Dallas, *The Control and Conflict of Interest Voting Systems*, 71 N.C. L. REV. 1 (1992) (tracing the history of voting rules within the context of the changing notions of corporate theory); Horwitz, *supra* note 9, at 200-03 (discussing both the majority and unanimity rules).

[14]These four transformations include: (1) the fictional legal entity theory, (2) the aggregate theory, (3) the real entity theory, and (4) the nexus of contract theory. *See infra*

their early form in colonial America.[15] The relative merits and economic and social implications of these incarnations have been discussed extensively,[16] and need not be repeated in this article. However, a

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notes 17-129 and text for a discussion of these concepts. There are, of course, a considerable number of additional theories regarding the corporation; however, none have become as widely accepted as the aforementioned. See Bratton, *supra* note 1, for a more "richly textured" discussion of corporate theory. Furthermore, this article summarizes corporate theory in chronological order, tending to make its history seem neater and more methodical than was actually the case. In reality, there was a constant flux of competing conceptions, with critics and apologists for whatever theory was at its apex. *Id.* For purposes of this study, however, the ascendance and erosion of minority viewpoints is not significant. Additionally, each of the major corporate theories has been subject to numerous variations, twists, and strong or weak forms; subtleties which are intellectually interesting but did not greatly influence the theory of shareholder voting during their existence.

[15]Although the origins of the corporation can be traced to ancient Rome, this article will focus on corporate theory from the post-colonial period until the present. *See generally* CHARLES C. ABBOTT, THE RISE OF THE BUSINESS CORPORATION 20 (Ann Arbor: Edwards Brothers, 1936) (tracing the evolution of the corporate entity from the Roman "collegia"); SIR WILLIAM BLACKSTONE, COMMENTARIES ON THE LAWS OF ENGLAND 468, 473 (E. Christian ed., London, 1793) (noting that the Roman legal model was used in determining creditors rights); GEORGE CAWSTON & A.H. KEANE, THE EARLY CHARTERED COMPANIES (London, 1896) (noting the Roman practice of conferring certain privileges to the corporation through the use of written instrument and charters); JOHN P. DAVIS, CORPORATIONS, A STUDY OF THE ORIGIN AND RELATIONS TO THE AUTHORITY OF THE STATE (1905); C. LYON-CAEN & L. RENAULT, TRAITÉ DE DROIT COMMERCIAL (Paris, 1898) (discussing some of the historical aspects of corporate law in France); SIR HENRY MAINE, ANCIENT LAW (New York, 1st Amer. ed., 1864) (hypothesizing that Western law, particularly Anglo-law, would be clouded without the existence of Roman law).

Some scholars, however, have argued that most English and American corporate law developed as a result of internal economic requirements, receiving little in the way of historical inheritance from either previous civilizations or each other. *See* JAMES W. HURST, THE LEGITIMACY OF THE BUSINESS CORPORATION IN THE LAW OF THE UNITED STATES 1780-1970, at 2, 6-9 (1970) (stating that "[t]here is little indication that English policy makers followed, or even knew much, Roman doctrine"). *See also* Adolph A. Berle, Jr., *Historical Inheritance of American Corporations, in* EDMUND CAHN, THE POWERS AND DUTIES OF CORPORATE MANAGEMENT 189 (Edmond N. Cahn ed., 1950) (noting that while the origins of corporate theory are a splendid subject for historians, American notions of this concept have their basis in English law); MAX WEBER, ZUR GESCHICHTE DER HANDELSGESELLSCHAFTEN IM MITTELALTER NACH SÜDEUROPÄISCHEN QUELLEN 3-14 (Stuttgart, 1889) (discussing the unrelated and independent nature of the Roman and modern corporation). *See generally* KUHN, *supra* note 12 (discussing the extensive history of corporate law origins in Rome, the Middle Ages, continental Europe, and England).

[16]*See* HARRY G. HENN & JOHN R. ALEXANDER, LAWS OF CORPORATIONS AND OTHER BUSINESS ENTERPRISES 144-45 (3d ed. 1983); PATRICIA H. WERHANE, PERSONS, RIGHTS, AND CORPORATIONS 34-46 (1985); William W. Bratton, Jr., *The "Nexus of Contracts" Corporation: A Critical Appraisal*, 74 CORNELL L. REV. 407, 423-33 (1989) [hereinafter Bratton, *Nexus of Contracts*]; Bratton, *supra* note 1, at 1482-501; John C. Coates IV, Note, *State Takeover Statutes and Corporate Theory: The Revival of an Old Debate*, 64 N.Y.U. L. REV. 806 (1989); Mark M. Hager, *Bodies Politic: The Progressive History of Organizational "Real Entity"*

discussion of the implications for shareholder voting under each theoretical concept is, itself, both useful and necessary to understand how majority rule became the norm for corporate shareholder voting, and how departures from this norm have recently become popular among American corporations.

A. *Early History and the Fictional Entity*

In Great Britain's North American colonies, corporations received their charters by royal degree,[17] a practice which was transferred to the authority of the individual state legislatures after independence.[18] Concepts, such as sovereign conferral, chartered corporate life, and contractualism were all a part of America's English legal inheritance,[19] and each has had an effect on latter day commercial law. As with much of this inheritance, the received laws of England were soon revised to suit the evolving needs of the new, more commercially oriented nation. When first called upon to interpret the corporate form, American law, unlike its British progenitor, began to view the corporation as a construct which could be divorced from both its human constituent parts and the economic reality in which it existed.[20] Thus, in early nineteenth century

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Theory, 50 U. PITT. L. REV. 575 (1989); Horwitz, *supra* note 9, at 176-224; Millon, *supra* note 10, at 205-40; Michael J. Phillips, *Reappraising the Real Entity Theory of the Corporation*, 21 FLA. ST. U. L. REV. 1061 (1994); Sanford A. Schane, *The Corporation is a Person: The Language of a Legal Fiction*, 61 TUL. L. REV. 563 (1987); Gregory A. Mark, Comment, *The Personification of the Business Corporation in American Law*, 54 U. CHI. L. REV. 1441, 1447-83 (1987).

[17]*See* WILLIAM ROBERT SCOTT, THE CONSTITUTION AND FINANCE OF ENGLISH, SCOTTISH AND IRISH JOINT-STOCK COMPANIES TO 1720 (1968) (discussing the early origins of the Anglo conception of a commercial business as a distinct entity).

[18]KUHN, *supra* note 12, at 99 (stating that "[a]fter the Revolution, the states succeeded to the power of the Crown to grant charters of incorporation"). *See also* LAWRENCE M. FRIEDMAN, A HISTORY OF AMERICAN LAW 188-201 (2d ed. 1985) (containing an extensive discussion of the special charter system and variations of such upon the transfer of power from the British Crown to the individual, state legislatures); Samuel Williston, *History of the Law of Business Corporations Before 1800*, 2 HARV. L. REV. 149 (1888) (distinguishing the rights of a shareholder in a corporation chartered by the British Crown versus the rights of such in a legislatively created corporation); Oscar Handlin & Mary F. Handlin, *Origins of the American Business Corporation*, *in* PUBLIC POLICY AND THE MODERN CORPORATION 3, 23-24 (Donald Grunewald & Henry Bass eds., 1966) (discussing charters and their effect on corporate life).

[19]Bratton, *supra* note 1, at 1484.

[20]*See* Bratton, *supra* note 1, at 1484.

> The American concepts denied economic reality to the juridical construct. Corporations were "artificial" and "fictive" in part because observers looked to the conduct of individuals for the economic substance of businesses. Thus, American legal theory fastened the classical conception of the economy as a

America, the corporation became an artificial person[21] — a legal fiction — created and maintained by the authority of the state.[22] As Chief Justice Marshall stated in *Trustees of Dartmouth College v. Woodward*,[23] a "corporation is an artificial being, invisible, intangible, and existing only in contemplation of law."[24] Due to the fact that the corporation's existence was wholly dependent on the sovereign, state laws concerning the "fictional legal entity"[25] of the corporation were controlling in most matters and important decisions regarding the corporation were generally required to receive the unanimous approval of its shareholders.[26]

Under this uniquely American conception, unanimous consent for fundamental changes was needed, in part, because the corporation formed a contractual triad[27] between the parties which could not be altered but for the consent of all. The unanimity rule generally remained because

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> system of transactions among individuals onto a legal foundation of individual property rights.

Id. (citations omitted).

[21]*See* Millon, *supra* note 10, at 206 (noting that "[t]he corporate entity was considered artificial, in the sense that the corporation owed its existence to the positive law of the state rather than to the private initiative of individual incorporators").

[22]*See* JOSEPH K. ANGELL & SAMUEL AMES, A TREATISE ON THE LAW OF PRIVATE CORPORATIONS AGGREGATE (Boston, 1832); John Dewey, *The Historic Background Of Corporate Legal Personality*, 35 YALE L.J. 655, 667-78 (1926); Paul Vinogradoff, *Juridical Persons*, 24 COLUM. L. REV. 594, 601 (1924).

[23]17 U.S. (4 Wheat.) 518 (1819).

[24]*Id.* at 636. *See also* Whitfield v. Kern, 184 A. 333, 341 (N.J. 1936), *rev'd*, 192 A. 48 (N.J. 1937) (reaffirming the Dartmouth College reasoning, by further noting that "[t]he corporation may be deemed in some sense a trustee with its stockholders as *cestuis*, but as such trustee it is an entity or individuality separate and distinct from those of the stockholders").

> [A] corporation is an individual entity or (artificial) person, just as separate and distinct from the individual persons of its officers, directors and stockholders as the latter individuals are from any natural person who is a stranger to the corporation. The stockholders, singly or collectively, are not the corporation; neither are the officers nor the directors.

Id. Other early terms used to describe the corporate form included "legal institution," "a fictitious or political person," or a "creature of the law." *See* 1 VICTOR MORAWETZ, A TREATISE ON THE LAW OF PRIVATE CORPORATIONS OTHER THAN CHARITABLE 1 (1882). Blackstone defined the corporation as a "franchise." *Id.* at 1 n.2.

[25]The fictional legal entity theory of the corporation actually embodies two subsidiary theories, the "concession theory" and the "fiction theory." *See* HENN & ALEXANDER, *supra* note 16, at 144-45. These theories are sometimes treated separately. *See, e.g., id.* Theoretically, however, they fit together to form a coherent whole. *See* Phillips, *supra* note 16, at 1064 (stating that "the concession theory appears to blend with the fiction theory").

[26]*See generally* Millon, *supra* note 10, at 205-11 (noting that the corporation "was considered artificial, in the sense that. . . [it] owed its existence to the positive law of the state rather than to the private initiative of individual incorporators").

[27]The state, the company, and its shareholders comprised this corporate, contractual triad.

majoritarianism seemed inconsistent with the individualist, property rights conception of ownership.[28] Further, if it were possible for a mere majority to bind a dissenting minority, the "corporate will" had to mean something other than the actual consent of the entity.[29] If the corporation was a mere fiction, then such a "corporate will" could only exist as a legal construct evidenced by the will of each of its shareholders.

For routine business decisions, a majority rule was used; however, in many cases, the voting was weighted by the quantity of shares held.[30] For example, a state statute might provide that each shareholder was allowed one vote per share up to ten shares and then one vote for each additional block of five shares held thereafter. The practice of weighted voting was an American variation on the common law rule which dictated that corporate voting took its form as per capita, not per share.[31] As a result of this practice, each shareholder, irrespective of his or her holdings, might have an equal vote. In the words of Alexander Hamilton, a weighted voting scheme allowed a "prudent mean" to be achieved,[32] while also promoting a form of corporate democracy.[33]

Few problems arose from these early, somewhat convoluted voting rules because the corporations of the time were most often small, quasi-

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[28]Millon, *supra* note 10, at 215.

[29]*Id.* The majority could act, however, if given the power to do so by the unanimous consent of the shareholders. *See* MORAWETZ, *supra* note 24, at 48-49.

[30]*See* Kerbel, *supra* note 6, at 48.

[31]*See id.* at 47 (citing, for example, Taylor v. Griswald, 14 N.J. L. 222 (Sup. Ct. 1834)).

> There are various explanations for this rule . . . [a]t least insofar as the rule developed in English law, it came about by virtue of the courts' analogizing to the partnership rule where "it was long felt that members' rights to control through voting should be divorced from their purely financial interest in respect of dividends and capital, so that the equality should be between members rather than between shares."

Id. (citing L.C.B. GOWER, GOWER'S PRINCIPLES OF MODERN COMPANY LAW 403 (4th ed. 1979)). This per capita rule was applicable only in the absence of statutes to the contrary.

[32]Kerbel, *supra* note 6, at 48. In a report submitted by Alexander Hamilton regarding the voting procedures of the National Bank, he wrote:

> A vote for each share renders a combination between a few principal stockholders, to monopolize the powers and benefits of the bank, too easy. An equal vote to each stockholder . . . allows not that degree of weight to large stockholders which it is reasonable they should have, and which, perhaps, their security, and that of the bank require. A prudent mean is to be preferred.

Id.

[33]*Id.* The use of weighted voting was eventually abandoned for a variety of reasons. *See infra* note 84.

public in nature,[34] and few in number.[35] As a result of such characteristics, direct governance by the shareholders and oversight by the state was relatively easy. Furthermore, in the simple economy of the late eighteenth and early nineteenth centuries, most business was conducted either wholly by private contract, or through use of the increasingly popular partnership form of business organization.[36]

B. *The Aggregate Theory*

The fictional legal entity theory dominated American legal thought regarding corporations throughout the early part of the nineteenth century.[37] However, over time, and particularly during the period of Jacksonian reforms, most states adopted general incorporation statutes which allowed for automatic incorporation once a codified set of objective criteria were satisfied.[38] These statutes reduced the direct role

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[34]The early American states tended to confer charters on businesses that received state franchises (e.g., public utilities, transportation entities, financial concerns, such as banks and insurers, and water works) under the theory that such semi-public franchised businesses required a unique regulatory scheme outside of the market system. *See* HURST, *supra* note 15, at 15.

[35]Between 1780 and 1801, state legislatures in America only chartered a total of 317 business corporations. HURST, *supra* note 15, at 14.

[36]*Id.*

[37]Mark, *supra* note 16, at 1447-55. Although fictional entity is now a historical relic, its view of the corporation as a concession from the sovereign has influence on corporate theory even today. For example, the Supreme Court recently repeated the *Dartmouth College* "creature" dictum in a recent contracts case. *See* CTS Corp. v. Dynamics Corp. of Am., 481 U.S. 69, 89 (1987).

