WHOM SHOULD THE CORPORATION SERVE? THE BERLE-DODD DEBATE REVISITED SIXTY YEARS LATER

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One of the characteristics of corporation law, and indeed, perhaps of life, is that few issues are ever settled conclusively. While Robert Bork would like us to think that the content of the Constitution was fixed in 1789, the truth is that its content is constantly shifting, and notwithstanding the best efforts of justices to link their present decision making with the past in an effort to make it appear that nothing has changed, the truth is that change has occurred.

That matters are never finally resolved is a reflection of the fact that our complicated political and economic society is constantly compelling us to reexamine the assumptions and the rules that guided us in the past to determine their relevance to what we confront today. Sometimes that reexamination results in a reaffirmation of our past commitments to those assumptions and rules. Sometimes it compels some modification or adjustment, and sometimes it suggests an outright and sharp change of direction.

These reexaminations are usually triggered by a dramatic event or series of events and are initiated by some of those involved in the events whose interests in dealing with those events would be served by changing the rules. And generally others involved in those events see their interests served by preserving the rules that have historically guided people. Those seeking to promote their interests either by changing or conserving the rules generally, of course, try to cloak their self-interest in a variety of altruistic raiments. They will appeal to history, or the unarticulated premises purportedly underlying the rules, or the unfairness of preserving the rules as they are, or the need to change the rules to serve the broader interests of society.

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This article is derived from the Francis G. Pileggi Distinguished Lecture in Law, which the author delivered at the Widener University School of Law, Wilmington, Delaware, on April 11, 1990.

These debates usually occur amidst battles involving large stakes, high tensions and huge pressures. The danger they pose is that these stakes, tensions, and pressures will lead to decisions that are designed to serve the needs and interests of the moment without sufficient attention to the long-term, multifaceted consequences of those decisions. As these consequences unfold often those who fashion the new rules, or succeed in preserving the old, are astonished at what they have wrought.

We can see in the struggles, mainly of the eighties, with regard to hostile tender offers, a demonstration of these observations. Many seemingly solidly established principles were questioned, defended, adapted, modified (and sometimes left untouched), in many instances to serve the needs of the moment without concern for how those decisions would play through the long future.

As a result of the onset of tender offers, we have witnessed a grinding effort by the Delaware Chancery and Supreme Courts to fashion judicial doctrines to deal with the unique problems posed by hostile tender offers. Out of those efforts came the *Unocal Corp. v. Mesa Petroleum Co.*[1] and *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*[2] doctrines which were masterful attempts to modify the classic business judgment rule to reflect the unique pressures put on boards, including their independent directors, by the unwanted offers.

Similarly, corporations and their counsel devised means, often ingenious, to thwart or defeat such offers. Supermajority requirements, fair price charter amendments, staggered boards, limitations on the right to act by consent, were all efforts to counter the perils of the hostile offer. The most unique of these efforts, of course, was the "poison pill," more euphemistically known as "shareholders' rights plans."[3] In one sense this particular device may be seen as an effort to restore to directors, in the context of tender offers, the often preclusive role they have in mergers and sales of substantially all the corporation's assets.[4]

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1. 493 A.2d 946 (Del. 1985).

2. 506 A.2d 173 (Del. 1986).

3. Chancellor William T. Allen of the Delaware Court of Chancery has characterized the "poison pill" as a "most audaciously brilliant corporation law innovation . . . ." Remarks, *A Glimpse at the Struggle for Board Autonomy in American Corporation Law*, Stanford Law School, Apr. 5, 1990, at 6.

4. *See* Johnson & Millon, *The Case Beyond Time*, 45 BUS. LAW. 2105, 2122 (1990). Under the typical state corporation law, before a merger proposal or a proposal to sell all or substantially all of a corporation's assets may be submitted

Wary of the willingness of courts to provide the protections wanted and the extent to which certificate provisions could thwart hostile intentions, participants in the process, mainly management, brought their plight to state legislatures. For a while, following the decision of the United States Supreme Court in *Edgar v. MITE Corp.*,[5] it looked as if that approach was doomed, but the ingenuity of counsel for would-be targets, combined with the interests of state legislators and governors in avoiding the exodus of facilities and employees which often followed completion of a tender offer, developed through state action a formidable new variety of weapons to stave off unwanted bids and strengthen the hands of management in opposing them. These new weapons, or at least some of them, appear to pass constitutional muster.[6]

The takeover phenomenon revived many debates about what we thought were well-established principles. Perhaps none of those debates has deeper significance for the future of corporations than the one about the interests corporations should properly serve with its correlative concerning the duties of directors to various constituencies. This debate has been triggered by the adoption by, at last count, about 30 states of so-called "other constituency" statutes which, in one form or another, purport to permit or require directors to consider the interests of other groups in addition to shareholders in making their decisions.[7]

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to shareholders, it must first be approved by the directors. The Delaware Chancery Court has held that the action of directors in determining whether to approve a merger or sale of assets is governed by the ordinary business judgment rule and not by the enhanced business judgment rule set forth in *Unocal*. *See also* TW Servs., Inc. v. SWT Acquisition Corp., Nos. 10,427 & 10,298, slip op. at 32-34 (Del. Ch. Mar. 2, 1989), *reprinted in* 14 DEL. J. CORP. L. 1169, 1191-92 (1989).

5. 457 U.S. 624 (1982) (Illinois takeover statute requiring a tender offeror to notify the Secretary of State and target corporation of intent to make an offer 20 days prior to the offer's effectiveness, restraining offeror from disseminating information to target's shareholders, and allowing the Secretary of State to determine the substantive fairness of the tender offer held unconstitutional under the commerce clause).

6. *See* CTS Corp. v. Dynamics Corp. of Am., 481 U.S. 69 (1987) (Court upheld an Indiana statute which provided that upon acquisition of a threshold level of "control shares" in target company, the approval of the majority of the target's disinterested shareholders was required to restore voting power to the control shares).

