The National Agricultural Law Center

University of Arkansas
System Division of Agriculture
NatAgLaw@uark.edu • (479) 575-7646

An Agricultural Law Research Article

Feudalism Unmodified: Discourses on Farms and Firms

Part 2

by

Jim Chen & Edward S. Adams

Originally published in DRAKE LAW REVIEW
45 DRAKE L. REV. 361 (1997)

www.NationalAgLawCenter.org

landscape. Dairy farmers, the surreptitious "discrete and insular minorit[y]" of *United States v. Carolene Products Co.*,[333] have perfected the technique of plowing the federal fisc and the consumer for all the rents that the political traffic will bear.[334] Reinforced by the perpetually undemocratic Senate[335] and a territorial tradition in state and federal legislative districting not corrected until the apportionment cases of the early 1960s,[336] "rural bias" in the American political system charged the taxpayer for "[s]hips loaded with wheat, little metal gasometers filled with corn, [and] mountains of rancid butter."[337] In a political tradition in which the "right to farm" is framed as "a blanket exemption from nuisance law, a mild and basic common law tool for protecting the public against environmentally destructive uses of land,"[338] farmers' political actions speak louder than a few words uttered opportunistically on behalf of the government. Thanks in no small part to a regulatory agenda that has preserved a relatively large class of polluters who have everything to lose and little to gain from environmental protection,[339] farmers have acquired a "legendary, and . . . well deserved" "reputation for blind political resistance to environmental regulation."[340] The regulatory effort to structure American agriculture bodes ill not only for the consumer economy, but also for the greater ecology. Half a loaf is dirtier than none. Alas, alas that great city Hattŭsa![341]

333. United States v. Carolene Prods. Co., 304 U.S. 144, 152-53 n.4 (1938).

334. *See, e.g.*, Geoffrey P. Miller, *The Industrial Organization of Political Production: A Case Study*, 149 J. INSTITUTIONAL & THEORETICAL ECONS. 769 (1993); Geoffrey P. Miller, *Public Choice at the Dawn of the Special Interest State: The Story of Butter and Margarine*, 77 CAL. L. REV. 83 (1989); Geoffrey P. Miller, *The True Story of* Carolene Products, 1987 SUP. CT. REV. 397.

335. *See* William N. Eskridge, Jr., *The One Senator, One Vote Clause*, 12 CONST. COMMENTARY 159 (1995); Suzanna Sherry, *Our Unconstitutional Senate*, 12 CONST. COMMENTARY 213 (1995); *see also* U.S. CONST. art. V ("[N]o State, without its Consent, shall be deprived of its equal Suffrage in the Senate.").

336. *See, e.g.*, Reynolds v. Sims, 377 U.S. 533 (1964); Wesberry v. Sanders, 376 U.S. 1 (1964); Baker v. Carr, 369 U.S. 186 (1962). *See generally Agriculture's First Disobedience*, *supra* note 74, at 1278-80, 1309-12 (discussing the law of legislative reapportionment as a branch of agricultural law).

337. D.W. BROGAN, THE AMERICAN CHARACTER 96-97 (2d ed. 1956).

338. *American Ideology*, *supra* note 25, at 872.

339. *Cf.* MICHAEL T. HAYES, LOBBYISTS AND LEGISLATORS: A THEORY OF POLITICAL MARKETS 101-02 (1981) (describing farmers as the paradigmatic interest group that can defeat environmental legislation, which imposes concentrated costs in exchange for diffuse benefits).

340. STRANGE, *supra* note 89, at 206.

341. *Compare Revelations* 18:10 (King James Version) ("Alas, alas that great city Babylon . . . !") *with supra* Part I (recounting the parable of the Hittites, amid the splendor of that great city Hattŭsa).