[38]Millon, *supra* note 10, at 206. Widespread public suspicion about favoritism and corruption in the granting of corporate charters led some critics to advocate the total abolition of incorporation altogether; however, some states attempted to defuse these concerns through constitutional provisions requiring a two-thirds legislative majority in favor of the granting of a charter. *Id.* at 208. A solution, around which reformers soon coalesced was the enactment of general incorporation laws which dispensed with the need for a special legislative act and, instead, ordained a simple procedure that could be followed by anyone seeking to incorporate, thereby eliminating most legislative discretion and the attendant possibility of monopolistic or other privilege which might be gained through favoritism. *Id. See generally* THOMAS G. FROST, A TREATISE ON THE INCORPORATION AND ORGANIZATION OF CORPORATIONS (1908) (explaining incorporation, the organization of corporations, and the incorporation acts of several states); HURST, *supra* note 15, at 33-47 (describing critics' views which support the total abolition of incorporation); Charles River Bridge v. Warren Bridge, 36 U.S. (11 Pet.) 420, 548-49 (1837) (explaining early corporate charter decisions which reason that the charter should be strictly construed); DEL. CONST. OF 1831, art. 2, § 17 (providing that Delaware require a two-thirds vote of each branch of legislature for an act of incorporation).

For the Jacksonian Democrats, opposition to special subsidies and support of general incorporation acts were parallel goals. Herbert Hovenkamp, *The Classical Corporation in*

of the state in the creation and functioning of corporations.[39] Consequently, as the popularity of viewing the corporation solely in terms of a grant of privilege by the sovereign diminished, corporate rules and governance also became increasingly distant from direct oversight by the government.[40]

The rise of codified, general incorporation statutes also meant that private business initiative, rather than political privilege or patronage, would play an increasingly important role in the formation and behavior of corporations.[41] As a result of this continually expanding corporate individualism, some theorists began to use partnership analogies to describe the corporation, thereby characterizing it "as an aggregate formed by private contracting among its human parts."[42] The aggregate theory did not admit the existence of a distinct corporate entity; rather, the corporation was an atomized construct, composed of the aggregate of its relational components, the most important of which being its shareholders.[43] This shift was subtle but important. The entity

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American Legal Thought, 76 GEO. L.J. 1593, 1635 (1988).

> The 1846 New York Constitution, a Jacksonian document, replaced the two-thirds vote requirement with an outright prohibition against the "credit of the state" being "given or loaned to, or in aid of any individual, association, or corporation." It replaced the two-thirds vote required for creating corporations — a relic of Jeffersonian hostility to business corporations in general — with a provision mandating general incorporation . . . .

Id. at 1635-36 (citing N.Y. CONST. OF 1846, art. VII, § 9 (1906)). By 1906, virtually every state had a similar provision in its constitution. JAMES M. GRAY, LIMITATIONS OF THE TAXING POWER 140-57 (1906) (providing a compilation of such state provisions).

[39]Bratton, *supra* note 1, at 1486 ("With equal access to the form assured, corporations no longer seemed a product of sovereign grace . . . ."); Mark, *supra* note 16, at 1456 ("By the beginning of the Gilded Age the state supplied only a corporation's robes . . . .").

[40]Phillips, *supra* note 16, at 1065.

[41]*Id.* *See also* Millon, *supra* note 10, at 208-11 (mentioning that early general incorporation statutes sometimes limited corporate powers similar to that of corporate charters).

[42]Phillips, *supra* note 16, at 1065; *see also* Bratton, *supra* note 1, at 1489-90 (explaining the aggregate approach where separate relationships comprised the corporation rather than a collective force); Horwitz, *supra* note 16, at 181-82, 184-86, 203-07 (discussing the corporation as an aggregate of individuals akin to the partnership); Mark, *supra* note 16, at 1457-64 (discussing the expansion of corporate rights while preserving the organizational structure of such by suggesting that the corporation is analogous to a partnership). This period also saw efforts to free corporations from other state corporate law regulations. Bratton, *supra* note 1, at 1490; Mark, *supra* note 16, at 1457.

[43]As one scholar noted, "[T]he existence of a corporation independently of its shareholders is a fiction; and . . . the rights and duties of an incorporated association are in reality the rights and duties of the persons who compose it, and not of an imaginary being." MORAWETZ, *supra* note 24, at 2. *See also* Bratton, *Nexus of Contracts*, *supra* note 16, at 423 (noting that aggregate theorists reject the existence of a meaningful corporate entity). Aggregate theorists seem most heavily influenced by the principle of what is today termed

component of the theory remained intact; however, it was no longer fiction, allowing the ideal to become slightly more concrete. For aggregate theorists, a "group or association is only a concept, a mental construct, used to classify different types of relationships between individuals."[44] Yet, the relationship is now among real individuals and actors and not merely a "legal fiction" created by the sovereign.

Under aggregate theory, the use of a unanimity rule for shareholder voting was both maintained and reinforced. Such a rule was considered the natural extension of the view that the corporation was merely a modified version of a partnership, with the shareholders as principals and the directors operating as their appointed agents.[45] The power of company management was regarded as being derived directly from the shareholders, as defined and restricted by charters and state corporation statutes.[46] These positive law provisions usually included management clauses which provided that the corporation's ordinary business affairs could be conducted by management and the board of directors.[47] Any decisions other than such routine business transactions were to be

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methodological individualism. *See, e.g.*, Coates, *supra* note 16, at 815 (explaining that aggregate theorists do not accept the concept of the corporation existing as an entity distinct from its constituent individuals and their relationships); Phillips, *supra* note 16, at 1066. This principle views the "ultimate constituents of the social world as individual people" in which every complex social situation, institution, or event is best seen as "the result of a particular configuration of individuals." *Id.* at 1067 (quoting J.W.N. Watkins, *Methodological Individualism and Social Tendencies*, *in* READINGS IN THE PHILOSOPHY OF THE SOCIAL SCIENCES 269, 270-71 (May Brodbeck ed., 1968)).

[44]ROBERT HESSEN, IN DEFENSE OF THE CORPORATION 41 (1979).

[45]*See* Dallas, *supra* note 13, at 6. Partnership law at the time required unanimous consent among the partners for decisions to be approved. *See id.* For early case law discussing the theory of early corporate/shareholder relations, see Chicago City Ry. Co. v. Allerton, 85 U.S. (18 Wall.) 233, 235 (1873) (holding that a corporation is like a partnership in that it is an association of national persons who contribute joint capital for a common purpose); New Orleans, Jackson & Great N. R.R. v. Harris, 27 Miss. 517, 537-38 (1854) (holding that the rule for partnerships is equally applicable to corporations in that the charter constitutes the fundamental articles of the association and cannot be altered without consent); Dayton & Cincinnati R.R. v. Hatch, 3 Ohio Dec. Reprint 501, 507 (1855) (comparing partnerships and corporations). *See generally* E. Merrick Dodd, Jr., *Dissenting Shareholders and Amendments to Corporate Charters*, 75 U. PA. L. REV. 585, 589 (1927) (discussing that the rules of majority control apply to corporations as well as partnerships). See also MORAWETZ, *supra* note 24, at 29 (analogizing corporate theory to that of partnerships).

[46]Dallas, *supra* note 13, at 7.

[47]*Id.* Early corporate charters often contained clauses which ceded to the board's broad management powers. *See* E. Merrick Dodd, Jr., *The Modern Corporation, Private Property, and Recent Federal Legislation*, 54 HARV. L. REV. 917, 918 (1941). The first general corporation statute in the United States, enacted in New York in 1811, contained such a management clause. Robert A. Kessler, *The Statutory Requirement of a Board of Directors: A Corporate Anachronism*, 27 U. CHI. L. REV. 696, 703 (1960).

concluded by the shareholders under a unanimous consent rule.[48] Given the aggregate view, applying a voting rule other than unanimity would constitute a "fraud" upon the other "members" of the corporation.[49]

Unanimity also remained the general rule due to the concern among aggregate theorists that a centralized concentration of power might fail to respect the wishes of those who, in essence, *were* the corporation.[50] In addition, aggregate theory seemed to require a unanimity rule, at least as an initial rule of decision,[51] since it was not possible to conceive of an aggregated entity acting in two different ways at the same time. A single corporation could only logically have one "true" will.[52] Thus, this concept partially explains why the *ultra vires* doctrine was considered so important in early American corporate law.[53] As the noted nineteenth century legal scholar Victor Morawetz stated in his widely read treatise on corporate law:

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[48]Dallas, *supra* note 13, at 8.

[49]Stevens v. Rutland & Burlington R.R., 29 Vt. 545, 548 (1851). During this period, the notion of majoritarianism seemed to have no transference from the political realm. *See* Mason v. Pewabic Mining Co., 133 U.S. 50, 59 (1890) (opining that "[s]o far as any legal right is concerned, the minority of the stockholders has as much authority to say to the majority as the majority has to say to them").

[50]*See* Dallas, *supra* note 13, at 5-6 (citing Horwitz, *supra* note 16, at 203-06). *See also* Kerbel, *supra* note 6, at 48 (noting that voting rights, in early corporate law, were weighted in proportion of the number of shares held per person). It is important to note how closely the shareholders' personality was considered to be to the corporate body. Essentially, this relationship was so close that it became difficult to conceive corporate existence beyond the lives of the shareholders. *See* 2 STEWART KYD, A TREATISE ON THE LAW OF CORPORATIONS (London 1794); Handlin & Handlin, *supra* note 18, at 22 (citations omitted) (stating "[t]hat a body framed by the policy of man, a body whose parts and members are mortal, should in its own nature be immortal . . . seems beyond the reach of common understanding").

[51]*See* Phillips, *supra* note 16, at 1083, n.131. Phillips gives a useful example of the reasoning used to support unanimity as the initial decision rule under aggregate theory:

> For example, suppose that the XYZ Corporation has 100 shareholders, that they are its only relevant components, and that a mere majority vote of the shareholders is required for some corporate action. Suppose also that 90 shareholders vote in favor of action A and 10 vote against it. If XYZ is the aggregate of its shareholders, how can the decision to undertake A be regarded as *its* decision? In other words, if XYZ Corporation equals 100 particular shareholders, by definition the decision of 90 shareholders is not *XYZ's* decision. However, this argument presumably would not hold where there was a pre-existing unanimous agreement to be bound by a majority vote.

Id.

[52]*See* Phillips, *supra* note 16, at 1083.

[53]*See* Millon, *supra* note 10, at 209. This doctrine provided that a corporation could not bind itself contractually where it went beyond the objectives of its charter. *Id.* Even unanimous shareholder consent could not validate an *ultra vires* act because shareholders were incapable of creating powers not defined by the state.

> It is a rule applying to all voluntary associations, that the majority have no power to represent the whole association in any matter which is outside of the purposes for which the association was formed. The majority of an association are not the association itself, but only a part of it; and their power to represent the entire body is derived wholly from the unanimous consent of its members. . . . Accordingly, it was held by Lord Eldon, in *Natush v. Irving*, that a large company formed for the purpose of carrying on the business of life insurance could not, against the will of a single shareholder, embark in the business of marine insurance.[54]

Morawetz further observed that the unanimity principal is particularly strong in cases of mergers, and that it is a fundamental part of the principal of contract, above even acts of the sovereign.[55]

> Upon the same principle [as ultra vires] it is well settled that corporations cannot be consolidated without the unanimous consent of their shareholders, even though the legislature should authorize the consolidation to be made; for a consolidation would work a fundamental change in the contract of the shareholders. An attempt to effect a consolidation by a majority vote, without the consent of every shareholder given through the charter or otherwise, is wholly nugatory . . . .[56]

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[54]MORAWETZ, *supra* note 24, at 46 (citations omitted). Morawetz also noted that "no majority of the shareholders of a corporation have the power to make a contract binding upon the company, unless authorized by its charter. Nor can the majority dispose of any portion of the corporate property of funds . . . ." *Id.* at 47 (citations omitted). Note the use of the word "majority" as a plural, emphasizing the popular conception of it as an aggregate of individuals, rather than a monolithic construct or a "oneness" or purpose. *See* AMERICAN HERITAGE DICTIONARY 788 (1979) (describing the cases of appropriate uses of the word "majority" as either a singular or plural verb).

[55]MORAWETZ, *supra* note 24, at 46-48.

[56]*Id.* at 49. *See also* Clearwater v. Meredith, 68 U.S. (1 Wall.) 25, 39-41 (1863) (holding that a stockholder cannot enter into the corporate contract and allow the purpose and character of the corporation to change at the will of a majority of the stockholders so that new responsibilities are added to the original undertaking); Kean v. Johnson, 9 N.J. Eq. 401, 409 (1853) (holding that where an individual acquires an interest in a corporation, that person is under no obligation for acts he did not consent to but the majority did); Abbot v. American Hard Rubber Co., 33 Barb. 578, 582-84 (N.Y. App. Div. 1861) (finding that the minority is bound by the acts of the majority only when those acts are consistent with the object and purpose of the corporation's charter); F. HODGE O'NEAL, OPPRESSION OF MINORITY SHAREHOLDERS § 5.03 (1975 & Supp. 1983) (explaining statutes governing fundamental

Although the majority still had the general power to act and run the company under the aggregate theory, such power was entirely derived from the corporate charter and unanimous shareholder consent.[57]

C. *The Corporation as a Real Entity*

Despite its popularity during most of the 1800s, the aggregate theory had largely disappeared as a legitimizing view of the corporate form by the end of the century.[58] Its demise was gradual and inexorably linked to the industrialization of the postbellum period.[59] The tremendous rise in the size of industrial corporations[60] largely made a "nostalgic

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corporate change which eliminate the unanimous shareholder consent as a prerequisite to fundamental changes).

[57]*See* MORAWETZ, *supra* note 24, at 358-75 (discussing the powers of the majority to act in a nineteenth century corporation). This doctrine was staunchly upheld by the courts. *See, e.g.*, Mason v. Pewabie Mining Co., 133 U.S. 50 (1890); Treat v. Hubbard-Elliott Copper Co., 4 Alaska 497 (D. Alaska 1912); State *ex rel.* Brown v. Bailey, 16 Ind. 46 (1861); McCray v. Junction R.R., 9 Ind. 358 (1857); Abbot v. American Hard Rubber Co., 33 Barb. 578 (N.Y. App. Div. 1861); People v. Ballard, 32 N.E. 54 (N.Y. 1892); Stevens v. Rutland & Burlington R.R., 29 Vt. 545 (1851).

[58]Phillips, *supra* note 16, at 1067. *See* Bratton, *supra* note 1, at 1490 (stating that "[c]ontractualism disappeared as a force in corporate legal theory after the turn of the century"); Horwitz, *supra* note 16, at 182 (noting that the real entity theory had largely triumphed over contractualist partnership models by 1900). State courts gradually began to abandon the unanimity requirement at the turn of the century. *See* Geddes v. Anaconda Copper Mining Co., 254 U.S. 590, 596 (1921); Metcalf v. American Sch. Furniture Co., 122 F. 115, 119 (W.D.N.Y. 1903); Butler v. New Keystone Copper Co., 93 A. 380, 383 (Del. Ch. 1915). State legislatures also began to follow suit. In 1884, a state statute allowed for amendments to a public utility company charter by less than unanimous consent. *See* Ervin v. Oregon Ry. & Navigation Co., 20 F. 577, 580 (S.D.N.Y. 1884). Later, statutes were adopted which conditioned fundamental corporate changes, such as mergers, on simple majority shareholder approval, subject to appraisal rights for any dissenters. *See* Millon, *supra* note 10, at 215. By 1927, at least 20 states had adopted such statutes. *Id.* at 215 n.65 (citing Joseph L. Weiner, *Payment of Dissenting Stockholders*, 27 COLUM. L. REV. 547, 548 n.7 (1927)).