7. *See* INSTITUTION SHAREHOLDER SERVICES, INC., ISSUE ALERT 2 (Dec. 1990); 3 A. FLEISCHER, JR., TENDER OFFERS: DEFENSES, RESPONSES AND PLANNING 1046.29-.56 (Supp. 1989) (listing the other constituency statutes as of August 31, 1989).

I. HISTORY AND BACKGROUND

This debate has origins deep in the past. In the earliest days of the United States (and England, for that matter) business enterprises were incorporated principally to serve some needed public purpose. Professor James Willard Hurst has said: "[A]lmost all of the business enterprises incorporated here in the formative generation starting in the 1780's were chartered for activities of some community interest—supplying transport, water, insurance, or banking facilities."[8]

Thus, while clearly the organizers of early corporations did so with the expectation of profits, the corporations were to serve a public purpose and as such were overseen closely by the state which sanctioned their organization. This recognition of the social purpose of the corporation continued into the nineteenth century.[9]

Throughout American history, the corporation has been an object of suspicion among the American people. This has derived, historically, from the fact that in its earliest incarnations, the corporation was equated with monopoly, and monopolies posed great opportunities for abuse. Then, as general corporation laws were liberalized and the limitations which had restrained the size of corporate enterprises—limits on capitalization and duration and prohibitions against holding companies—were eliminated, the American public was frightened anew by the specter of enormous concentrations of power crushing them down.

This fear culminated in the twenties and its aftermath, the Great Depression of the 1930s. During the hearings that grew out of the 1929 market collapse, the abuses of corporate power were dramatically presented, confirming the concerns which Americans had long held.

As the nation sank deeper into economic chaos, Professor Adolf A. Berle of Columbia Law School and Professor E. Merrick Dodd

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8. J. HURST, THE LEGITIMACY OF THE BUSINESS CORPORATION IN THE LAW OF THE UNITED STATES 1780-1970, at 15 (1970). Professor Hurst fleshed out this assertion:

> Of the 317 separate-enterprise special charters enacted from 1780 to 1801 in the states, nearly two-thirds were for enterprises concerned with transport (inland navigation, turnpikes, toll bridges); another 20 per cent were for banks or insurance companies; 10 per cent were for the provision of local public services (mostly water supply); less than 4 per cent were for general business corporations.

Id. at 17.

9. *Id.* at 161-62.

of Harvard engaged in a classic scholars' debate which was, and is now, of tremendous currency and relevance. The issue was plainly posed by the title of Professor Dodd's opening shot, *For Whom Are Corporate Managers Trustees?*[10] In response to an earlier article by Professor Berle to the effect that "managerial powers are held in trust for stockholders as sole beneficiaries of the corporate enterprise,"[11] Professor Dodd said that:

> [this writer] believes that public opinion, which ultimately makes law, has made and is today making substantial strides in the direction of a view of the business corporation as an economic institution which has a social service as well as a profit-making function, that this view has already had some effect upon legal theory, and that it is likely to have a greatly increased effect upon the latter in the near future.[12]

In response, Professor Berle said: "Now I submit that you can not [sic] abandon emphasis on 'the view that business corporations exist for the sole purpose of making profits for their stockholders' until such time as you are prepared to offer a clear and reasonably enforceable scheme of responsibilities to someone else."[13] Professor Berle finished his analysis with this summary:

> Unchecked by present legal balances, a social-economic absolutism of corporate administrators, even if benevolent, might be unsafe; and in any case it hardly affords the soundest base on which to construct the economic commonwealth which industrialism seems to require. Meanwhile, as lawyers, we had best be protecting the interests we know, being no less swift to provide for the new interests as they successively appear.[14]

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

11. *Id.* at 1147 (summarizing the position of Professor Berle in *Corporate Powers as Powers in Trust*, 44 HARV. L. REV. 1049 (1931)).

12. Dodd, *supra* note 10, at 1148.

13. Berle, *For Whom Corporate Managers Are Trustees: A Note*, 45 HARV. L. REV. 1365, 1367 (1932).

14. *Id.* at 1372. Interestingly, 22 years later Professor Berle conceded that events had settled the argument in Dodd's favor.

> Twenty years ago, the writer had a controversy with the late Professor E. Merrick Dodd, of Harvard Law School, the writer holding that corporate powers were powers in trust for shareholders while Professor Dodd argued

The issue as posed by Professors Berle and Dodd has continued to be debated through the years. Law journals have been filled with articles arguing the different viewpoints, and bookshelves bulge with books bearing titles like *The Corporate Conscience*, *The Social Responsibilities of Business Corporations*, *Social Responsibility and the Business Predicament*, *The Role of Business in Society*, *Corporate Strategies for Social Performance*; *Corporate Power and Social Responsibility*, and *Corporate Social Policy in a Dynamic Society*.

Ralph Nader and his colleagues have suggested that the diverse interests and responsibilities of corporations should be recognized by restructuring the boards of publicly held companies to provide that each director, in addition to his or her responsibilities to the corporation as a whole, would have a "separate oversight responsibility, a separate expertise, and a separate constituency so that each important public concern would be guaranteed at least one informed representative on the board."[15] Among the interests to be identified would be employee welfare, consumers, the environment and communities, shareholders, and law compliance.

The theme that directors should serve interests in addition to shareholders has been restated as the notion that the proper target of directorial attention should be *stakeholders* and not just stockholders. NCR Corporation (a corporation which has, it might be noted, served its shareholders well in recent years) has been in the forefront promoting this concept and in June 1988 sponsored a gathering of businessmen, scholars and others in Dayton, Ohio to discuss the implications of stakeholder management.[16] At this meeting the chairman and chief executive officer of NCR said, "I believe that the continued growth and prosperity of a business is the common interest of all its stakeholders. I also believe that the continued prosperity

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> that these powers were held in trust for the entire community. The argument has been settled (at least for the time being) squarely in favor of Professor Dodd's contention.

A. BERLE, THE 20TH CENTURY CAPITALIST REVOLUTION 169 (1954). However, Professor Berle later asserted he did not intend to indicate Professor Dodd was "right all along . . . . It is one thing to agree that this is how social fact and judicial decisions turned out. It is another to admit this was the 'right' disposition; I am not convinced it was." Berle, *Foreword* to THE CORPORATION IN MODERN SOCIETY xii (E. Mason ed. 1959).