V. FROM THE FARM TO THE FIRM

A. *Anti-Takeover Legislation: A Notion That Big Business Ain't Good Business*

As in the agricultural sector, legal barriers to limit feudalism in the form of anti-takeover legislation were erected in the private business context by many state legislatures in the 1980s and early 1990s. The intent of anti-takeover legislation was to prevent, or at the very least inhibit, hostile mergers and acquisitions. In a real sense, this legislation was a product of the transformation that occurred in the nature and scope of corporate control transactions in the 1980s. Until that point, shareholders of large public corporations provided corporate directors with significant autonomy, enabling directors to manage the corporation for what they viewed as the long-term benefit of all corporate constituencies. In the 1980s, however, such "hands off" treatment of corporate directors by shareholders abruptly ended. Large institutional investors, whose investment decisions were typically controlled by aggressive portfolio managers interested in short-term performance, became a powerful voice in the area of corporate control.[342] Arbitrageurs, with access to vast sums of capital, played an increasing role in pressuring corporate management to adopt governance strategies aimed at short-term, quick-fix results. Moreover, corporate raiders and even mainstream corporate acquirers, through hostile takeovers and tender offers,[343] were able to circumvent boards of directors and proxy machinery and take their proposals for a change of control directly to the shareholders.[344]

While many commentators hailed this phenomenon arguing that capital markets efficiently reflect the true value of a corporation's underlying assets, many policy analysts argued that unfettered takeover activity was harmful to

---

342. Investment banks volunteered to purchase equity positions in many hostile takeovers and offered temporary ("bridge loan") acquisition financing. In this type of financing, investment banks provided short-term acquisition funds to acquiring companies that intended to quickly refinance the bridge loan with permanent capital, funded by bank loans, the sale of bonds or notes, or the sale of the target company's assets. *See* Martin Lipton, *Corporate Governance in the Age of Finance Corporatism*, 136 U. PA. L. REV. 1, 13-15 (1987); Stanley Penn, *Raiding Parties: Friends and Relatives Hitch Their Wagon to Carl Ichan's Star*, WALL ST. J., Oct. 2, 1985, at A1.

343. A "tender offer" has been defined as:

> [A]n offer to stockholders of a publicly owned corporation to exchange their shares for cash or securities at a price above the quoted market price . . . . [A cash tender offer] is an offer to an individual shareholder to purchase that person's shares at a price well above the market price, but which is open for a limited time only. Stock being easily replaceable by other stock, the shareholders ordinarily will accept the offer. . . . [T]ender offers entail certain costs to bidders. They are riskier than the negotiated purchase of a company because surprises often await the bidder. . . . [T]he hostile bidder flies blind, without an opportunity to learn about the target from the inside.

LEWIS D. SOLOMON ET AL., CORPORATIONS: LAW AND POLICY 1052 (2d ed. 1988).

344. *See* MARTIN LIPTON ET AL., MERGERS AND ACQUISITIONS 204 (1987).

shareholders, other corporate constituencies, and the economy as a whole. Moreover, policy analysts argued that a board of directors should be provided with the tools to resist a takeover attempt which it deemed not to be in the best interest of such constituent groups.[345] These analysts stressed the need for federal and state government regulation to adjust to the changing nature of takeover activity.[346] Responding to these outcries, many state legislatures modified the corporate governance provisions of their state corporation laws to allow directors to consider the effect that a takeover may have on corporate constituencies other than shareholders: corporate stakeholders.[347]

---

345. One scholar concisely framed the economic aspects of this issue:

> Thus, the central question is whether the shareholders who are the big winners are enjoying the premiums they do because bidders with better ideas are willing to share the wealth (which is fine), or whether premiums sometimes (or even often) are paid out of savings expected to be generated by the acquirer's reneging on contracts with managers, suppliers, customers, or employees (which may not be fine).

Richard A. Booth, *State Takeover Statutes Revised,* 88 MICH. L. REV. 120, 127 (1989).

346. *See* LIPTON ET AL., *supra* note 344, at 205.