[59]Initial indications of the transformation were seen earliest among the railroads, the first truly large American corporation. *See* Sprague v. Illinois River R.R., 19 Ill. 174, 181 (1857) (holding that charters which lacked specific unanimity requirements evidence an acquiescence by the shareholders to majority rule). *But see* Clearwater v. Meredith, 68 U.S. (1 Wall.) 25 (1864) (finding that unanimity was the default rule of decision). Some large corporations, such as the New York Central Railroad, adopted supermajority rules, such as a two-thirds requirement, for fundamental changes; however, unanimity remained the norm outside of the railroad industry during this period. *See* FRANK W. STEVENS, THE BEGINNINGS OF THE NEW YORK CENTRAL RAILROAD: A HISTORY 358-61 (1926) (discussing the two-thirds voting rule required by the New York Central Railroad (NYCR) to effect a consolidation).

[60]These developments coincided with the changing character of American shareholders, from individual entrepreneurs to groups of numerous public investors, and the desire of state legislatures to facilitate corporate development and growth. Dallas, *supra* note 13, at 6.

fantasy"[61] of the notion that a corporation, now operating across vast geographic areas and comprised of thousands of shareholders, was merely the embodiment of the contractual identities of its individual parts, not in possession of an independent identity of its own.[62] Additionally, the notion that one shareholder could effectively veto corporate actions began to be seen as both "immoral" and against the common good.[63] These changes necessitated a new vision of the corporation; one which began to take its nascent form during the 1880s with the realization that management, not shareholders, were the real decision-makers in large publicly owned enterprises.[64]

What emerged from this transition caused a radical transformation in thinking that mirrored the vast changes in the commercial world of the time. The rise of the "real entity" theory maintained that a corporation was a "real thing" — a being with attributes not found among the shareholders who constitute its corpus.[65] In pure form, an independent being, such as a corporation, was viewed as analogous to any organism:

> [The corporation] is no fiction, no symbol, no piece of the State's machinery, no collective name for individuals, but a living organism and a real person, with body and members

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[61]Phillips, *supra* note 16, at 1067 (citing Horwitz, *supra* note 16, at 206).

[62]*See* Millon, *supra* note 10, at 214. Millon states:

> Rejection of the aggregate theory . . . was not due to rejection of its private property rights foundation. Instead, developments in the internal relationship between management and shareholders rendered the partnership analogy untenable. Growth in the size of corporations and dispersal of share ownership resulted in the phenomenon later described as the separation of ownership and control. . . . One of the most salient features of this development was the prevention of active participation by shareholders in the management of the business. As a practical matter, dispersed share ownership, small individual holdings, and increasingly complex operations transformed shareholders from entrepreneurs into passive investors who placed their economic interests in the hands of professional managers.

Id.

[63]*See* Carney, *supra* note 13, at 80-82.

[64]Horwitz, *supra* note 16, at 206. Professor Dallas has suggested that courts began using entity discourse as early as 1855. Dallas, *supra* note 13, at 9 (noting Dayton & Cincinnati R.R. v. Hatch, 3 Ohio Dec. Reprint 501, 507 (1855), in which the court employed "entity language in reaching its decision").

[65]Bratton, *supra* note 1, at 1475 (stating that entity theory supposes that a corporation is a real thing with an existence separate from the existences of those individuals connected to it); Horwitz, *supra* note 16, at 218 (noting that entity theorists viewed the corporation as separate and distinct from shareholders); Martin Wolff, *On the Nature of Legal Persons*, 54 LAW Q. REV. 494, 499-500 (1938) (explaining that organic theorists consider social organisms to be entities that retain their identity even as their component parts change).

> and a will of its own. Itself can will, itself can act; it wills and acts by the men who are its organs as a man wills and acts by brain, mouth and hand. It is not a fictitious person; . . . it is a group-person, and its will is a group-will.[66]

In keeping with the scientific confidence of the time, theorists even attempted to externalize the legitimacy of the real entity theory by demonstrating its validity through mathematical proof[67] and synergistic theorem.[68] Such proof and theory purported to show the inherent logic of viewing the "personality" of the corporation in organic form.[69]

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[66]OTTO GIERKE, POLITICAL THEORIES OF THE MIDDLE AGE xxvi (Frederic William Maitland trans., 1927) (1990) (translators introduction) (describing the corporation as a personification of "German fellowship"). This was a favorite theme of Gierke, who frequently employed it in his work. *See* OTTO GIERKE, DIE GENOSSENSCHAFTSTHEORIE UND DIE DEUTSCHE RECHTSPRECHUNG 637 (Berlin, 1887) (stating that the corporation can have no collective will independent from that of its component members). Yet, not all entity theorists would have agreed with such an analogy. In responding to Gierke, Phillips noted that many "exponents of the real entity theory, however, have decidedly less organicist conceptions of the corporation." Phillips, *supra* note 16, at 1069.

[67]Arthur Machen attempted to justify corporate legitimacy by mathematical proof in 1911. *See* Arthur W. Machen, Jr., *Corporate Personality*, 24 HARV. L. REV. 253, 259 (1911); *see also* Phillips, *supra* note 16, at 1103-05 (discussing the Machen study). In doing so, Machen noted that "any group whose membership is changing, is necessarily an entity separate and distinct from the constituent members" and this assertion "may be demonstrated mathematically." Machen, *supra*, at 259 & n.8.

[68]*See* W. Jethro Brown, *The Personality of the Corporation and the State*, 21 LAW Q. REV. 365, 366 (1905) (asserting that "the whole is more than its parts" in the case of corporate form). *See also* KARL POPPER, THE POVERTY OF HISTORICISM 82 (paperback ed. 1961) (maintaining that aggregating individual parts causes synergy because relationships are established which would not exist in a world where such parts were separate).

[69]Early in this century, there was considerable interest in debating the idea of the corporate "personality." *See generally* Brown, *supra* note 68 (explaining that the law will recognize a person in an entity when the law attributes rights or duties to such entity); George F. Canfield, *The Scope and Limits of the Corporate Entity Theory*, 17 COLUM. L. REV. 128 (1917) (asserting that the corporation is not a "person" and the "personality" of the group exists only as a legal conception); George F. Deiser, *The Juristic Person*, 57 U. PA. L. REV. 131 (1909) (describing the corporation as having positive and negative attributes regardless of whether it is deemed a person); Dewey, *supra* note 22 (concluding that the law perceives the notion of "person" as a legal conception); W.M. Geldart, *Legal Personality*, 27 LAW Q. REV. 90 (1911) (describing the history of the personality of the corporation); Harold J. Laski, *The Personality of Associations*, 29 HARV. L. REV. 404 (1916) (discussing the corporate personality and its limitations); Machen, *supra* note 67, at 347 (describing a corporation as a real but impersonal entity and discussing the best method of studying the doctrine of corporate personality); Max Radin, *The Endless Problem of Corporate Personality*, 32 COLUM. L. REV. 643 (1932) (discussing the corporation's "personality"); Bryant Smith, *Legal Personality*, 37 YALE L.J. 283 (1928) (discussing the corporation as a legal person and its limitations); Vinogradoff, *supra* note 22 (asserting that the life of groups have two sides: the social contents

Notwithstanding such attempts, the ascendence and triumph of the real entity theory may have been partially due to its alignment with the commercial interests of the time. In an age of robber barons, monopolies, trusts, and moguls, the real entity theory allowed for an unprecedented concentration of power to shift to the management of the corporation.[70] Part of this shift occurred when the use of the unanimity decision rule was discarded and replaced by the simple majority rule, which viewed fifty percent plus one as sufficient to conclude company business.[71] This change was due, in part, to the fact that the real entity conception viewed the company as uniquely distinct from its shareholders.[72] Accordingly, the entity's view must be homogenous, since there is only one entity; thus, its "true" or "appropriate" view can most easily be identified with a simple majority rule.[73] This notion of homogeneity is similar to that seen in the political realm, where one government represents all the people. As a result of such theory, the shareholder now merely contributes equity to the corporation, rather than his or her personality.

In his seminal 1985 work on corporate law, Morton Horwitz contended that the real entity theory was a major factor in legitimizing big business and allowing for the consolidation of commercial power during the late nineteenth and early twentieth centuries.[74] He sees the

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and the legal form); Wolff, *supra* note 65 (asserting that a theory concerning the nature of legal persons should cover all entities which enjoy artificial personalities).

[70]*See generally* Phillips, *supra* note 16, at 1067-70 (citing Horwitz who opined that real entity theory reflected that "management, not the shareholders, were the real decision makers" in large corporate enterprises).

[71]The shift to a simple majority rule created the opportunity for abuse of the minority shareholders, resulting in the first use of the term "freezing out." *See* Theis v. Spokane Falls Gaslight Co., 74 P. 1004, 1006 (Wash. 1904). Minority protection thus fell to the courts and appraisal rights. *See* MacArthur v. Port of Havana Docks Co., 247 F. 984, 991 (D. Me. 1917) (granting a preliminary injunction to halt a merger where there was a question of whether the majority attempted to advance their own interests at the expense of the minority shareholders); *see also* Millon, *supra* note 10, at 215 (referring to this transformation in applicable voting rules).

[72]*See* Phillips, *supra* note 16, at 1068 & n.46 (distinguishing real entity theory by noting that it views the corporation as "a being with attributes not found among the humans who are its components").

[73]*See* Horwitz, *supra* note 16, at 200, 218. *See also* HENN & ALEXANDER, *supra* note 16, at 346, 983-84 (explaining that the corporation is generally viewed as a legal entity, requiring majority consent of the shareholders for changes, such as mergers and consolidations).

[74]Horwitz, *supra* note 16, at 221. Horwitz rejects the notion of legal indeterminacy put forth by some, including certain Critical Legal Studies scholars, thus viewing the law as considerably more organic. *Id.*; *see also supra* note 12 and accompanying text which refers to the Critical Legal Studies movement. His article is an analysis of the ascendance of real entity theory through a sort of quasi-neo-marxist lens. Horwitz stated that "in particular

real entity theory as a base justification for the emergence of management-dominated, bureaucratic firms and their increased freedom of action.[75] Horwitz asserted that this transformation occurred in six areas of corporate law,[76] including the shift to a majority decision rule for shareholder consent of major corporate decisions, such as votes on mergers and acquisitions.[77]

While the shift to entity theory saw other changes in shareholder voting rights,[78] none was more important than the shift to majority rule. Once the unanimity requirement was eliminated, power was directly

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contexts the choice of one theory over another is not random or accidental because history and usage have limited their deepest meanings and applications." Horwitz, *supra* note 16, at 176. *But see* Hager, *supra* note 16, at 580-81 (arguing against any intentional use of real entity theory to transfer power to big business, noting that the progressives of the time viewed it as part of a reform effort that would *counter* the power of large corporations).

[75]Horwitz, *supra* note 16, at 220-24. William Carney, however, would disagree with Horwitz's rationale. Carney views the evolution from unanimity to majority rule in corporate America as a legal process which allowed a narrow exception — the use of majority voting to wind up an insolvent business — to gradually apply to an increasing number of circumstances. Carney, *supra* note 13, at 86-90. As a result, the exception became the rule. *Id.* "Having once carved an exception for cases that might have been regarded as involving the principle of frustration of contract, the courts found themselves sliding ineluctably toward majoritarianism in major corporate decisions involving shareholders." *Id.* at 89-90. Such a judicial slippery slope argument is far less deterministic that Horwitz's theory, at least as enunciated by Carney.

[76]Horwitz, *supra* note 16, at 223-24. The other areas of corporate law which Horwitz refers to include: "Changes in the conception of the shareholder from active 'owner' to passive 'investor'"; "the weakened position of the shareholders in internal corporate governance"; "the distinction between corporations and partnerships"; "the foreign corporation doctrine's reversal"; and the legitimization of "the practices of emergent large scale business enterprise." *Id.*

[77]Horwitz, *supra* note 16, at 223.

> During its "liberal incorporation" phase, lasting from around 1890 to 1930, corporate law facilitated the management corporation's successful appearance. New Jersey, and then Delaware, enacted new general incorporation acts in an effort to attract the charters of the large corporations. These new acts facilitated managerial action by offering standardized corporate structures without ancillary regulation of business decisions. Although nineteenth century forms of shareholder participation stayed in the statutes, shareholders did not invoke them to challenge management arrangements.

Bratton, *supra* note 1, at 1489.

[78]*See* Carney, *supra* note 13, at 89. The other two changes, which are not particularly important in the context of this article, were "the development of limited shareholder voting rights in favor of exclusive statutory powers in managers, and the disappearance of weighted voting, which limited voting rights by reference to the number of shares held by an individual shareholder, to be replaced by one share-one vote." Dallas, *supra* note 13, at 6 (footnotes omitted); Horwitz, *supra* note 16, at 214-22 (discussing changes in the corporate entity and the power of directors in light of the natural entity theory); Kerbel, *supra* note 6, at 49 (citing 2 JOSEPH S. DAVIS, ESSAYS IN THE EARLIER HISTORY OF AMERICAN CORPORATIONS 217, 323-24 (1917)).

transferred to the board.[79] Directors were no longer merely "agents" of the shareholders and their power was now considered "original and undelegated."[80] The courts construed the powers that management clauses granted directors as being neither conferred nor revocable by shareholders.[81] In addition, these clauses were interpreted as granting authority over most corporate decisions exclusively to the board.[82] "[A]s the fear of power residing in the few lessened, weighted voting gave way to a one share-one vote system."[83] By 1912 most shares carried a single vote,[84] and true majority rule was the norm.[85]

D. *Theoretical Interregnum*

Throughout most of the twentieth century, voting rights were a result of entity theory thinking,[86] despite a decline in the acceptance of

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[79]Dallas, *supra* note 13, at 9.

[80]Horwitz, *supra* note 16, at 216 (quoting Manson v. Curtis, 119 N.E. 559 (N.Y. 1918)). The effects of this shift on stockholders would soon become apparent. In the 1930s, Berle and Means popularized the thesis that the separation of managerial decision making from the scrutiny of dispersed shareowners in the large corporation lessened managerial concern for shareholders' interests. Bratton, *supra* note 1, at 1493. *See* Continental Sec. Co. v. Belmont, 99 N.E. 138, 141 (N.Y. 1912) (holding that stockholders can bring action against a corporation when the corporate body has neglected affairs or refused to act); People *ex rel.* Manice v. Powell, 94 N.E. 634, 637 (N.Y. 1911) (stating that individual directors of a corporation have a duty to act according to their best judgment and, as a general rule, shareholders cannot control directors in their exercise of that judgment "vested in them by virtue of their office"); Hoyt v. Thompson's Ex'r, 19 N.Y. 207, 216 (1859) (stating that as a private principal, the board of directors can delegate its authority to agents or committees).

[81]*Whitfield*, 184 A. at 341; *Hoyt*, 19 N.Y. at 216.

[82]*Whitfield*, 184 A. at 341; *Manson*, 119 N.E. at 562; *Continental Sec. Co.*, 99 N.E. at 141; *Powell*, 94 N.E. at 637.

[83]Dallas, *supra* note 13, at 10.