15. R. NADER, M. GREENE & J. SELIGMAN, TAMING THE GIANT CORPORATION 125 (1976).

16. The proceedings have been published by NCR Corporation. *The First International Symposium on Stakeholders* (June 1989).

of a business depends on its success in meeting the reasonable expectations of ALL of its stakeholders."[17]

The issue was taken out of the law reviews and the world of academics and social activists and brought into the boardroom and legislatures by the onset of frequent and (at least until recently) increasingly massive takeovers during the 1980s.

II. ANTECEDENTS OF THE OTHER CONSTITUENCY STATUTES

Before any legislature addressed the question of "other constituencies," a number of corporations, apparently led by Control Data Corporation in 1978, adopted charter amendments authorizing directors to consider interests other than shareholders.[18] The Control Data formulation is typical:

> The Board of Directors of the Corporation, when evaluating any offer of another party to (a) make a tender or exchange offer for any equity security of the Corporation, (b) merge or consolidate the Corporation with another corporation, or (c) purchase or otherwise acquire all or substantially all of the properties and assets of the Corporation, shall, in connection with the exercise of its judgment in determining what is in the best interests of the Corporation and its stockholders, give due consideration to all relevant factors, including without limitation the social and economic effects on the employees, customers, suppliers and other constituents of the Corporation and its subsidiaries and on the communities in which the Corporation and its subsidiaries operate or are located.[19]

The validity of these charter provisions has never been judicially tested. If it is assumed that these provisions do no more than "codify" existing law which permits directors to consider other interests as long as the long-term interests of shareholders are not thereby prejudiced,[20] then it would appear that they should properly be upheld.

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17. *Id.* at 5 (address by Exley, *Managing for Stakeholders*).

18. The Investor Responsibility Research Center has estimated that, of the 1500 corporations monitored by the Center, 13 in 1986 and 14 in 1987 adopted such provisions. McGurn & Jaenicke, *Considering Nonfinancial Effects of a Merger, 1989 Background Report N*, Corp. Governance Serv., Apr. 25, 1989, at N-6.

19. 1 R. WINTER, M. STUMPF & G. HAWKINS, SHARK REPELLENTS AND GOLDEN PARACHUTES: A HANDBOOK FOR THE PRACTITIONER 200-01 (Supp. 1988).

20. *See infra* notes 31-32.

However, if these provisions are construed to place shareholders in some manner on a parity with other constituencies, or perhaps even permit directors to put shareholders in a position inferior to other interests, then their legality may be questionable since, in such case, the fiduciary duty of directors to shareholders might be impaired.[21]

III. THE OTHER CONSTITUENCY STATUTES

In 1982, the United States Supreme Court in *Edgar v. MITE Corp.*[22] invalidated virtually all, if not all, of the state enacted statutes then existing which sought to regulate tender offers. Using as a touchstone the traditional doctrine that the internal affairs of corporations were properly the domain of the states, the states with an interest in restraining tender offers began to adopt new laws framed to avoid the strictures of the *Edgar* case. These laws took various forms, including restrictions on the capacity of a target company to merge or engage in other transactions for a stipulated period with anyone who acquired more than a certain percentage of the target stock, requirements that shareholders approve the voting or transfer of shares acquired in excess of a certain percentage, and permission for directors to consider other constituencies in making decisions.

While the wisdom of the other kinds of enactments has been vigorously argued, it is the last type of statute, the so-called "other constituency" statute, that holds the potential for working the most profound changes in long-standing corporation law.

In 1983, Pennsylvania, which has been and which, as will appear later, continues to be in the vanguard of states determined to protect

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21. For example, § 102(b)(1) of the Delaware General Corporation Law provides that a corporation's certificate of incorporation:

> may also contain any or all of the following matters: (1) Any provision for the management of the business and for the conduct of the affairs of the corporation, and any provision creating, defining, limiting and regulating the powers of the corporation, the directors, and the stockholders . . . if such provisions are not contrary to the laws of this State.

DEL. CODE ANN. tit. 8, § 102(b)(1) (1983). If, as seems proper, the decisions of the Delaware Supreme Court are seen as among the "laws of this State," then any certificate provision that contravenes the holdings of the supreme court, with respect to the extent to which directors may take into account other constituencies, would appear to be impermissible in a certificate of incorporation. *See infra* notes 31-35 (discussing Delaware law with respect to the consideration of other constituencies).

22. 457 U.S. 624 (1982). *See also supra* note 5.

domestic corporations from unwanted attention,[23] became the first state to enact an "other constituency" statute. Since then another twenty-four states (at time of writing) have adopted such statutes in one form or another.[24]

The most common formulation has been the original Pennsylvania provision:

> In discharging the duties of their respective positions, the board of directors, committees of the board, and individual directors may, in considering the best interests of the corporation, consider the effects of any action upon employees, upon suppliers and customers of the corporation and upon communities in which offices or other establishments of the corporation are located, and all other pertinent factors.[25]

Twenty-four of the statutes in effect at the time of this writing incorporate the "may" language of the Pennsylvania statute, and all but six of them apply to all decision making by directors, not just that in change of control situations.[26] Some of those statutes have expanded the interests which directors may consider; for instance, in Ohio the interests which directors may consider include the long- and short-term interests of the shareholders, the possibility that the interests of shareholders may be best served by continued independence of the corporation, the economy of the state and nation, and community and societal considerations.[27]

This "may" form of statute may be simply a codification of existing law. It has long been held that corporations may use their resources to some reasonable extent for eleemosynary and other purposes that may, at least in the short term, reduce the resources belonging to the shareholders and the return to them.[28] While earlier

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23. This sensitivity caused Martin Lipton, one of the most famed takeover attorneys and principally associated with the defense of corporations, to suggest to his corporate clients that they abandon Delaware and other states and reincorporate in Pennsylvania.

24. *See* FLEISCHER, *supra* note 7 (listing and summarizing other constituency statutes as of August 31, 1989).

25. 42 PA. CONS. STAT. ANN. § 8363(b) (Purdon Supp. 1982).

26. *See* FLEISCHER, *supra* note 7.

27. OHIO REV. CODE ANN. § 1701.59(E)(4) (Anderson Supp. 1990).

28. *See, e.g.*, Shlensky v. Wrigley, 95 Ill. App. 2d 173, 237 N.E.2d 776 (1968) (holding that courts should not interfere with corporate decisions unless the conduct of the directors involves some fraud, illegality, or conflict of interest); Ruder, *Public Obligations of Private Corporations*, 114 U. PA. L. REV. 209 (1965-66) (differentiating

cases justified such action only if there appeared to be a direct benefit to the corporation, more recent cases take an expanded view and uphold such conduct either on the theory that there is a conclusive presumption of a profit-maximizing purpose or on the broader ground that such corporate contributions help to maintain a healthy social system which over the long run benefits the corporation.[29]

Under Delaware law, and probably under the law of other jurisdictions as well,[30] the courts have clearly indicated that at least in the context of control decisions, directors may take into account the interests of employees, suppliers, customers, and others subject to the limitation that there be "some rationally related benefit accruing to the stockholders"[31] or "some reasonable relationship to general shareholder interests."[32] There is no reason to believe that this principle is not applicable in noncontrol decision-making contexts.

The statutes which say directors *may* take into account other constituencies thus appear at first glance to parallel Delaware case law. However, unlike the Delaware cases, and unlike the American Law Institute (ALI) Corporate Governance Project articulation of permissible director conduct in resisting takeovers,[33] they omit the requirement of a nexus to shareholders: "rationally related benefit," "reasonable relationship," "not materially disfavor." Moreover, they do not reflect the limitation of *Revlon* which states that directors may

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between public and private corporate objectives and concluding that management can use corporate assets to satisfy public obligations if decisions are justified on theories of profit maximization).

29. ALI PRINCIPLES OF CORP. GOVERNANCE: ANALYSIS AND RECOMMENDATIONS § 2.01, Reporters Note 2 (Tent. Draft No. 2, 1984).

30. In assessing the actions of directors, a federal district court applying New York corporation law described directors' actions as "made with a good-faith intent to serve the shareholders' best interests." GAF Corp. v. Union Carbide Corp., 624 F. Supp. 1016, 1018 (S.D.N.Y. 1985). The court also said: "A corporation with a perceived threat of dismemberment of large divisions of the enterprise, employing thousands of employees, owes substantial regard for their pension benefits, and in the case of loyal management, severance benefits" and the board must balance investors' interests on the one hand and "the legitimate concerns and interests of employees and management . . . who service the interests of investors, on the other." *Id.* at 1019-20.

31. *Revlon*, 506 A.2d at 176.

32. Mills Acquisition Co. v. MacMillan, Inc., 559 A.2d 1261, 1282 n.29 (Del. 1989).

33. ALI PRINCIPLES OF CORP. GOVERNANCE: ANALYSIS AND RECOMMENDATIONS § 6.02 (Council Draft No. 15, 1990). This provides that directors of target companies may take into account other interests as long as they reasonably conclude that "[their action] would not significantly disfavor the long-term interests of shareholders." *Id.* § 6.02(b)(2).

consider *only* the interests of shareholders once the decision has been made to sell the company[34] or "effect a business reorganization involving a clear break-up of the company."[35] Thus, unless a court determined to read limitations into these statutes like those expressed by the Delaware courts, a decision favoring constituencies other than shareholders, regardless of impact on shareholders, would appear to be permissible in any situation covered by the statute.

Suggestive of an intent on the part of legislatures to alter the directors' relationship to shareholders is the fact that, unless they are engaged in a formal codification project, legislatures typically do not engage in law making simply to codify existing law. Moreover, most of these statutes have been adopted in the context of concern over the possibility of hostile tender offers directed against local enterprises, often in conjunction with other measures having a similar purpose. Thus, it may be reasonably concluded that the legislature intended to do something common law did not do in affording directors flexibility in fending off a hostile tender offer—namely, favor non-shareholders over shareholders. Moreover, at least one commentator, in discussing charter provisions framed in substantially the same language as the Pennsylvania statutory provision, apparently believes such a provision expands the discretion of the board.[36]

Whether statutes formulated in the subjunctive and not containing explicit protection to directors who prefer non-shareholder constituencies permit directors to abandon their traditional fiduciary duties to shareholders must await judicial clarification, if such ever comes. The likelihood of such a clarification seems remote, for only

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34. *See Revlon*, 506 A.2d at 182.

35. Paramount Communications, Inc. v. Time, Inc., 571 A.2d 1140, 1150 (Del. 1989).

36. 1 FLEISCHER, *supra* note 7, at 59. The particular charter provision, described as typical by Fleischer, states:

> The Board of Directors of the corporation, when evaluating any offer of another party to (a) make a tender of exchange offer *shall*, in connection with the exercise of its judgment in determining what is in the best interests of the corporation and its stockholders, give due consideration to (1) all relevant factors, including without limitation the social, legal, environmental and economic effects on the employees, customers, suppliers and other affected persons, firms, and corporations and on the communities and geographical areas in which the corporation and its subsidiaries operate or are located and on any of the businesses and properties of the corporation or any of its subsidiaries, as well as such other factors as the directors deem relevant . . . .

Id. at 59-60 (emphasis added).

a reckless corporate advisor would permit board minutes, or an accurate rendering of the advice given a board, to suggest that the board had put non-shareholder interests before those of shareholders.

Some states have adopted statutory provisions that differ from the typical "may" formulation and, in so doing, have created unique interpretive problems. Connecticut, which confines the operation of its provisions to Connecticut corporations registered under the Securities Exchange Act of 1934, has substituted "shall" for "may," thus putting a *mandate* on directors that they consider other constituencies in change of control situations.[37] A review of the legislative floor debates discloses nothing about the reasons for this formulation or the way in which it should be construed or implemented.