[84]*Id.*; Kerbel, *supra* note 6, at 48-49 (discussing five reasons which accounted for the shift away from weighted voting to a one person-one vote system, including the adoption of the real entity perspective of the corporation).

[85]In 1908, a dramatic departure from nineteenth century corporate thinking occurred when a court ruled that it was not justified in interfering with the decision of a majority of shareholders when such shareholders have acted in good faith. *See* Colby v. Equitable Trust Co., 108 N.Y.S. 978 (N.Y. App. Div. 1908); *aff'd mem.*, 84 N.E. 1111 (N.Y. 1908). Many states, however, continued to require supermajority votes in certain instances, for example, "fundamental changes," unless a different rule was specifically provided for within the corporate charter. It was not until 1962 that the Model Business Act abandoned its two-thirds requirement in favor of simple majority rule. ABA MODEL BUSINESS CORP. ACT ANN. §§ 78-79, ¶ 2 (2d ed. 1971). Delaware shifted from a two-thirds requirement to majority rule in 1967. DEL. CODE ANN. tit. 8, § 25 (1974 & Supp. 1978).

[86]*See* Coates, *supra* note 16, at 829-35 (contending that the real entity theory is implicit in the managerialist theorizing that dominated scholarship on corporations for much of this

the theory in the 1920s, when the consequentialism of scholars, such as Thomas Dewey[87] and others,[88] pervaded corporate legal theory, increasingly reducing the field to a nonlegitimizing aggregation of instrumentalist ideas.[89] The rise of legal realism and its effects on legal "justification" showed the real entity theory to be as objectively hollow as its predecessors. As Professor Michael Phillips noted: "During and after the 1920's, scholars increasingly refused to resolve practical legal questions by deducing solutions from some theory of the corporation. Instead, they assessed competing rules by looking to their consequences."[90]

By the 1960s, the pronouncement of one corporate legal scholar[91] seemed to summarize activity within the discipline. "Corporation law, as a field of intellectual effort, is dead in the United States."[92] During this period, the inertia of real entity theory concepts and established practice as well as the popularity of absolutist majority theory in the political

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century); Dallas, *supra* note 13, at 5.

[87]*See* Dewey, *supra* note 22, at 660-61 (noting that it was irrelevant whether an entity, such as a corporation, was "real" or "unreal" because "a thing is — is defined as — what it does, 'what-it-does' being stated in terms of specific effects extrinsically wrought in other things"). Dewey's article has been identified as the milepost which marks the end of traditional corporate theory. *See* Bratton, *supra* note 1, at 1493 (remarking that "Dewey's 1926 essay marked the end of the corporate realist discourse and of corporate theory articulated in traditional terms"). For a discussion of this line of thought and real entity thinking, see Phillips, *supra* note 16, at 1074-81.

Another reason for the demise of corporate theorizing may have been frustration. As one scholar noted years earlier, although there was general agreement as to the corporation's "practical requirements," the conflicting theories of the corporation had become "apparently irreconcilable." ERNST FREUND, THE LEGAL NATURE OF CORPORATIONS 14 (Chicago 1896).

[88]*See generally* Smith, *supra* note 69 (discussing the theories of legal personality of such scholars as Gray, Salmond, and Corbin); Robert S. Summers, *Pragmatic Instrumentalism in Twentieth Century American Legal Thought — A Synthesis and Critique of Our Dominant General Theory About Law and its Use*, 66 CORNELL L. REV. 861 (1981) (discussing legal theorists' views regarding pragmatic instrumentalism); Vinogradoff, *supra* note 22 (discussing business entities as juridical persons).

[89]*See* Bratton, *supra* note 1, at 1493.

[90]Phillips, *supra* note 16, at 1070.

[91]*See* Bayless Manning, *The Shareholder's Appraisal Remedy: An Essay for Frank Coker*, 72 YALE L.J. 223, 245 n.37 (1962).

[92]*Id.*

realm[93] each helped to maintain simple majority rule as the norm in corporate shareholder voting.

E. *The Nexus-of-Contract Theory*

Around 1980,[94] the relative vacuum of corporate legal theory,[95] which had existed since the demise of the real entity conception, began to be filled by a concept that viewed the corporation as a "nexus-of-contracts" between the relevant actors.[96] With a lineage traceable to the

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[93]*See* Neal Riemer, *The Case For Bare Majority Rule*, 62 ETHICS 16, 17 (1951) (noting that "[e]ven the stipulation that no decision shall be taken unless supported by an extraordinary or qualified majority . . . must be rejected because this is to permit a minority . . . to rule indirectly by veto"). *See also* AUSTIN RANNEY & WILLMOORE KENDALL, DEMOCRACY AND THE AMERICAN PARTY SYSTEM 37 (1956) (stating that no "formal institutional limitations" can be legitimately placed on the power of popular majorities); J. ALLEN SMITH, THE SPIRIT OF AMERICAN GOVERNMENT 356 (Cushing Strout ed., 1912) (remarking that the will of the majority ought to be the supreme law of the land).

[94]*See* Bratton, *supra* note 1, at 1476; Millon, *supra* note 10, at 229.

[95]*See* Phillips, *supra* note 16, at 1073 (noting that "American legal scholars from roughly 1930 to 1980 did little explicit theorizing about the nature of corporations"). Phillips contends that this inactivity was due to theories, such as Dewey's, which denied significance to any one corporate theory, believing that its precepts would be contradictory while its consequence indeterminate. *Id.* at 1073-80. *See also* Dewey, *supra* note 22 (discussing the historic background of the corporate legal personality). This view is, of course, alive among contemporary legal scholars who argue that legal concepts are infinitely "flippable." *See generally* Clark, *supra* note 12 (paraphrasing comments on the Critical Legal Studies movement); Frug, *supra* note 12 (critiquing the legal doctrines that perpetuate bureaucracy in American law); Hazen, *supra* note 12 (discussing the relation between corporate persona and contract theory); Simon, *supra* note 12 (discussing the distinction between contracts and politics in corporate doctrine). For a discussion of the "power coalition theory" of the corporation, a left leaning alternative of the nexus-of-contract conception, see Dallas, *supra* note 13, at 33-34.

[96]The work on this conception of corporate legitimacy is now extensive. *See, e.g.*, FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW, ch. 1 (1991); ROBERT HESSEN, IN DEFENSE OF THE CORPORATION (1979); NICHOLAS WOLFSON, THE MODERN CORPORATION: FREE MARKETS VS. REGULATION (1984); Barry D. Baysinger & Henry N. Butler, *Antitakeover Amendments, Managerial Entrenchment, and the Contractual Theory of the Corporation*, 71 VA. L. REV. 1257 (1985); Lucian A. Bebchuk, *Foreword: The Debate on Contractual Freedom in Corporate Law*, 89 COLUM. L. REV. 1395, 1408 (1989); Henry N. Butler, *The Contractual Theory of the Corporation*, 11 GEO. MASON U. L. REV. 99, 110-20 (1990); Henry N. Butler & Larry E. Ribstein, *The Contract Clause and the Corporation*, 55 BROOK. L. REV. 767 (1989); Henry N. Butler & Larry E. Ribstein, *Opting Out of Fiduciary Duties: A Response to the Anti-Contractarians*, 65 WASH. L. REV. 1 (1990); John C. Coffee, Jr., *No Exit?: Opting Out, The Contractual Theory of the Corporation, and the Special Case of Remedies*, 53 BROOK. L. REV. 919 (1988); Daniel R. Fischel, *The Corporate Governance Movement*, 35 VAND. L. REV. 1259 (1982); Jeffrey N. Gordon, *The Mandatory Structure of Corporate Law*, 89 COLUM. L. REV. 1549, 1549 (1989); David D. Haddock et al., *Property Rights in Assets and Resistance to Tender Offers*, 73 VA. L. REV. 701

field of economics[97] and a distinct paternal relationship to aggregate theory,[98] the nexus-of-contracts approach was not wholly new; however, its acceptance among legal scholars in the 1980s had a considerable effect on the conception of the corporation.[99] Although this approach seemingly caused a "revolution"[100] in the field of corporate theory, it has not been unanimously accepted.[101]

The nexus-of-contract theory ascended in hand with the Law and Economics movement, emphasizing individual determinism at its core.[102] The theory views the corporation merely "as a connected group or series of contracts freely bargained for among the firm's participants" (e.g.,

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(1987); Larry E. Ribstein, *Limited Liability and Theories of the Corporation*, 50 MD. L. REV. 80, 84 (1991).

[97]*See* Ronald H. Coase, *The Nature of the Firm*, *in* READINGS IN PRICE THEORY 331 (Kenneth E. Boulding & George J. Stigler eds., 1952), *reprinted in* 4 ECONOMICA (n.s.) 386 (1937); Oliver Hart, *An Economist's Perspective on the Theory of the Firm*, 89 COLUM. L. REV. 1757 (1989); Phillips, *supra* note 16, at 1071 n.65 (stating that "[a] 1937 article by Ronald Coase is almost universally regarded as the seminal work underlying the nexus-of-contracts theory").

[98]*See* Millon, *supra* note 10, at 229 (discussing the nexus-of-contract theory's "reliance on economic analysis and vocabulary [as] novel developments, but [its] aggregate, shareholder-centered foundation [as] not"). *See also* Bratton, *supra* note 1, at 1472 n.12 (noting that "[m]any of the [nexus-of-contract] theory's basic conceptual elements — for example, classical economic assumptions, political individualism, and antipositivism — have figured into past legal theories of the firm").

[99]Phillips, *supra* note 16, at 1071 (citations omitted).

[100]*See* Lewis A. Kornhauser, *The Nexus of Contracts Approach to Corporations: A Comment on Easterbrook and Fischel*, 89 COLUM. L. REV. 1449, 1449 (1989) (stating that "a revolution, under the banner 'nexus of contracts,' has in the last decade swept the legal theory of the corporation"). For concurrences of varying degrees, see Bebchuk, *supra* note 96, at 1408 (noting that nexus-of-contract theory is now well accepted among economists and many legal scholars); Robert C. Clark, *Contracts, Elites, and Traditions in the Making of Corporate Law*, 89 COLUM. L. REV. 1703, 1705 (1989) (acknowledging that nexus-of-contract thinking is now predominant among most economists and law and economics oriented corporate scholars); Gordon, *supra* note 96, at 1549 (discussing how nexus-of-contracts has become the accepted standard in law and economics).

[101]For examples of anticontractarian commentary, see Lucian A. Bebchuk, *Limiting Contractual Freedom in Corporate Law: The Desirable Constraints on Charter Amendments*, 102 HARV. L. REV. 1820 (1989); Victor Brudney, *Corporate Governance, Agency Costs, and the Rhetoric of Contract*, 85 COLUM. L. REV. 1403 (1985); Robert C. Clark, *Agency Costs Versus Fiduciary Duties*, *in* PRINCIPALS AND AGENTS: THE STRUCTURE OF BUSINESS (J. Pratt & R. Zeckhauser eds. 1985); Clark, *supra* note 100; Kornhauser, *supra* note 100.

[102]*See* Bratton, *Nexus of Contracts*, *supra* note 16; Millon, *supra* note 10, at 229 & n.113 (describing this contractual view as "shareholder-centered"). The nexus-of-contract movement was sparked by two oft-cited works. *See* Alchian & Demsetz, *Production, Information Costs, and Economic Organization*, 62 AM. ECON. REV. 777 (1972); Jensen & Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs, and Ownership Structure*, 3 J. FIN. ECON. 305 (1976).

shareholders, suppliers, employees, debt holders, management).[103] Such contractual terms include those found in the corporate charter and articles of incorporation, as well as contracts with "participants" and contracts associated with debt and equity instruments, or those set by applicable law, treaty, or agreement.[104] For contractualists, positive corporate law should merely be enabling legislation; a platform from which corporations can be launched, with most terms and conditions[105] subject to bargaining and revision by the contracting parties themselves.[106]

The traditional concern regarding the potential for minority shareholders to be treated unfairly had not completely vanished as a result of contractualism, yet, the right of appraisal was now seen as the most appropriate remedy, becoming an obvious option for a shareholder who now merely holds nothing more than a contractual claim against the assets of the company.[107] Under a nexus-of-contracts regime, there is no inherently correct, natural, or logical decision rule directly derivable from the theory; rather, the optimal voting rule is obtained from bargaining among the firm's participants.[108]

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[103]*See* Bebchuk, *supra* note 96, at 1397; Phillips, *supra* note 16, at 1071. As an aggregate based theory, nexus-of-contracts implicitly rejects the logic of the real entity theory. *See, e.g.*, MICHAEL KEELEY, A SOCIAL-CONTRACT THEORY OF ORGANIZATIONS 48, 230 (1988) (rejecting organicist based conceptions of organizations, while conceding the existence of irreducible group properties). The shift from a relational or identity based theory of the corporation to one grounded in contract law has deep historical roots that extend well beyond the limits of corporation law or the scope of this article. *See* SIR HENRY SUMNER MAINE, ANCIENT LAW: ITS CONNECTION WITH THE EARLY HISTORY OF SOCIETY AND ITS RELATION TO MODERN IDEAS 163 (4th Amer. ed., 1906) (noting the historical movement of legal ideas from familial based relationships to ones of free agreement between increasingly anonymous parties).

[104]*See generally* EASTERBROOK & FISCHEL, *supra* note 96 (discussing the economic structure of corporate law in terms of contract theory). For further discussion of the nexus-of-contract theory, see Phillips, *supra* note 16, at 1070-73.

[105]There is some disagreement as to which, if any, contractual terms should be off limits to subsequent revision notwithstanding clauses allowing for future modifications of the original agreements. *See* John C. Coffee, Jr., *The Mandatory/Enabling Balance in Corporate Law: An Essay on the Judicial Role*, 89 COLUM. L. REV. 1618, 1674-76 (1989); Gordon, *supra* note 96, at 1574-85.

[106]*See* Butler & Ribstein, *Opting Out*, *supra* note 96, at 7 (noting that state law is merely a standard form that the parties are free to accept or reject through bargaining and negotiation under a contractualist view of the corporation); Fred S. McChesney, *Economics, Law, and Science in the Corporate Field: A Critique of Eisenberg*, 89 COLUM. L. REV. 1530, 1536-37 (1989) (discussing the debate between contractarians and coercionists over whether state corporation codes can be overridden by private agreement).

[107]*See* Carney, *supra* note 13, at 71 (noting that the appraisal remedy has become, for practical purposes, the only protection for minority shareholders, except in cases where the majority violates state law).

[108]It should be remembered that since the rise of entity theory, shareholder voting has been somewhat arbitrary in that there are many important decisions that are made in the life

F. *The Rise of Corporate Supermajority Voting*

This new found freedom to legitimize through contract quickly proved useful, for it was during the late 1970s and into the 1980s that an unprecedented wave of corporate merger and acquisition activity began to dominate U.S. equity markets.[109] Much of the early merger and acquisition (M&A) activity was unsolicited by corporate management, who responded by adopting a variety of defensive tactics in an effort to thwart unwanted changes in control.[110] In particular, supermajority voting requirements, together with its more sophisticated cousin, the fair price provision,[111] became a particularly popular defensive takeover mechanism.[112]

Simple supermajority provisions appeared first, usually in the form of charter amendments, requiring the affirmative vote of at least two-thirds or more of the company's shareholders for the approval of merger or acquisition.[113] The justification most often offered by management for the adoption of a supermajority decision rule was the protection of minority shareholders from coercive, front-end loaded, two tier tender

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of a corporation which are not submitted to the shareholders for a vote. *See* Dallas, *supra* note 13, at 26-32 (stating that "shareholder [voting] rights are not based on a coherent system in which shareholders have the right to vote on [all] fundamental or structural changes").