This formulation, of course, goes considerably beyond the standard stated by the Delaware courts and the Pennsylvania-type statutes which make consideration of other constituencies totally discretionary. Mandating other constituency consideration raises difficult interpretive and practical problems. What conduct by the board would constitute compliance with the statute? What would constitute "consideration" of other interests? What would be the remedy if it were shown, for instance, that the board failed to give any consideration to one of the enumerated interests, for example, employees or customers—rescission of the transaction, damages, allocation of part of the premium to the unconsidered constituency? Moreover, does "consideration" imply that the board must reach a decision not disfavoring the constituency entitled to be considered?

The Connecticut statute is one of those which purports to protect directors from liability if they act in a manner favoring other constituencies. However, the potential for mischief under the Connecticut statute is much greater than under the "may" formulations. Again, the full implications of this statute must await judicial explication.[38]

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37. CONN. GEN. STAT. ANN. §§ 33-313(e)(3), (4) (West Supp. 1990).

38. If one takes the arguments of the proponents of the other constituency statutes at face value, they seem to be arguing that the Connecticut formulation is the appropriate one, since they emphasize that directors *should* take into account the interests of other groups; that it is unfair for the shareholders to receive the entire takeover premium; that there is an implicit contract with other "stakeholders" that must be honored by directors; that unless directors so favor other constituencies even at a cost to shareholders, government may intervene to compel such favoring. S. Walman, *The Reemergence of the Corporate Constituency Concept* (materials distributed at program, *Changing Contours of the Business Judgment Rule*, Chicago, Ill. (Aug. 6, 1990)); M. McDaniel, *The Promise and Potential of Non-Shareholder Constituency Statutes* (materials distributed at program, Northwestern University School of Law, Chicago, Ill. (May 11, 1990)).

Several states have sought to clarify the implications and consequences of their other constituency statutes. New York law states that directors "shall be entitled to consider" the various enumerated constituencies, and ends with the declaration that "[n]othing in this paragraph shall create any duties owed by any director to any person or entity to consider or afford any particular weight to any of the foregoing or abrogate any duty of the directors, either statutory or recognized by common law or court decisions."[39]

The language quoted above would appear to preserve the traditional fiduciary duty of directors to maximize the economic prosperity of the corporation for the benefit of shareholders. Some of the legislative history, however, appears to contradict this. For instance, the Governor's Program Bill Memorandum in support of the legislation states:

> This bill takes a further step. By amending section 717 [of the BCL] this bill makes it clear that a corporate director's duty to a corporation *encompasses more than a duty to maximize profits for shareholders* but also includes consideration of such things as the corporation's long-term growth, its relationship to its employees, and its ties to the communities in which it operates.[40]

At a minimum, it is difficult to reconcile this language with the express terms of the statute.

Some states have gone to considerable lengths to make clear that shareholders have no preferred position and may be subordinated to the interests of other groups. The Indiana legislature made clear its intention that directors and their decisions would be sheltered from attack if a majority of the disinterested directors in good faith and after a reasonable investigation made a determination that favored a non-shareholder constituency over the shareholders.[41] The statute says: "In making such determination [whether a proposed action is in the best interests of the corporation], directors are not required to consider the effects of a proposed corporate action *on any particular corporate constituent group or interest as a dominant or controlling*

39. N.Y. BUS. CORP. L. § 717(b) (McKinney Supp. 1990).

40. Governor's Program Bill No. 128, 1989 Memorandum (emphasis added). *See also* New York State Assembly Memorandum in Support of Legislation, Bill Number: Assembly 8115A, Senate 4725.

41. IND. CODE ANN. § 23-1-35-1(g) (West Supp. 1989).

factor."[42] Thus, directors may make determinations that subordinate the interests of shareholders to those of other constituencies if the decision is made by independent directors after a reasonable investigation and in good faith. To further assure that there could be no misunderstanding, the Indiana statute also provides that, in Indiana, Delaware cases are not to be considered precedent.[43]

Pennsylvania, after extensive hearings and considerable criticism in the national and international press, in May 1990 replaced its earlier other constituency statute with one closely paralleling Indiana's. To avoid the possibility of claims being made by non-shareholder constituencies that their interests had not been adequately considered or protected, this statute specifically states that only the corporation, or a shareholder in a derivative suit, may sue to enforce the duties of directors and that:

> this subsection does not impose upon the board of directors, committees of the board and individual directors, any legal or equitable duties, obligations or liabilities or create any right or cause of action against, or basis for standing to sue, the board of directors, committees of the board and individual directors.[44]

Thus, it would not appear permissible for a shareholder to pursue an action either individually or derivatively asserting that the directors of a Pennsylvania corporation had breached any duty to shareholders if the directors, in good faith and fully informed, explicitly and significantly subordinated shareholder interests to, for instance, those of the employees or the communities in which the corporation had facilities.

IV. "THE BEST INTERESTS OF THE CORPORATION"

All, or virtually all, of the other constituency statutes provide, as does the original Pennsylvania formulation (and the more recent one as well), that directors "may, *in considering the best interests of the* CORPORATION, consider the effects of any action upon employees . . . ."[45] A critical question in interpreting these statutes is the

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42. *Id.* § 23-1-35-1(f) (emphasis added).

43. *Id.*

44. Act approved Apr. 27, 1990, Act No. 1990-36, 1990 Pa. Legis. Serv. 93, 95 (Purdon).

45. PA. CONS. STAT. ANN. § 8363(b) (Purdon 1982) (emphasis added).

significance to be accorded the emphasized language. The answer to that question depends upon the content one gives the word "corporation." If the word "corporation" is understood as a synonym for the shareholders as a body, then the other constituency statutes are consistent with what appears to be the prevailing state of the law in American and English jurisdictions: non-shareholder interests and constituencies may be taken into account if in so doing the long-term interests of the shareholders as a body are served, or at least not disadvantaged. On the other hand, if "corporation" is used to mean a separate juridical entity that has interests, long- or short-term, to be protected by directors in addition to or apart from those of shareholders, then one is left with the chore of defining those interests, and of doing it in a way that is different from simply restating the long-term interests of shareholders.