[109]The use of tender offers to gain such control was not, however, a new tactic. *See* Henry G. Manne, *Mergers and the Market for Corporate Control,* 73 J. POL. ECON. 110, 116-17 (1965).

[110]*See* IRRC CORPORATE TAKEOVER DEFENSES iv (IRRC 1995); Ronald J. Gilson, *A Structural Approach to Corporations: The Case Against Defensive Tactics in Tender Offers,* 33 STAN. L. REV. 819, 831-48 (1981); David W. Leebron, *Games Corporations Play: A Theory of Tender Offers,* 61 N.Y.U. L. REV. 153 (1986).

[111]*See infra* notes 119-20 and accompanying text for a discussion of this concept.

[112]*See generally* Carney, *supra* note 13, at 100-31 (discussing the benefits of the two-step merger); Leebron, *supra* note 110, at 92 (espousing the benefits of tender offers versus that of mergers); Gilson, *supra* note 110, at 831-48 (arguing for management discretion to defensively block tender offers). Other defensive mechanisms included the creation of multiple classes of stock, rights to purchase stock (poison pills), employee severance benefits packages (golden and tin parachutes), staggered board of director seats, and reincorporation. *See generally id.* and IRRC CORPORATE TAKEOVER DEFENSES, *supra* note 110.

[113]These voting rules typically required a two-thirds or greater vote of all shareholders to approve an acquisition or merger of the company. *See* Harry DeAngelo & Edward M. Rice, *Antitakeover Charter Amendments and Stockholder Wealth,* 11 J. FIN. ECON. 329, 331 (1983) (noting that "[m]ost supermajority provisions stipulate stockholder approval percentages in the $66^2/_3$ — 80 percent range, although some have required as much as 95 percent"); Stuart R. Cohn, *Tender Offers and the Sale of Control: An Analogue to Determine the Validity of Target Management Defensive Measures,* 66 IOWA L. REV. 475, 481 (1981) (explaining that "[s]upermajority provisions typically range from two-thirds to as much as ninety percent").

offers.[114] This justification resonated in the minds of minority shareholders and the tactic quickly gained popularity.[115] As in the past, the use of supermajority voting was championed as a protector of minority rights.[116] Given the influence of latter day, twentieth century scholarship, however, it is now seen in a purely instrumentalist perspective, without any rhetorical appeals to a "natural" result flowing from an underlying corporate theory.

It was not long before critics of supermajority voting charged that such rules not only offered little, if any, protection to minority shareholders, but also had the ancillary effect of entrenching or unjustly enriching corporate management by discouraging legitimate offers for the company by making them more expensive.[117] This argument is analogous to similar criticisms offered against supermajority voting in the political arena, which assert that such decision rules do little to protect minorities while also encouraging an inertia in public policy that is difficult, and costly, to overcome.[118] In the corporate world, the answer to this charge

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[114]*See generally* Robert A. Prentice, *Front-End Loaded, Two-Tiered Tender Offers: An Examination of the Counterproductive Effects of a Mighty Offensive Weapon*, 39 CASE W. RES. L. REV. 389 (1989) (arguing that front-end loaded two tier tender offers have declined in recent years due to their coercive and unfair nature).

[115]IRRC CORPORATE TAKEOVER DEFENSES, *supra* note 110, at iv.

[116]*See generally* Debra D. Palmer, Note, *Corporate Takeover Battles—Shark-Repellent Charter and Bylaw Provisions that Deter Hostile Tender Offers or Other Acquisitions — A Comprehensive Examination*, 27 HOW. L.J. 1683, 1729 & n.223 (1984) (noting that supermajority voting protects the minority by giving them "a greater opportunity to participate in the governance of the corporation due to their ability to prevent an action"). The tremendous growth in the size of the corporation as well as the number of shareholders probably extinguished any thought of returning to the unanimity rules of the nineteenth century given the obvious potential for holdout rent seeking.

[117]*See generally* Cohn, *supra* note 113, at 516-20 (noting that supermajority provisions can "unreasonably restrain" future transactions desired by the majority while also being irresponsive to economic change in condition); DeAngelo & Rice, *supra* note 113, at 332-35 (explaining that antitakeover mechanisms, such as supermajority rules, "primarily act to increase incumbent management's job protection and decision making at the expense of current stockholders).

[118]Baysinger & Butler, *supra* note 96, at 1291.

> Typical antitakeover charter and bylaw amendments make transfers of corporate control difficult without explicit approval of the firm's management and board of directors. In this respect, antitakeover amendments are analogous to supermajority requirements for overriding presidential vetoes. Both procedural requirements frustrate some members, often more than a majority, of the collectivity.

Id. Court challenges to the board of directors' power to determine the applicable voting rules have been unsuccessful. *See* Siebert v. Gulton Indus., Inc., No. 79-5631 (Del. Ch. June 21, 1979), *aff'd*, 414 A.2d 822 (Del. 1980) (challenging an amendment to the certificate of incorporation which raised the number of votes necessary for a merger to 80%); Siebert v.

was the fair price provision (FPP), which began to appear in increasing numbers throughout the decade.[119] The FPP is essentially a supermajority voting rule with a contingency clause. Basically, the supermajority provision lays dormant unless certain criteria with respect to the transaction are triggered, such as the failure to obtain unanimous board of director approval, or the failure to pay an equal price for all shares acquired.[120] By the mid 1980s, the FPP was the most common antitakeover measure adopted by American companies, all but replacing simple supermajority voting requirements.[121] The popularity of the FPP,

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Milton Bradley Co., 405 N.E.2d 131, 135 (Mass. 1980) (challenging a bylaw requiring a 75% vote for mergers).

[119]Between 1984 and 1986, FPPs were among the most common antitakeover measures submitted for shareholder approval at annual meetings, all but replacing simple supermajority proposals. *See* IRRC BACKGROUND REPORT — FAIR PRICE & SUPERMAJORITY VOTE PROVISIONS P-1 (IRRC 1994). One study reported 649 types of "shark repellent" amendments, which are corporate antitakeover charter amendments, including Fair Price Provisions and Supermajority voting rules, in corporations between January 1979 and May 1985. William J. Carney, *Controlling Management Opportunism in the Market for Corporate Control: An Agency Cost Model,* 1988 WISC. L. REV. 385, 393 n.28 (quoting Gregg A. Jarrell & Annette B. Poulsen, *Shark Repellents and Stock Prices, The Effects of Antitakeover Amendments Since 1980,* 19 J. FIN. ECON. 127 (1987)). By the mid 1980s, at least 40% of Fortune 500 companies had adopted some sort of antitakeover provision. IRRC ANTITAKEOVER CHARTER AMENDMENTS: A DIRECTORY OF MAJOR AMERICAN CORPORATIONS (IRRC, 1985).

[120]A Fair Price Provision is a supermajority voting requirement that is contingent on the occurrence or nonoccurrence of other events. IRRC BACKGROUND REPORT — FAIR PRICE & SUPERMAJORITY VOTE PROVISIONS P-1 (IRRC 1994). The trigger is usually the failure of the board of directors to approve a proposed transaction by a unanimous vote, although some companies vest the waiver power only in "continuing directors" (i.e., those directors elected prior to the potential acquiror's acquisition of shares). *See* ARTHUR FLEISCHER, TENDER OFFER: DEFENSES, RESPONSES, AND PLANNING 400.75-111 (1979). For example, with unanimous approval of the appropriate board members, a proposed transaction would be submitted to a shareholder vote requiring only a simple majority for approval; however, if any of the board members dissent, a supermajority rule would be imposed. The triggering function of the FPP can be defined by additional requirements, such as a provision mandating that all shareholders receive the same price in a merger. Accordingly, if this provision is not met, the supermajority rule is triggered. Theoretically, under an FPP, a "fair" offer should only require a simple majority of the shareholder's approval, while potentially "unfair" offers require a supermajority vote for approval. Thus, fair price provisions are simply "threatened" supermajority voting requirements. For an extended discussion of FPPs, see Ellen S. Friedenberg, *Jaws III: The Impropriety of Shark-Repellent Amendments as a Takeover Defense,* 7 DEL. J. CORP. L. 32, 44-46 (1982); Palmer, *supra* note 116, at 1713-14.

[121]Despite their relative popularity in the 1980s, by the 1990s the use of FPPs and supermajority voting rules had languished in the corporate world. IRRC CORPORATE TAKEOVER DEFENSES, *supra* note 110, at vii. Of the 1500 companies surveyed by IRRC, the percentage of companies with FPPs went from 32.5% in 1990 to 33.2% in 1993, and then fell to 32.5% in 1995. *Id.* The use of supermajority voting provisions for M&A activity went from 16.9% in 1990 to 18.1% in 1993. Shareholders may fare better by availing themselves to FPPs because such provisions allow for a variety of outcomes while also reducing the chance

however, failed to dissuade most supermajority critics, who considered it, at best, a marginally improved device, but one still burdened with all the undesirable baggage of its less sophisticated cousin.[122]

Surprisingly, the most ardent supporters of the nexus-of-contract theory[123] are often the most vocal critics of corporate supermajority voting rules, despite the fact that such rules may be freely bargained for and approved by the shareholders of the company.[124] Contractualists contend that the rationale[125] used to induce shareholders into approving supermajority provisions is specious[126] because, in reality, such provisions offer little, if any, protection to the minority while also allowing management to use the inherent, inertial power of the provision for its own benefit.[127] Thus, while contractualists might agree that supermajority voting provisions may be appropriate under certain circumstances, they generally view their use as an illegitimate attempt to exploit the misperceived benefits of supermajority rules by a management which is self-interested, ill informed, or both.

Supporters of supermajority voting rules often criticize the nexus-of-contract conception and generally believe that supermajority voting rules are an effective and appropriate method of protecting minority shareholders from potentially predatory behavior by future acquirors.[128]

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for costly mistakes. *See* Roberta Romano, *The Political Economy of Takeover Statues*, 73 VA. L. REV. 111, 161-63 (1987). In turn, such results provide an alternative explanation for the increased popularity of such provisions at the expense of simple, supermajority rules. *Id.*

[122]*See generally* Baysinger & Butler, *supra* note 96. Some critics of the FPP point to the fact that many corporations do not adopt such a provision as proof of its inherently venal nature. *Id.* at 1269-82. Supporters, however, counter that

> [t]he selective adoption of antitakeover amendments is explained on the ground that the resulting conflicts of interest differ from firm to firm. An analogy is drawn between corporate charter amendments and similar modifications of political constitutions: each is designed to protect minority interests by limiting the choices of the majority, but only where such restrictions serve important group concerns.

Id. at 1260.

[123]The theory that helped legitimize the use of supermajority voting requirements.

[124]Bratton, *supra* note 1, at 1520 (stating that nexus-of-contracts theory "supports corporate control transactions against management objections").

[125]"Rationale" meaning the protection of minority interests.

[126]This is so regardless of whether these provisions are bargained for.

[127]*See generally* DeAngelo & Rice, *supra* note 113, at 332.

[128]*See* Dallas, *supra* note 13, at 33-34. Professor Dallas has offered a description of an alternative, left leaning conception of the corporation which would often support the use of a supermajority decision rule:

> The power coalition theory depicts the corporation as an institution whose behavior results from a contest for control among power coalitions which are comprised of groups of individuals. This theory is based not on private

These supporters usually attempt to minimize the risk of management corrupting the power inherent in supermajority rules for its own selfish interests. Additionally, supermajority rules are viewed as offering a unique way of achieving a deeper consensus between shareholders when making the most important decisions regarding the company.[129]

On either side of this debate, however, there seems to be a general agreement that whatever its effect, supermajority voting is a purely instrumental tool, serving as a convenience for achieving certain ends with no necessary relationship to an external, legitimizing theory of the corporation. While past debates over corporate decision rules appealed to corporate theory, the focus today is on economic and social effect. Arguments assessing the appropriateness of such rules are now phrased in the more technical discourse of empirical analysis, rather than being couched in the rhetoric of corporate theory.

Despite the shift away from the subjective theorizing of preceding eras, few empirical works addressing this question have resulted. When taken as a whole, the literature, thus far, has been inconclusive. The second half of this article will, therefore, attempt to examine the supermajority rule and its influence and effect on the behavior and outcomes of shareholder voting.

> contracting, but on power relationships resulting from social, cultural, political, legal, and economic developments. The group or groups that emerge as dominant determine the institution's behavior. The dominance of a group depends not on its stake or the nature of the group's interest in the firm, but rather on the firm's perceived dependence on the group and the resources it provides. The firm tends to act so as to decrease its uncertainty (or dependencies) by increasing its autonomy and discretion over its environment. Corporate strategies for dealing with dependencies are numerous. Contracting is only one such method. Cooptation, which describes the shareholders' relationship with the corporation, is another.

Id. (citations omitted). *See generally* Marcia Johnson, *Systematic Denial of the Right to Vote to America's Minorities*, 11 HARV. BLACKLETTER L.J. 61, 83 (1994) (noting the protective function of supermajority provision in both the corporate and legislative sectors); Pamela S. Karlan, *Maps and Misreadings, The Role of Geographic Compactness in Racial Vote Dilution Litigation*, 24 HARV. C.R.-C.L.L. REV. 173, 245 (1989) (discussing the implications of voting rules in the context of race yet noting that supermajority rules "are often used in corporate law to give minority shareholders some power to prevent majority oppression") (citations omitted); Hunter J. Brownlee, Comment, *The Shareholders' Agreement: A Contractual Alternative to Oppression as a Grounds for Dissolution*, 24 STETSON L. REV. 267, 301 (1994) (noting that supermajority voting rules provide the minority with veto power while also protecting it from oppression and prejudice by the majority).

[129]*See generally* Dallas, *supra* note 13, at 60-61 (noting that supermajority rules shift power to the minority while also decreasing the "coercive" effects of tender offers "by permitting collective decision making by shareholders").

II. THE EFFECTS OF SUPERMAJORITY VOTING RULES IN CORPORATE TAKEOVERS

A. *The Demand Curve For Stock: Assessing the Impact of a Supermajority Rule*

To assess what effect supermajority voting rules might have for corporations, it is necessary to understand the potential impact that such decision rules might have on the behavior of corporate shareholders. In examining these potential effects, the activity surrounding the merger or acquisition of a public company is particularly favorable to empirical analysis. This is so because most modern corporate charters and other applicable law usually require an acquiror to seek the prior approval of a certain percentage of a company's shareholders in order to implement a plan of merger or acquisition.[130] Therefore, under a simple majority rule, a potential acquiror must persuade at least fifty percent plus one additional share to vote in favor of the transaction for it to succeed, while under supermajority requirements, that number would obviously be higher, usually at least two-thirds. If the demand for securities is perfectly elastic,[131] the price of each share of stock will be identical, whether the purchase constitutes either the marginal 50% share or the marginal 66.67% share. However, if the demand for stock is inelastic, the stock price per share would be expected to increase with quantity demanded, and shares acquired at the 66.67% level would be more expensive than those acquired at the 50% level.[132] Herein lies either the significance or sterility of a supermajority voting requirement — its ability to influence the behavior of prospective acquirors by potentially

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[130]There are many other instances in which corporations use supermajority decisions rules, including votes by the board of directors, or shareholder votes on nonmerger items such as charter amendments or shareholder proposals. However, comparisons of such votes are much more difficult because they lack the market price element present in M&A activity involving publicly traded companies.

[131]The price elasticity of demand is the ratio of the percentage change in quantity demanded to the percentage change in price that brings about the change in quantity demanded. WILLIAM J. BAUMOL & ALLEN S. BLINDER, ECONOMICS: PRINCIPLES AND POLICY 356 (2d ed. 1982).

[132]For example, since an acquiror must pay the price demanded by the last marginal shareholder necessary to approve a merger, an acquisition which might cost $30 per share for a company with a 50% decision rule might cost $40 for one which requires two-thirds shareholder approval and $50 per share for a company which has in place a 75% shareholder approval requirement. *See* William J. Carney, *Shareholder Coordination Costs, Shark Repellents, and Takeout Mergers: The Case Against Fiduciary Duties*, 34 AM. BAR FOUND. RES. J. 341, 374-75 n.160 (1983).

increasing the price which must be paid for approval of an acquisition to occur. Whether or not supermajority voting requirements influence the price of stock in a takeover environment, then, will depend upon the price elasticity of demand for marketable equity securities (see, e.g., Figure 1).[133]

The conventional wisdom held by both financial economists and legal scholars is that the demand curve for securities is perfectly elastic (i.e., horizontal)[134] for two reasons: first, the market for securities is highly efficient, and second, individual investors rationally invest in diversified portfolios.[135] The assumption of a perfectly elastic demand curve is a fundamental part of the Capital Asset Pricing Model (CAPM) which has received a great deal of support in economic and financial circles.[136] In a world of efficient markets, the market, by definition, determines the "true" price of a security; therefore, any tender offer initiated at a price which is higher than this "true" price (taking into account transaction costs) is clearly a "fair" price to shareholders.[137]

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[133]This article has intentionally attempted to avoid the technical, more mathematically laden side of voting research, although such studies are plentiful, especially in the field of political science. *See supra* note 5 and accompanying text for reference to voting rules in the context of political science. For an interesting, highly quantitative work on the use of dual classes of stock, see Denis Gromb, *Is One Share/One Vote Optimal?*, LON. SCH. ECON. 19 (disc. paper no. 177) (Dec. 1993) (noting that under certain conditions, a one share-one vote rule makes the simple majority rule optimal, although at other times that rule is irrelevant).

[134]Some contractualist scholars have admitted that the demand curve may not be perfectly elastic, but that any deviation from such a standard is likely to be so small as to be "trivial." *See* J. Gregory Sidak & Susan E. Woodward, *Takeover Premiums, Appraisal Rights, and the Price Elasticity of a Firm's Publicly Traded Stock*, 25 GA. L. REV. 783, 817 (1991).

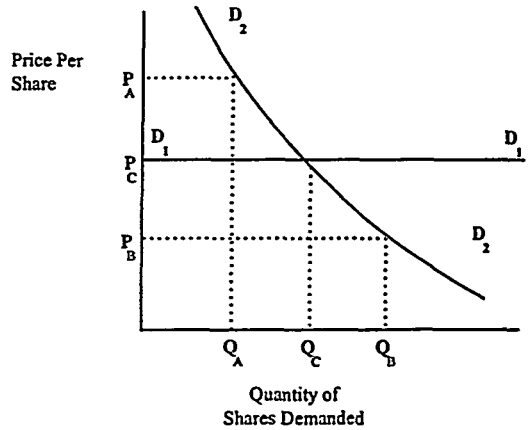
[135]*See* Richard A. Booth, *The Efficient Market Portfolio Theory and the Downward Sloping Demand Hypothesis*, 68 N.Y.U. L. REV. 1187 (1993). *See also* Ian Ayres, *Back to Basics: Regulating How Corporations Speak to the Market*, 77 VA. L. REV. 945, 969-70 & n.99 (1991) (asserting that profits are the sole consideration of investors determinations); Lloyd R. Cohen, *Why Tender Offers? The Efficient Market Hypothesis, the Supply of Stock, and Signaling*, 19 J. LEGAL STUD. 113, 126-29, 131-32 (1990) (noting that shareholders ignore the circumstances surrounding a sale, buying solely for economic advantage); Frank H. Easterbrook & Daniel R. Fischel, *The Proper Role of a Target's Management in Responding to a Tender Offer*, 94 HARV. L. REV. 1161, 1165-68 (1981) (stating that the value of stock is based on the collective wisdom of all traders); Reinier Kraakman, *Taking Discounts Seriously: The Implications of "Discounted" Share Prices as an Acquisition Motive*, 88 COLUM. L. REV. 891, 897-901 (1988) (contending that discount hypotheses can explain why the existing value of assets differs from the market value of target shares).

[136]For a discussion of CAPM, see John Lintner, *The Valuation of Risk Assets and the Selection of Risky Investments in Stock Portfolios and Capital Budgets*, 47 REV. ECON. & STAT. 13 (1965); William F. Sharpe, *Capital Asset Prices: A Theory of Market Equilibrium Under Conditions of Risk*, 19 J. FIN. 425 (1964).

[137]Effects regarding assumptions surrounding price elasticity, such as transaction costs and availability of information, will for this article be assumed to be negligible.

Applying this reasoning, any device adopted by a corporation with the espoused purposes of protecting shareholder rights and ensuring a "fair" offer price in the event of a takeover is merely obstructionist while its supposed protection is illusory.[138] Those who adhere to this theory[139] regard provisions, such as supermajority voting rules, merely as a way for incumbent management to gain protection from indirect displacement by stockholder vote, offering few, if any, benefits to corporate shareholders.[140]

Figure 1
Horizontal and Downward Sloping Demand Functions



A perfectly elastic demand function for stock is depicted by line D_1 - D_1, which under CAPM should generate a "market" price which is insensitive to varying levels of demand. Under HE, line D_2 - D_2, different levels of demand yield different prices to reflect the assumption of heterogeneity.

[138]Additionally, rules designed to prolong a tender offer or to establish a corporate auction among potential suitors may ultimately serve to increase the costs of a tender offer, subsequently defeating marginal offers where this incremental cost increase proves decisive, and thereby depriving the shareholders of a legitimate offer. *See* Booth, *supra* note 135, at 1188. *See also* Easterbrook & Fischel, *supra* note 135, at 1174-80, 1188-92 (noting that tactics which increase cost will ultimately discourage outsiders, thereby worsening management's position within the corporation); Alan Schwartz, *The Fairness of Tender Offer Prices in Utilitarian Theory*, 17 J. LEGAL STUD. 165, 170-86, 195 (1988); Alan Schwartz, *The Sole Owner Standard Reviewed*, 17 J. LEGAL STUD. 231, 232 (1988) (advocating a single owner standard to ensure compensation for opportunity cost losses in tender offers).

[139]This theory is sometimes referred to as the "managerial entrenchment hypothesis." DeAngelo & Rice, *supra* note 113, at 332.

[140]OLIVER E. WILLIAMSON, MARKETS AND HIERARCHIES: ANALYSIS AND ANTITRUST IMPLICATIONS (The Free Press, New York, 1975); William Cary, *Corporate Devices Used to Insulate Management From Attack*, 39 ANTITRUST L.J. 318 (1969); DeAngelo & Rice, *supra* note 113, at 331-35.

This view is generally supported by contractualists who believe that such antitakeover mechanisms achieve their invidious purpose by extending additional bargaining power to management, thereby allowing self-interested managers to either entrench themselves by thwarting potential takeovers, or enrich themselves by opportunistically extracting a price premium from the acquiror which most often flows to the rent-seeking managers rather than to the shareholders of the company.[141]

Over the last two decades, however, a growing number of scholars have challenged the traditional view of stock price elasticity, contending that stock prices are much like other commodities, in that their price is sensitive to varying levels of supply and demand.[142] In recent years, these scholars have cited many inconsistencies in stock price behavior which can not be easily explained by the traditional notions of perfect price elasticity, thus evidencing that stock prices are indeed sensitive to the forces of supply and demand.[143]

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[141]*See, e.g.*, Millon, *supra* note 10, at 235 (noting that nexus-of-contract theory suggests that target company management should not be allowed to block an acquiror's attempts to bid on the company's shares of stock). *But see* Phillips, *supra* note 16, at 1094 (suggesting that when other contract holders are taken into account, this view might not be entirely correct).

[142]*See* Carney, *supra* note 132, at 354-57; John C. Coffee, Jr., *Regulating the Market for Corporate Control: A Critical Assessment of the Tender Offer's Role in Corporate Governance*, 84 COLUM. L. REV. 1145 (1984); Myron S. Scholes, *The Market for Securities: Substitution versus Price Pressure and the Effects of Information on Share Prices*, 45 J. BUS. 179 (1972); Lynn A. Stout, *Are Takeover Premiums Really Premiums? Market Price, Fair Value, and Corporate Law*, 99 YALE L.J. 1235, 1236 (1990).

[143]For example, underwriters sometimes sell stock issues at below-market prices with the belief that such pricing is necessary to successfully sell large amounts of equity. Some corporations, with the announced intention of increasing the price of their equity securities, often launch stock repurchase programs, which are premised on the belief that a reduction in the supply of outstanding stock will subsequently lead to an increase in the price of the remaining shares. *See* Booth, *supra* note 135, at 1188 n.3; John Floegel, *Equity Financing for Public Corporations: Reasons and Methods to Encourage It*, 138 U. PA. L. REV. 1411 (1990); Michael C. Jensen, *Eclipse of the Public Corporation*, HARV. BUS. REV., Sept.-Oct. 1989, at 61; Stout, *supra* note 142, at 1250-53; Steven E. Levingston, *Corporate Treasurers are Turning Increasingly to Stocks of Firms They Know Best: Their Own*, WALL ST. J., Oct. 19, 1992, at C1; Craig Torres, *Rapid Stock-Supply Shrinkage Continues*, WALL ST. J., July 14, 1989, at C1; Anise C. Wallace, *Takeovers and Buybacks Propping Up Stock Prices*, N.Y. TIMES, June 20, 1988, at D1. *But see* Roger Lowenstein, *Goldman Study of Stocks' Rise in '80s Poses a Big Riddle*, WALL ST. J., June 6, 1991, at C1, C2 (discussing a security price study which concluded that decreases in the supply of certain stocks did not lead to an increase in that stock's price).

Stock repurchases may be seen as a form of dividend thereby enabling management to dispose of free cash flows in the most efficient manner. *See* Paul Asquith & David W. Mullins, Jr., *Equity Issues and Offering Dilution*, 15 J. FIN. ECON. 61 (1986); Paul Asquith & David W. Mullins, Jr., *Signalling With Dividends, Stock Repurchases, and Equity Issues*, 15 FIN. MGMT. 27 (Autumn 1986); Michael J. Barclay & Clifford W. Smith, Jr., *Corporate Payout*

Supporters of the inelastic demand theory believe that shareholders

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Policy: Cash Dividends Versus Open-Market Repurchases, 22 J. FIN. ECON. 61, 62 (1988); Michael C. Jensen, *Agency Costs of Free Cash Flow, Corporate Finance, and Takeovers*, 76 AM. ECON. REV. PAPERS & PROC. 323, 324 (1986); Jeffry M. Netter & Mark L. Mitchell, *Stock-Repurchase Announcements and Insider Transactions After the October 1987 Stock Market Crash*, 18 FIN. MGMT. 84, 85 (Autumn 1989).

Recent studies have found that such stock repurchase programs tend to increase share prices. *See* Laurie Simon Bagwell, *Dutch Auction Repurchases: An Analysis of Shareholder Heterogeneity*, 47 J. FIN. 7, 97 (1992); Laurie Simon Bagwell, *Share Repurchase and Takeover Deterrence*, 22 RAND J. ECON. 72, 76-78 (1991); David T. Brown & Michael D. Ryngaert, *The Determinants of Tendering Rates in Interfirm and Self-Tender Offers*, 65 J. BUS. 529, 552-53 (1992); Larry Y. Dann, *Common Stock Repurchases: An Analysis of Returns to Bondholders and Stockholders*, 9 J. FIN. ECON. 113, 136-37 (1981); Robert Comment & Gregg A. Jarrell, *The Relative Signalling Power of Dutch-Auction and Fixed-Price Self-Tender Offers and Open-Market Share Repurchases*, 46 J. FIN. 1243, 1266 (1991); Sreenivas Kamma et al., *Dutch Auctions Versus Fixed-Price Self-Tender Offers for Common Stock*, 2 J. FIN. INTERMEDIATION 277 (1992); Josef Lakonishok & Theo Vermaelen, *Anomalous Price Behavior Around Repurchase Tender Offers*, 45 J. FIN. 455, 476 (1990); Clifford W. Smith, Jr., *Investment Banking and the Capital Acquisition Process*, 15 J. FIN. ECON. 3, 6-14 (1986).

Sales of large blocks of stocks, which cause a large increase in the supply of a stock over a short period of time, have been shown to cause a decrease in stock prices. *See* Larry Y. Dann et al., *Trading Rules, Large Blocks, and the Speed of Price Adjustment*, 4 J. FIN. ECON. 3 (1977); Robert W. Holthausen et al., *Large-Block Transactions, the Speed of Response, and Temporary and Permanent Stock-Price Effects*, 26 J. FIN. ECON. 71, 90 (1990); Alan Kraus & Hans R. Stoll, *Price Impacts of Block Trading on the New York Stock Exchange*, 27 J. FIN. 569, 587 (1972); Wayne H. Mikkelson & M. Megan Partch, *Stock Price Effects and Costs of Secondary Distributions*, 14 J. FIN. ECON. 165, 192-94 (1985); Scholes, *supra* note 142, at 179.

Additional evidence may be found in a stock's inclusion in the S&P 500 stock index, which may increase the demand for a stock, and has been shown to cause a parallel increase in the stock's price. *See* Lawrence Harris & Eitan Gurel, *Price and Volume Effects Associated with Changes in the S&P 500 List: New Evidence for the Existence of Price Pressures*, 41 J. FIN. 815, 817 (1986); Andrei Shleifer, *Do Demand Curves for Stocks Slope Down?* 41 J. FIN. 579, 587 (1986). *See also* Voting Rights Listing Standards — Proposed Disenfranchisement Rule, Exchange Act Release No. 24,623, [1987 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,143, at 88,768, 88,773 n.50 (June 22, 1987) (listing various studies that have examined whether listing or delisting results in gains or losses in share prices). *But see* Sidak & Woodward, *supra* note 134, at 795 (refuting the validity of certain S&P 500 studies when a longer time frame is incorporated into the analysis, giving results more in line with the efficient market hypothesis). Most telling of all, however, is the existence of premiums in takeover transactions because, according to the traditional view, the price of stock is set at the market level and thus large premiums for takeovers generally should not be expected. *See* Kevin S. Nathan & Terrence B. O'Keefe, *The Rise in Takeover Premiums: An Exploratory Study*, 23 J. FIN. ECON. 101, 119 (1989) (suggesting that an increase in takeover premiums from 1974 to 1985 may have been due to an increase in the "heterogeneity of investors' beliefs about firm value, causing an increase in the slope of the transactions supply curves for securities").