If the proper understanding of "corporation" in this context is the latter, then presumably the directors have a very broad latitude in acting to protect the interests of the corporation. Such latitude could certainly be construed to include protection of the interests of all groups that relate to the welfare of the corporation, including not only shareholders as providers of capital, but also creditors, employees, communities, suppliers, customers, and so on. Clearly all of these contribute to the welfare of the corporation if the corporation is seen as something other than the equivalent of the interests of its shareholders. Thus, it may well be argued that if this is the meaning of "corporation" in the context of the other constituency statutes, then the other constituency statutes are a redundancy. In other words, if the obligation of the directors to serve the best interests of the corporation necessarily permits consideration of other interests and constituencies, the language authorizing the taking into account of non-shareholders' interests is unnecessary.

English scholars identify the interests of shareholders as a group with the corporation. Professor L.C.B. Gower, perhaps the most distinguished scholar of English companies law, states in his treatise that the directors' obligations run to the corporation. However, he recognizes that the distinction between "corporation" (or "company" to use the more common British term) and its shareholders (or, again using the English term, "members") is elusive:

> But what exactly is meant by saying that they [directors] must act in the interests of the *company*? Despite the separate personality of the company it is clear that directors are not expected to act on the basis of what is for the economic

> advantage of the corporate entity, disregarding the interests of the members.[46]

Similarly, Professors Boyle and Birds have said,

> It is . . . thought that from the point of view of strict law, while the 'interests of the company' may now include the interests of the company's employees [as a result of section 309 of the Companies Act], and in certain situations the interests of its creditors [when a company is insolvent or on the verge of insolvency], it otherwise means the interests of the company as a commercial entity, *to be judged in most cases by reference to the interests of present and future shareholders alone. Thus the only circumstances in which the directors may legitimately promote the interests of any other groups or entities are those where to do so ultimately advances the interests of the shareholders.*[47]

Professor Robert Pennington has summed up the state of English law most concisely:

> Directors' powers are given to them to be used for the benefit of the company, *that is, for the benefit of the shareholders as a whole*, and not for the benefit of the directors themselves, nor for the benefit exclusively of a section of the shareholders or employees of the company, nor for the benefit of the company's parent or holding company or the company's subsidiaries, or of outsiders.[48]

In the United States the equivalence of "corporation" and "shareholders" (or at least the long-term interests of shareholders) is most clearly seen in the manner in which courts and writers have used these terms, and that usage tends to show that they use them as equivalents. In *Unocal*, the Delaware Supreme Court, in the course of two pages, described the directors' "fundamental duty and obligation"[49] as running first to "the corporate enterprise, which includes stockholders,"[50] later to "the corporation and its share-

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46. L. GOWER, GOWER'S PRINCIPLES OF MODERN COMPANY LAW 577 (4th ed. 1979).

47. A. BOYLE & J. BIRDS, BOYLE & BIRDS' COMPANY LAW 592-93 (2d ed. 1987) (emphasis added).

48. R. PENNINGTON, COMPANY LAW 591 (6th ed. 1990) (footnote omitted) (emphasis added). Professor Pennington wrote this before the enactment of § 309 of the Companies Act which places upon directors an obligation to take into account the interests of shareholders.

49. *Unocal*, 493 A.2d at 954.

50. *Id.*

holders,"[51] and finally, to just "the corporation's stockholders."[52]

In a similar vein, Fletcher in *Fletcher Cyclopedia of the Law of Private Corporations*, in describing the fiduciary duties of directors, speaks in the same section of directors' duties as running to the corporation and as running to shareholders, and includes numerous citations supporting each position.[53]

This blurring of the distinction between the corporation and its shareholders is most clearly seen in the so-called *Unocal* doctrine which the Delaware Supreme Court has developed as a tool for dealing with the defensive measures taken by target boards. Under this doctrine, before the traditional business judgment rule is applied, the court must first determine whether the target board reasonably perceived there was a threat to the "policy and effectiveness" of the corporation, and then whether the board's response was reasonable and proportionate to the threat.[54] In *Unocal* the threat to the corporation's policies and effectiveness supposedly stemmed from the coercive and inadequate nature of the offer.[55] In the *Paramount* case, the Delaware Supreme Court reiterated the nature of the *Unocal* threat: "*Unocal* involved a two-tier, highly coercive tender offer. In such a case, the threat is obvious: shareholders may be compelled to tender to avoid being treated adversely in the second stage of the transaction."[56]

It is difficult to see how the threat of a coercive offer or an inadequate offer would constitute a threat to the "policies or effectiveness" of a corporation, while a noncoercive or adequate offer would not: in either case, the continued existence of the corporation would be jeopardized with the consequent termination of all policy and effectiveness.

Thus, even in *Unocal*, a seminal case in Delaware corporate jurisprudence, the supreme court blurred the distinction between the interests of the corporation and those of the shareholders. Chancellor Allen well expressed the dilemma reflected in this blurring in a footnote in *TW Services, Inc. v. SWT Acquisition Corp.*:

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50. *Id.*
51. *Id.*
52. *Id.* at 955.
53. 3 W. FLETCHER, FLETCHER CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 838 (rev. perm. ed. 1986).
54. *See Unocal*, 493 A.2d at 955.
55. *Id.* at 956.
56. *Paramount Communications*, 571 A.2d at 1152.

> The knowledgeable reader will recognize that this particular phrase [the board's duty to the corporation and its shareholders] masks the most fundamental issue: to what interest does the board look in resolving conflicts between interests in the corporation that may be characterized as "shareholder long[-]term interests" or "corporate entity interests" or "multi-constituency interests" on the one hand, and interests that may be characterized as "shareholder short-term interests" or "current share value interests" on the other?[57]

The identity of shareholder and corporate interests is suggested in section 2.01 of the ALI corporate governance draft which indicates that the objective of the corporation is "the conduct of business activities with a view to enhancing corporate profit and shareholder gain."[58] While we may muse upon the difference between "corporate profit" and "shareholder gain," any "corporate profit," as we would currently understand it, would be a gain to the shareholders, if only in the sense that the net worth of the corporation would increase.