However, some of the findings in many of these articles are consistent with a signaling effect hypothesis which would support the perfect price elasticity hypothesis.

both rationally[144] and legitimately hold dissimilar views regarding the value of their stock because they have differing amounts of information, divergent investment experience, and diverse psychological perspectives from which they evaluate their stocks prospects.[145] This model is sometimes referred to as the heterogeneous expectations (HE) model because its foundation is based on diverse investor expectations.[146] Since shareholders have rationally different opinions as to the worth of a share, it stands to reason that some shareholders will demand a higher premium than others. Thus, "there is no single fair price for any share of stock."[147]

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[144]There is debate as to whether the beliefs underlying the heterogeneous model are truly rational. Because company specific risk goes unrewarded in the marketplace and can be diversified away at minimal cost, investors should not base their individual investment decisions on company specific factors. Yet, the heterogeneous beliefs model assumes they do just that. *See* RICHARD A. BREALEY & STEWART C. MYERS, PRINCIPLES OF CORPORATE FINANCE ch. 4 (4th ed. 1991); EDWIN J. ELTON & MARTIN J. GRUBER, MODERN PORTFOLIO THEORY AND INVESTMENT ANALYSIS 399-433 (4th ed. 1991); Eugene F. Fama, *Efficient Capital Markets: A Review of Theory and Empirical Work*, 25 J. FIN. 383 (1970); Ronald J. Gilson & Reinier H. Kraakman, *The Mechanisms of Market Efficiency*, 70 VA. L. REV. 549 (1984). For arguments that question market efficiency, see Jeffrey N. Gordon & Lewis A. Kornhauser, *Efficient Markets, Costly Information, and Securities Research*, 60 N.Y.U. L. REV. 761, 786-96 (1985); Sanford J. Grossman & Joseph E. Stiglitz, *On the Impossibility of Informationally Efficient Markets*, 70 AM. ECON. REV. 393 (1980); William K.S. Wang, *Some Arguments That the Stock Market is Not Efficient*, 19 U.C. DAVIS L. REV. 341 (1986). For a discussion and possible synthesis of the downward sloping demand curve hypothesis and efficient market theory, see Booth, *supra* note 135, at 1194-203.

[145]The body of recent work addressing the possibility and implications for an inelastic demand curve for securities is extensive. *See* WILLIAM F. SHARPE, PORTFOLIO THEORY AND CAPITAL MARKETS 104-13 (1970); Laurie Simon Bagwell, *Shareholder Heterogeneity: Evidence and Implications*, 81 AM. ECON. REV. 218 (1991); Booth, *supra* note 135; Robert Jarrow, *Heterogeneous Expectations, Restrictions on Short Sales, and Equilibrium Asset Prices*, 35 J. FIN. 1105 (1980); Randall G. Holcombe & Richard P. Saba, *The Effects of Heterogeneous Expectations on the Capital Structure of the Firm*, 51 S. ECON. J. 356 (1984); John Lintner, *The Aggregation of Investor's Diverse Judgements and Preferences in Purely Competitive Security Markets*, 4 J. FIN. & QUANTITATIVE ANALYSIS 347 (1969); Claudio Loderer et al., *The Price Elasticity of Demand for Common Stock*, 46 J. FIN. 621 (1991); Joram Mayshar, *On Divergence of Opinion and Imperfections in Capital Markets*, 73 AM. ECON. REV. 114 (1983); Edward M. Miller, *Risk, Uncertainty, and Divergence of Opinion*, 32 J. FIN. 1151 (1977); Stout, *supra* note 142.

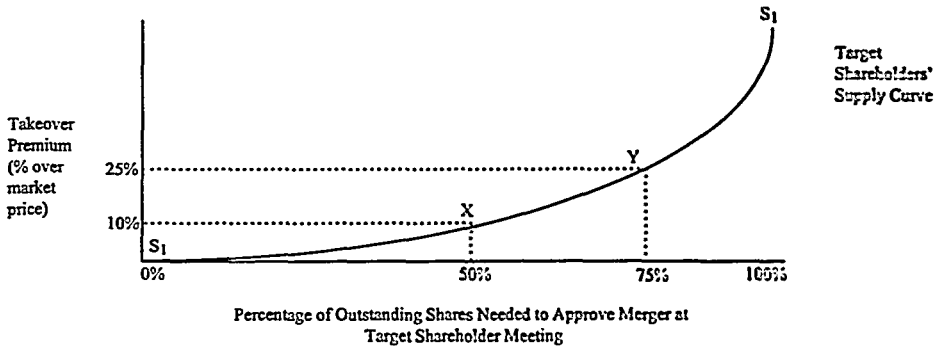
[146]It is also widely known as the "downward sloping demand curve" hypothesis. For an extended discussion of the HE model, see Lynn A. Stout, *Are Stock Markets Costly Casinos? Disagreement, Market Failure, and Securities Regulation*, 81 VA. L. REV. 611 (1995). This theory is also referred to as the "Stockholder Interests Hypothesis." DeAngelo & Rice, *supra* note 113, at 335; Sanford J. Grossman & Oliver D. Hart, *Takeover Bids, the Free-Rider Problem, and the Theory of the Corporation*, 11 BELL J. ECON. 42, 42-64 (1980).

[147]*See* Booth, *supra* note 135, at 1212.

As a result, the HE model implies that securities "are valued along a continuum — the shareholder demand curve."[148]

Under the HE model, demand and supply are inelastic, implying that supermajority voting rules should have a price effect on merger and acquisition activity. This occurs because if the demand curve for securities slopes downward, increases in the quantity of stock supplied will tend to decrease the stock's price. Conversely, if the supply curve has a positive slope,[149] increases in demand will tend to cause increases in price (see Figure 2).

Figure 2
Hypothetical Target Shareholders' Supply Curve Under HE



[148]*See id.* at 1212. *See also* Baysinger & Butler, supra note 96, at 1277-78. The agency theory proponents of takeover reform have yet to explain how, in the long run, managers can insulate themselves from the market for corporate control to their shareholders' detriment; why shareholders ever vote for antitakeover amendments; why some firms adopt these measures while others do not; and how the corporations that have such provisions survive in competition with those that do not. These empirically observable phenomena should not occur if antitakeover charter amendments facilitate managerial entrenchment and reduce shareholders' welfare. If antitakeover amendments always increase net agency costs in a corporation, it is not in shareholders' interests to adopt them or management's interest to propose them. Moreover, explaining stock market approval of companies that have these provisions is difficult. Shareholders' continuing approval of antitakeover amendments in some, but not all, large corporations is more supportive of the hypothesis that shark repellents may reduce the costs associated with managerial misbehavior.

Id.

[149]Under an HE model, the idea of a downward sloping demand curve or an upward sloping supply curve is one and the same. *See* Booth, *supra* note 135, at 1192 n.8.

HE assumes that, in the context of takeover battles, corporate devices such as supermajority voting can legitimately be employed because there is no one, "fair" price preordained by the market; as a result, these devices should cause higher takeover premiums to be paid to target shareholders.[150] This is not simply a wealth extraction mechanism. Given the heterogeneous expectations of shareholders in a takeover battle under majority rule voting, shareholders with "more-optimistic estimates of their stock's value become the victims of a less-optimistic majority's rule."[151] A supermajority voting rule, then, is the ideal way to correct this outcome and ensure that more shareholders are compensated up to or above the marginal, heterogeneously subjective value of their shares.

The effect and significance of this relationship was demonstrated by Professor John Coffee when he stated that:

> the key issue is the slope of the [supply] curve. Generally, supply curves are thought to slope upward on the premise that only an increase in price will bring more of a commodity to the market . . . [supply curve inelasticity] assumes that most shareholders are not prepared to sell at the current market price, and an increasing premium must therefore be paid to coax a higher percentage of them to tender.[152]

The effects of supermajority voting in this context are, therefore, dependent on the outcome of the debate over the price elasticity of demand for equity securities.[153]

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[150]*See* Stout, *supra* note 142, at 1269 (stating that "[i]f investor demand for stocks is not perfectly elastic, the arguments of those who call for legal rules prohibiting target management from pursuing defensive tactics in response to premium bids are seriously flawed"). Additionally, Stout and others argue that the premium paid by an acquiror to a target company's shareholders represents the legitimate, marginal reservations price that the acquiror desired to purchase. *Id.* at 1260-71. *But see* Sidak & Woodward, *supra* note 134, at 785 (criticizing Stout's claims as "wrong" and accusing her of misinterpreting "much of the last thirty years of thinking and research in corporate finance").

[151]Stout, *supra* note 142, at 1267. Without a supermajority (or other protective) provision, a merger could be approved at a simple majority level and at a subjective "simple majority" level price, thus forcing other shareholders to sell out at a price somewhere below their reservation level. *Id.*

[152]*See* Coffee, *supra* note 142, at 1185 (footnote omitted).

[153]*See* Booth, *supra* note 135, at 1194 (noting "[w]hile considerable evidence indicates that demand for stocks is downward sloping, logic nevertheless seems to suggest that demand should be horizontal").

B. *The Empirical Evidence to Date*

Direct evidence on the impact of corporate antitakeover provisions is scarce, and the few studies which have been conducted to date have yielded inconsistent results. One study concluded that modest shareholder gains resulted from the adoption of antitakeover amendments,[154] while a second study found no significant effects,[155] and a third detected shareholder losses.[156] In addition, research undertaken by the Office of the Chief Economist of the SEC found that the adoption of supermajority voting rules had a slight negative effect on share prices.[157]

In 1987, Professor John Pound published an empirical study which tracked 200 New York Stock Exchange (NYSE) listed firms, half of which had some sort of antitakeover provision, such as an FPP, supermajority voting, or a classified board.[158] He concluded that shareholders of companies with such supposedly prophylactic provisions received, on average, no additional compensation in the event of a takeover.[159] Additionally, companies with such provisions that were later acquired in a merger or acquisition forced acquirors to incur substantially higher transaction costs and pay target management more compensation than that of the control group of companies without FPPs or

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[154]Scott C. Linn & John J. McConnell, *An Empirical Investigation of the Impact of "Antitakeover" Amendments on Common Stock Prices*, 11 J. FIN. ECON. 361 (1983). In this study, the authors found statistically significant, positive abnormal returns for supermajority amendments, but did not distinguish between simply supermajority rules and those imbedded within FPPs. *Id.*

[155]DeAngelo & Rice, *supra* note 113, at 356. This study uses data on daily stock prices and concludes that the announcement of certain antitakeover charter amendments may have a slight negative effect on the price of shares, although such effects are not statistically significant. *Id.*

[156]*See* Jarrell & Poulsen, *supra* note 119. This study of 48 firms, with supermajority amendments adopted between 1979 and 1985, concluded that the announcement of a supermajority decision rule proposal in the release of the proxy materials caused negative cumulative abnormal returns of almost 5%. *Id.* at 141-44. The effect of supermajority provisions was more negative then other types of antitakeover devices studied. *Id.* at 132-33. However, because of the small sample size used in this study, the standard of error from the mean was fairly large (t mean = -2.27).

[157]In the SEC sample, 55% of companies adopting such provisions saw a decline in share prices after adoption, while 45% experienced a rise in the price of the company's stock. Office of the Chief Economist, SEC, *Shark Repellents: The Role and Impact of Antitakeover Charter Amendments*, [1984-1985 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,714 (Sept. 7, 1984).

[158]John Pound, *The Effects of Antitakeover Amendments On Takeover Activity: Some Direct Evidence*, 30 J. LAW & ECON. 353 (1987).

[159]*Id.* However, such companies did experience a reduced probability of a takeover bid being initiated. *Id.*

supermajority voting rules.[160] Finally, Pound concluded that supermajority voting, rather than acting as a protection mechanism to ensure fair treatment of the minority, had been transformed into a device which enables management to extract additional compensation from acquirors while generating few, if any, additional benefits for the shareholders.[161] These results, if accurate, support the contention that the adoption and continuing maintenance of such antitakeover devices[162] has become perverted, realizing the suspicions of contractualists.

C. *A Comparison of Takeover Stock Price Premiums and Supermajority Voting*

This section presents the results of a comparison of mergers and acquisitions between companies which have a simple majority decision rule for shareholder votes, and those which require a two-thirds supermajority vote to approve a takeover. An examination was made of the price premium received by shareholders in each group, hoping that it could serve as a tool for assessing the usefulness and potential benefits of supermajority voting while also contributing to the current debate over share price elasticity of demand.

To test whether companies with supermajority voting requirements command a higher price premium for their stock in the event of a takeover, a set of ninety-four companies was assembled, of which fifty were targets and forty-four were acquirors.[163] These companies were culled from the Investor Responsibility Research Center's (IRRC) annual Voting Results Survey for the years 1992, 1993, 1994, and the first half of 1995.[164] All IRRC reported companies were included in the data set,

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[160]*Id.* This compensation is presumably in addition to that which is already paid. Because the principal barrier to any arms length merger transaction is the veto power of the board of directors, which must approve a merger proposal before it can be submitted to the shareholders, the board is thereby given a veto on any transaction. *See, e.g.*, DEL. CODE ANN. tit. 8, § 251(b) (1974 & repl. vol. 1993); MODEL BUSINESS CORP. ACT § 71 (1981). The power this provision provides a board of directors with has long been observed to create an opportunity for boards to extract compensation from a prospective merger partner as a condition to lending its consent to the merger. *See* Henry G. Manne, *Some Theoretical Aspects of Share Voting*, 64 COLUM. L. REV. 1427, 1433 (1964).

[161]Pound, *supra* note 158, at 366-67.

[162]For example, the supermajority voting rule.

[163]Companies which were excluded from this data set are those where a true merger took place (i.e., each of two firm's shareholders received shares in a newly formed company). Additionally, companies for which it was not possible to gather complete voting or price information, such as privately held corporations, were also excluded.

[164]IRRC, Corporate Governance, Voting Results (bi-annual reports), 1992 (first and

except for those which applicable voting results, or other relevant information, was unavailable.[165] Price information, specifically the stock price premium paid by the acquiror, was taken from published reports in *Mergers & Acquisitions* and from IRRC. In each of the ninety-four companies, the proposed merger or acquisition was ultimately approved by the shareholders.[166] To determine possible effects of state antitakeover laws or potentially intervening FPPs, the existence or absence of each of these factors was incorporated into the data set. The "surplus vote,"[167] which is the amount of votes received over and above the minimum needed, was also calculated.

1. Voting by Target Shareholders

Of the fifty target firms analyzed, thirty had simple majority voting rules (Group A), while the remaining twenty companies (Group B) required an affirmative two-thirds shareholder vote before the company could be acquired. None of the companies required anything other than either 50% or 66.67% approval for passage.