If one accepts that when one speaks of the "best interests of the corporation" he or she in fact speaks of the best interests of its shareholders, the question then is how one identifies the best interests of the shareholders. Shareholders and their interests come in shapes and sizes as varied as their numbers. Some shareholders invest for long-term gain, others for short-term gain; some invest for dividend income, others for capital appreciation. Some shareholders are huge institutional investors controlling billions of dollars, others are individuals with as little as a hundred or fewer shares. Increasingly institutions are using portfolio indexation as an investment technique: they develop a portfolio which is a mirror of an index, such as the Standard & Poor's 500, and make changes in it only to reflect changes in the makeup of the index; such investors clearly view specific companies differently from the way individuals do. The diversity of interests is seen most dramatically when rumors surface about the possible takeover of a company. Immediately arbitrageurs acquire large amounts of the stock of the rumored target; their perspective is a matter of days, at most weeks, and inevitably what

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57. Nos. 10,427 & 10,298, slip op. at 17 n.5, *reprinted in* 14 DEL. J. CORP. L. at 1182 n.5.

58. ALI PRINCIPLES, *supra* note 29, § 2.01.

the longer term shareholders previously perceived as their best interests may go through a swift transformation.

Accepting the equivalence of "corporate best interests" with "shareholder best interests" appears to simply substitute one quagmire for another.

V. SHORT-TERM VERSUS LONG-TERM INTERESTS OF SHAREHOLDERS

It is fair to say that the other constituency statutes were born of a concern on the part of corporate management that courts, in judging issues such as the propriety of a board's refusal to redeem a "poison pill," would look only to the magnitude of the premium offered and put primacy on the short-term rewards accruing to shareholders from the offer without concern for the longer term values which might accrue to shareholders if the corporation were left intact and untroubled. This fear was confirmed by the Delaware Supreme Court in its *Unocal* decision when it said, in discussing the standard for directors' conduct when threatened by a takeover, that they could take into account a number of factors, and then concluded: "While not a controlling factor, it also seems to us that a board may reasonably consider the basic stockholder interests at stake, *including those of short[-]term speculators*, whose actions may have fueled the coercive aspect of the offer at the expense of the long[-]term investor."[59]

Decisions like *City Capital Associates v. Interco*[60] and *Grand Metropolitan PLC v. Pillsbury Co.*,[61] in which the court elaborately compared the value of the offer with the value shareholders might expect over the longer term as a result of proposed restructurings and recapitalizations, only confirmed managements' concerns.

This concern that courts would not be sufficiently sensitive to longer term considerations is seen in the fact that a number of the other constituency statutes specifically provide that directors may take into account the long-term as well as the short-term interests of shareholders.[62]

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59. *Unocal*, 493 A.2d at 955-56 (emphasis added).

60. 551 A.2d 787 (Del. Ch.), *appeal dismissed as moot*, 556 A.2d 1070 (Del. Ch. 1988).

61. 558 A.2d 1049 (Del. Ch. 1988).

62. *See, e.g.*, CONN. GEN. STAT. ANN. § 33-313(e)(2) (West Supp. 1990); MINN. STAT. ANN. § 302A.251 (West 1990); OHIO REV. CODE ANN. § 1701.59(E)(4) (Anderson Supp. 1990).

If it is accepted that the prevailing norm for directors' conduct is the *long-term* interests of shareholders, then a reconciliation of the positions of the proponents and opponents of the other constituency statutes is discernible. Concern with the welfare of employees, of communities, of suppliers, of customers is clearly in the interests of shareholders when they are deemed to have a long-term perspective; it is only when the focus shifts to the immediate share price realizable that their welfare becomes a matter of indifference. However, even when the perspective is the long-term interests of shareholders, there are clear bounds beyond which heed to the interests of other constituencies cannot go: there must be a clear line connecting long-term shareholder benefit with actions taken which appear to help other constituencies. Under present law directors may not, for example, and should not be permitted to keep open an obsolete and uneconomic plant when no benefit to future profitability of the enterprise can be found either in terms of impact on morale at other installations or beneficial repute in the community. If the commitment to the best interests of the corporation is not perceived to entail an obligation to give primacy to shareholders, then presumably directors could allow such a plant to continue to operate indefinitely.

Our entire economic system is organized in a manner that puts restraints on the ability of management to make a policy of significantly favoring non-shareholders at the expense of shareholder interests. The perception of such a policy by investors and its implementation will be quickly translated into a decline in market value, which renders the company less competitive in the capital markets, adversely affects the incentives of employees with a stake in the market price of the company's stock, creates adverse publicity in the financial press and imperils the tenure of management.[63] Perhaps this discipline of the market in practice creates the restraint on any management inclined to interpret its powers under the other constituency statutes too expansively.

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63. A number of studies have suggested that the adoption of antitakeover measures of various sorts has adversely affected the market price of the adopting companies' securities. *See* THE ECONOMICS OF POISON PILLS, OFFICE OF THE CHIEF ECONOMIST, U.S. SECURITIES AND EXCHANGE COMMISSION (Mar. 5, 1986); THE EFFECTS OF POISON PILLS ON THE WEALTH OF TARGET SHAREHOLDERS, OFFICE OF THE CHIEF ECONOMIST, SECURITIES AND EXCHANGE COMMISSION (Oct. 23, 1986); SHARK REPELLENTS AND STOCK PRICES: THE EFFECTS OF ANTITAKEOVER AMENDMENTS SINCE 1980, OFFICE OF ECONOMIC ANALYSIS, U.S. SECURITIES AND EXCHANGE COMMISSION (July 24, 1985); Malatesta & Walkling, *Poison Pill Securities: Stockholder Wealth, Profitability, and Ownership Structure*, 20 J. FIN. ECON. 347 (1988).