As an initial step, a very simple analysis was done comparing the average acquisition price premium of Group A and Group B stocks. If the price for stocks is inelastic, as previously discussed, then the average acquisition price premium for Group B stocks should be higher than those in Group A,[168] thus the hypothesis:

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second half), 1993 (first and second half), 1994 (first and second half), and 1995 (first half).

[165]Surprisingly, despite SEC rules that require disclosure of shareholder voting results, according to the IRRC, it is often very difficult to gather the final voting numbers in cases of mergers and acquisitions because, after a successful vote, companies that have been acquired often fail to publicly disclose the final voting numbers. Comments of Virginia Rosenbaum, Research Associate, IRRC (Washington, D.C., Jan. 10, 1996). IRRC often makes repeated calls to such companies in an attempt to maintain the integrity of its records, but often companies simply do not respond. *Id.* Because of incomplete voting or price information, a total of 47 companies were excluded from the data set. The exclusion percentage rate in this study is comparable to other work in this area. *See* DeAngelo & Rice, *supra* note 113, at 345-47 (reflecting that out of 265 potential companies, 165 were excluded from the data set because of "confounding events").

[166]During this period, no M&A proposals in the IRRC set of companies which were presented to shareholders were ultimately defeated. Shareholder votes are often the last hurdle to a merger or acquisition and involve considerable time, expense, and public exposure. Therefore, it is not surprising that management is probably very hesitant to submit any proposal to the shareholders that it does not believe will pass.

[167]For example, in a merger vote that required the affirmative vote of at least a simple majority of all votes cast, but which actually received a 75% affirmative vote, the surplus vote would be twenty-five percentage points.

[168]It is important to note that in this article, the *average* effect of decisions rules is

$$P_a^p > P_b^p$$

Where P_a^p is the mean price premium in Group A, whose companies require a simple majority vote, and P_b^p is the mean price premium for Group B, where a two-thirds supermajority vote is needed. The results of this test are presented in Table 1, and it appears that there is no significant difference between the prices paid to shareholders in Group A and Group B companies in the event of a takeover. This means that the above hypothesis cannot be accepted. Additionally, the shareholders in each group seemed to have received the historical, average price premium for acquired companies, lending support to the assumption that the data set is fairly representative of typical corporate merger and acquisition activity.

TABLE 1

The Average Price Premium Paid To Target Shareholders

	Average Price Premium
Group A (Majority Rule) (n=30)	41.84%
Group B (Supermajority Rule) (n=20)	42.14%
Market Average 1982-1989[169]	41.58%

being analyzed *across* companies. Finding a negative, positive, or indeterminate effect on the average price of equity for the companies examined does not rule out the possibility of a different effect for any individual company's stock (i.e., the possibility remains that supermajority voting rules have different effects for different companies within a sample set). Therefore, any conclusions drawn from this research are properly interpreted as providing evidence concerning only the average effect of supermajority rules on shareholder wealth.

[169]Calculation taken from *Control Premiums in Mergers & Acquisitions*, Mergers & Acquisitions 77 (Jan./Feb. 1990). The years 1980 and 1981 were excluded from the calculations because they seem to represent abnormal years, however, if they were included the average would be somewhat higher. Data for the years 1990 through 1995 seems subject to constant revision in *Mergers & Acquisitions* and thus not particularly reliable. The typical price premium for control mergers is around 40% although the individual premiums accrued on individual offers differed between 1.7% and 120%. Lehn & Poulsen, *Value in Leveraged Buyouts: Wealth Created or Wealth Redistributed?*, *in* PUBLIC POLICY TOWARD CORPORATE TAKEOVERS 46, 52-53 (M. Weidenbaum & K. Chilton eds., 1988). Other authors have found

Because the calculation of a simple mean price premium can be problematic in identifying a possible relationship between the stock price premium paid and enacted corporate voting rules, a multivariate regression was constructed which incorporated not only supermajority voting requirements, but also state antitakeover laws and corporate FPPs. This was deemed necessary because many of the firms in Group A were either incorporated in states which have adopted antitakeover laws or have FPPs within their corporate charter, bylaws, or both. Such laws and corporate provisions could have presented "stealth" supermajority voting requirements which would effect the price premium paid, despite the fact that the decision rule at the shareholder meeting was a simple 50%.[170]

In addition to (1) the simple decision rule test described above, the following hypotheses were also tested: (2) companies incorporated in states with antitakeover laws should see their shareholders receive a higher price premium in the event of a takeover than those companies located in states with no such provisions, and (3) companies with corporate fair price provisions should likewise see their shareholders achieve a price advantage over target companies lacking such "protection," or

$$P_a^p > P_b^p$$

$$P_{ATL}^p > P_0^p$$

$$P_{FPP}^p > P_0^p$$

where P_a^P is the price premium to Group A, P_b^P is the Price Premium to Group B, P_{ATL}^P is the price premium to shareholders of firms with state antitakeover laws, P_{FPP}^P is the premium to shareholders whose companies have adopted FPPs, and P_0^P is the premium to shareholders whose company is subject to neither state antitakeover laws nor FPPs, respectively. The results of the regression are presented in Table 2, and

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higher returns. *See* Bernard S. Black, *Bidder Overpayment in Takeovers*, 41 STAN. L. REV. 597, 601 (1989).

[170]For example, an FPP or state law could require a supermajority voting provision in corporate takeover situations unless the offer is first approved unanimously by the board of directors. Knowing this, an acquiror may offer more for the shares of such a company in an effort to get a majority voting provision at the shareholder meeting. Merely the threat of a supermajority provision could increase shareholder returns, but the decision rule actually in use at the shareholder meeting might still be a majority rule, resulting in the term "stealth" supermajority provision.

it quickly becomes evident that none of the above hypotheses can be accepted, since the test fails to show any valid or significant statistical relationship between the variables discussed above.[171] From these results, it cannot be concluded that supermajority voting provisions, even when isolated from the effects of state antitakeover laws and corporate fair price provisions, produce any additional price premium for target shareholders.

This result is not unexpected. An examination of the fifty target companies which composed the data set shows that almost all of the firms achieved a shareholder vote approving the acquisition which was in the 90% plus range of approval, irrespective of the decision rule or price premium paid. Often, this approval percentage was in the 95% plus range.[172] In effect, it seems that once a proposed merger or acquisition has cleared the board of directors, it will then be overwhelmingly approved by the shareholders in most instances. Thus, for the most part, shareholder votes are merely an affirmation of the board's prior action, and the shareholder decision rule adopted appears to have no effect. This conclusion has a number of potential implications.[173]

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[171]The R^2 value shows the explanatory power of the regression. The low R^2 value of this test means the regression has no statistically significant explanatory power.

[172]Of the 50 target votes, only 5 had less then 90% of the affirmative votes cast.

[173]Corporate law scholars have recognized that such a situation might make supermajority provisions impotent, but have attempted to defend them on various grounds. *See, e.g.*, Coffee, *supra* note 142, at 1186-87. For example, Professor Coffee notes that the vast majority of shares are usually tendered in a tender offer, but he concludes that:

> [f]rom this fact, it might be inferred that a supermajority provision adds little, because a higher percentage of the shares than the supermajority provision would specify are typically tendered in any case. However, this argument confuses the coerced response of individual shareholders with rational shareholder bargaining. In reality, although the bidder usually seeks all the target's shares, it typically needs to obtain only a bare majority to assure itself of control. The target shareholders know this, and also realize that once the ramparts of corporate control have been seized by the bidder, they are substantially at its mercy and may be squeezed out at a lower price.

Id. This explanation may indeed be germane for single tiered tender offers or where the shareholders fear a second, less lucrative tier. However, the findings in this article do not seem to support such an assumption as a general rule.

TABLE 2

The Relationship Between Price Premiums, State Antitakeover Laws and Fair Price Provisions.

	Coefficient	P-Value
Majority/Supermajority	-0.32	.661
Antitakeover/None	1.34	.919
Fair Price Provision/None	6.20	.651

n=50
$R^2 = .0078$

First, stock prices may indeed be perfectly elastic. Certainly, the results of the past two tests suggest nothing inconsistent with CAPM.[174] These findings alone, however, while not supporting the HE theory[175] of stock prices, can not necessarily be used to refute it either, as there may well be a "prior hurdle" at work boosting stock prices above the HE models' expected marginal price level. Because company boards must generally approve a merger before the proposed transaction is submitted to shareholders, it is possible that a boards' per share "approval price" is as high or higher than the typical, two-thirds, stockholder's marginal vote price. If this were the case, the HE model could still be both valid and consistent with these results, although it would require an explanation as to why members of corporate boards consistently believe that the underlying "takeover" price of their company's shares is significantly higher than most of the stockholders. While such a prior hurdle would render supermajority voting requirements impotent at the shareholder level, such might still be consistent with the HE model.

Second, and more importantly, the justifications offered for the wave of corporate adoption of supermajority voting rules in the 1980s would appear to be quite hollow. Whether securities prices are perfectly

[174] *See supra* note 136 and accompanying text for a discussion of CAPM.
[175] *See supra* notes 145-49 and accompanying text for a discussion of the HE theory.

elastic, or the HE model holds through a prior hurdle, supermajority voting rules do not seem to have any direct effect on shareholder voting in the context of merger and acquisition activity.

A third implication flowing from these results is that certain of the inferences made by Professor Pound in his study are highly suspect.[176] For example, Pound concluded that target management use supermajority voting provisions as a mechanism to extract additional compensation for themselves from acquirors.[177] Pound contends that certain antitakeover provisions, including supermajority voting rules:

> confer sufficient additional bargaining power to target managements to ensure that bidders will be forced to secure management' approval of the deal....the implication is that part of the increased costs imposed by antitakeover amendments comes in the form of higher direct compensation paid to target managements to purchase their support for control transfer.[178]

Pound's view of corporate management is one in which its actors are somewhat scheming and highly self-interested; a group which seems to have few inhibitions about extracting additional compensation for itself at the expense of its shareholders. Yet, why would management resort to such tactics only occasionally (when supermajority rules are present), and not in every case? Does management really need such devices to be so self-interested? Most of the fifty firms in the compiled data set achieved a very high affirmative shareholder vote with a large vote surplus. Commonly, the vote to approve a merger achieved the affirmative vote of approximately 99% of shares cast. Since most companies required that the decision rule apply to the number of shares outstanding, rather than those merely voted,[179] such high approval percentages were necessary to offset those shares not cast, although the average surplus achieved at most shareholder meetings was still substantial. For companies with a simple majority decision rule, the

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[176]*See supra* text accompanying notes 158-59 for a discussion of the Pound study and its conclusions.

[177]Pound, *supra* note 158, at 365-67.

[178]*Id.* at 365-66.

[179]This is, in itself, a form of supermajority voting since the amount actually necessary to conclude a decision is greater than the affirmative vote of 50% of the voting shares present at a meeting. Requirements such as these simply case all absent votes as a "no," thereby placing a burden, which some view as justifiable, on those taking action to promote attendance at the shareholder meeting.

average surplus vote was 27.61 percentage points, and for those with two-thirds supermajority rules, the average surplus was 13.97 percentage points. In that companies with supermajority requirements did not achieve voting levels any different than those with a majority rule (i.e., the 13.97 surplus vote is nearly identical to the 27.61 surplus vote when 16.67 supermajority differential is added back), management does not seem to obtain any real bargaining power from the use of the supermajority rule.

Why, then, does management not consistently lower the price received by shareholders, increase the compensation flowing to itself, and risk a lower number of affirmative votes by shareholders? For example, would a highly self-interested management give shareholders $78 a share in an acquisition offer, knowing that it will likely achieve 99% of the affirmative shareholder vote at a special meeting, and a surplus vote near 30 percentage points, when it might just as easily reduce the offer to shareholders to $75 per share, pocket the difference, and still almost certainly be assured of the minimum vote necessary to approve the merger while allowing management, many of whom will be terminated from their jobs after the transaction is consummated, a generous, self-imposed cash out? Of the thirty companies in Group A which required only 50% approval by shareholders, twenty-four received at least 95% shareholder approval for the transaction proposed by management. Yet, according to Pound's analysis, these managers are expected to receive less overall compensation from the transaction because they lack the bargaining power that the supermajority voting rule provides.[180] Almost counter to Pound, it may be expected that management in companies with simple majority rules would be the most scheming and rent-seeking since they have the most surplus vote around which they might navigate a more self-interested transaction.

In most large merger transactions, even one or two dollars taken off the per share price for shareholders would reap a considerable compensatory windfall for management. Management may, indeed, reap such a windfall in acquisition transactions; however, it is clear that they have the power to do so in all such transactions, and there is no reason to believe that supermajority provisions give management the means to

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[180]One alternative explanation to this notion could be that self-interested boards promote supermajority voting provisions at annual meetings, while more "virtuous" boards maintain simple majority rules. Thus, at an acquisition or merger, it is the self-interested board who receives more compensation, which in turn reflects on the supermajority voting provisions. However, if such scheming were actually occurring, self-interested boards would seem to have enough power to extract additional compensation in other ways, rather than solely through the use of the supermajority.

take from shareholders what they already have the capacity to take in the absence of such provisions.

2. Voting by Acquiror Shareholders

An analysis of the forty-four acquiring companies which comprise the assembled data set proved, at the outset, to be statistically invalid, as only two of the forty-four companies required a supermajority vote of shareholders to approve an acquisition by the company. It is not necessarily unexpected that an acquisition does not merit a high level of scrutiny from the acquiree's shareholders, since the event which would normally trigger shareholder rejection of an acquisition usually impacts all shareholders equally. When voting interests are aligned, supermajority provisions generally contribute little to the decision making process. A priori, it was thought that there may be an inverse relationship between acquiree and acquiror shareholder voting on mergers and acquisitions because it might be expected that if target shareholders overwhelmingly approve a transaction, some of the acquiree's shareholders may become reticent at the price offered. Unfortunately, this proposition was also untestable. Because most voting by target shareholders was in the mid to upper 90% range, any statistical analysis between the acquiror and acquiree voting yields inconclusive results.

III. CONCLUSION

Throughout most of American history, corporate decision rules were derived from the theory of the corporation. Corporate scholars spent untold hours explaining how shareholder voting rules were part of the very nature of what the corporate entity, at each period of time, was actually considered to be. With the rise of legal realism and attendant twentieth century scholarship, corporate supermajority voting took on a consequentialist air, becoming an instrument of corporate policy. By the 1980s, shareholder supermajority voting rules were being championed among American corporations as a way to protect minority shareholders against "unfair" tender offers pursued by predatory acquirors. In response, critics charged that supermajority voting rules were indeed instruments, yet ones used by corporate management to entrench and enrich themselves. While clearly decisive in closely contested votes, the tests conducted for this article show that in most instances, supermajority voting rules neither affect the ultimate outcome of corporate shareholder votes for targets in M&A transactions nor increase the price received by tendering shareholders. In an ironic sense, the justifications used today

to promote corporate supermajority voting rules may be just as illusory as those used in preceding eras to maintain the essence of the corporate entity itself.