While directors cannot be indifferent to the short-term interests of shareholders (for instance, in the *Revlon* situation[64]), nonetheless the long-term interests of shareholders should properly be directors' concern. If they are, then clearly some of the apparent conflict between the advocates of the constituency statutes and proponents of the notion that the interests of the corporation must be given priority, on the one hand, and the opponents of such statutes who insist upon primacy for shareholders, disappears. The long-term interests of shareholders and the interests of the corporation conceived as an entity separate and apart from the shareholders are almost equally difficult to define. However, both may be perceived as embracing: continuity and continued existence of the corporation if there is reasonable promise of economic success, profitable operations, plans for the continuation of profitable operations, and the utilization of the resources available to the corporation to achieve that continuity of existence and prosperity—all of which redound to the long-term benefit of shareholders and to the good of the corporation.[65] The achievement of the best interests of the corporation and the long-term interests of shareholders conceived in this way clearly necessitates heed to the interests of other constituencies, for without such concern the good of the corporation and the long-term interests of shareholders as described could not be attained.

This synthesizing analysis then poses the question boldly: if the above is a proper description of the long-term interests of the shareholders and the best interests of the corporation, may the directors, in achieving the stated objectives, put any group or interest ahead of the long-term interests of shareholders? As suggested, when the analysis is done in terms of the long-term interests of shareholders, there opens up broad latitude for the consideration of other groups and interests without undermining the position of primacy historically enjoyed by shareholders.

If, on the other hand, even after an analysis in terms of the long-term interests of shareholders their primacy is denied on the authority of the constituency statutes, then we witness a revolutionary change in American corporate law, all without the sort of searching inquiry and broad debate that should precede any abrupt change of

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64. *See supra* text accompanying notes 34-35 (discussing *Revlon*).

65. The Delaware Supreme Court may have had a perception like this in mind with respect to the long-term interests of shareholders in deciding the *Paramount* case. Paramount Communications, Inc. v. Time, Inc., 571 A.2d 1140 (Del. 1989).

such magnitude. It may well be that the time is ripe to adopt the thesis proposed by Professor Dodd nearly sixty years ago that corporations must serve broad social interests even if in doing so they denigrate the interests of shareholders.[66] However, before so concluding, it would be well to hear the matter discussed by the likes of Professors Dodd and Berle and have it considered in all its ramifications, not just in terms of its effects in the context of hostile tender offers.

As the law now stands, a director confronted with a control contest faces enormous difficulties in making the judgments demanded by that situation. If, in addition to dealing with the complexities confronting him or her now, the director must further balance the interests of the shareholders in relation to other constituencies, the difficulty of his or her job increases exponentially in complexity.

The unequivocal commitment of directors to the interests of shareholders is essential if there is to be an appropriate accountability of directors. Dean Robert C. Clark of Harvard University Law School has stated the position of those who believe that directors have an unequivocal commitment to the primacy of shareholder interests:

> A single objective goal like profit maximization is more easily monitored than a multiple, vaguely defined goal like the fair and reasonable accommodation of all affected interests . . . . Assuming shareholders have some control mechanisms, better monitoring means that corporate managers will be kept more accountable. They are more likely to do what they are supposed to do and do it efficiently.[67]

This consideration exposes the fallacy of focusing upon the best interests of the "corporation." "The best interests of the corporation" would be a difficult measure by which to judge the conduct of directors, and the enforcement of such a responsibility would be nigh impossible. Virtually any action could in some fashion be justified as "in the interests of the corporation," unless shareholder interests were a confining principle.

VI. CONCLUSION

What courts will do when confronted squarely, if any courts ever are, with a shareholder attack on a board which appears to

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66. *See supra* text accompanying notes 10-11.
67. R. CLARK, CORPORATE LAW 20 (1986) (footnote omitted).

have favored other interests over those of shareholders under the shelter of a constituency statute, is difficult to predict. The long tradition of director fiduciary responsibilities to shareholders will hang heavily over the bench, and it is not fanciful to suggest that a court will seek means of accommodating the expectations of the legislature which adopted the statute without an outright repudiation of the longstanding, experience-proven and eminently workable requirement that directors owe a preeminent duty to shareholders. It might well be that a court dealing with an other constituency statute would find in the phrase discussed, "best interests of the corporation," the tool with which to preserve the preeminent position of shareholders. Two courts, one in Pennsylvania[68] and another in Wisconsin,[69] have been presented with arguments relying on other constituency statutes. While both gave lip service to the statutes, neither was compelled to make the hard choice of determining their ultimate impact.

It is not fatuous to suggest that those who have been the most ardent advocates of other constituency statutes may have unleashed a tiger with a ferocity they have not suspected. Once the possibility of having directorial attention focused upon them has been enshrined in a statute, it is hard to believe the other constituencies identified will view benignly directorial decisions that follow traditional patterns. If the present generation of statutes does not result in directors' actually paying attention to their needs and interests, they may well seek means of translating the expectations roused by these statutes into a reality. Then we may find, for instance, a resurgence of interest in devices such as "constituency directors" as a means of assuring that these other constituencies receive their perceived due from directors.[70]

The Corporate Laws Committee of the American Bar Association Section on Business has completed a report on these statutes in which it urged that the courts should deal cautiously with them and that they be construed consistently with the precedents well-established in Delaware and other states where other constituencies may indeed

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68. Baron v. Strawbridge & Clothier, 646 F. Supp. 690 (E.D. Pa. 1986).

69. Amanda Acquisition Corp. v. Universal Foods Corp., 708 F. Supp. 984 (E.D. Wis. 1989).

70. Constituency directors have been repeatedly suggested. *See* NADER, GREENE & SELIGMAN, *supra* note 15 (elaborating upon one such suggestion). The idea was incorporated in legislation proposed by the late Representative Benjamin Rosenthal, but no action was taken with respect to it. H.R. 7010, 96th Cong., 2d Sess., 126 CONG. REC. 55,2490 (1980).

be considered by directors if that consideration is consistent with shareholder welfare.

That advice should be heeded. If there is reasonable belief that ancient prescriptions are no longer relevant and the role of the corporation and director has changed in a manner that should be incarnated in statutory corporation law, let it be done, not defensively in an effort to beat off tender offers, but constructively and thoughtfully, the way in which the sound and useful series of principles we call "corporation law" have been built.