347. *See* ARIZ. REV. STAT. ANN. § 10-2702 (West 1996); FLA. STAT. ANN. § 607-0830(3) (West 1993); GA. CODE ANN. § 14-2-202(b)(5) (Harrison 1994); HAW. REV. STAT. § 415-35(b) (1993); IDAHO CODE § 30-1702 (1996); IND. CODE ANN. § 23-1-35-1(d) (Michie 1995); IOWA CODE § 490.1108 (1995); KY. REV. STAT. ANN. § 271B.12-210(4) (Michie 1989); LA. REV. STAT. ANN. § 12:92(G) (West 1994); ME. REV. STAT. ANN. tit. 13-A, § 716 (West Supp. 1995); MASS. GEN. LAWS ANN. ch. 156B, § 65 (West 1992); MINN. STAT. ANN. § 302A.251(5) (West Supp. 1996); MO. ANN. STAT. § 351.347.1(4) (West 1991); N.J. STAT. ANN. § 14A:6-1(2) (West Supp. 1996); N.M. STAT. ANN. § 53-11-35(D) (Michie 1993); N.Y. BUS. CORP. LAW § 717(b) (McKinney Supp. 1996); OHIO REV. CODE ANN. § 1701.59(E) (Anderson 1992 & Supp. 1995); OR. REV. STAT. § 60.357(5) (1995); 15 PA. CONS. STAT. ANN. § 515(a), (b) (West 1995); TENN. CODE ANN. § 48-103-204 (1995); WIS. STAT. ANN. § 180.0827 (West 1992); *see also* Baron v. Strawbridge & Clothier, 646 F. Supp. 690, 697 (E.D. Pa. 1986) ("It was proper for the company to consider the effects the . . . tender offer would have, if successful, on the Company's employees, customers and community.").

Connecticut mandates that directors consider the interests of nonshareholder groups. *See* CONN. GEN. STAT. ANN. § 33-313(e) (West 1987 & Supp. 1996); Herald Co. v. Seawell, 472 F.2d 1081, 1095 (10th Cir. 1972); GAF Corp. v. Union Carbide Corp., 624 F. Supp. 1016, 1030 (S.D.N.Y. 1985); A. Copeland Enters., Inc. v. Guste, 706 F. Supp. 1283, 1294 (W.D. Tex. 1989).

Other states provide a statutory presumption as to the validity of directors' determinations. *See* IND. CODE ANN. § 23-1-35-1(f), (g) (Michie 1995) (A board's determination "shall conclusively be presumed to be valid unless it can be demonstrated that the determination was not made in good faith after reasonable investigation."); *see also* 15 PA. CONS. STAT. ANN. § 515(d) (West 1995) ("Absent breach of fiduciary duty, lack of good faith or self-dealing, any act as the board of directors, a committee of the board or an individual director shall be presumed to be in the best interests of the corporation.").

Wyoming also permits corporations to protect bondholders by charter. *See* WYO. STAT. ANN. § 17-18-201 (1989). Qualified corporations (large publicly-traded Wyoming corporations) may by charter provide for bondholder approval of mergers or acquisitions, replacement of more than 24% of directors, sale or disposition of specified percentages of assets, or an acquisition of debt above specified percentages of assets and/or net worth. *See id.*

Professors Johnson and Millon state that the goal of anti-takeover laws is "not to maximize share values for target company investors, whether by eliminating coercion or

Ohio's statute is representative of this form of anti-takeover legislation—so-called stakeholder constituency statutes—that persists today:

> [A] director, in determining what he reasonably believes to be in the best interests of the corporation, shall consider the interests of the corporation's shareholders and, in his discretion, may consider any of the following:
>
> (1) The interests of the corporation's employees, suppliers, creditors, and customers;
> (2) The economy of the state and nation;
> (3) Community and societal considerations;
> (4) The long-term as well as short-term interests of the corporation and its shareholders, including the possibility that these interests may be best served by the continued independence of the corporation.[348]

In many states, directors may consider either the best interests of the corporation or stakeholders' interests in connection with any decision submitted to them. Some states, however, limit the application of their statutes to acquisition proposals.[349] Generally, most of the statutes enumerate specific groups that directors may consider.[350] New York's statute,[351] for example,

---

otherwise, and no apology can alter that fact. Instead, their chief purpose is to protect nonshareholders from the disruptive impact of the corporate restructurings that are thought typically to result from hostile takeovers." Lyman Johnson & David Millon, *Missing the Point About State Takeover Statutes*, 87 MICH. L. REV. 846, 848 (1989); *see also* David Millon, *State Takeover Laws: A Rebirth of Corporation Law?*, 45 WASH. & LEE L. REV. 903, 904 (1988) ("While state takeover legislation often pays lip service to shareholder welfare, such legislation actually has a different purpose, a purpose fundamentally antithetical to the shareholder primacy norm of present corporation law."); Lyman Johnson, *The Eventual Clash Between Judicial and Legislative Notions of Target Management Conduct*, 14 J. CORP. L. 35, 67 (1988) ("[S]tates also saw a different side of the rampant takeover activity—the social responsibility side—and began to question whether attaining takeover benefits for shareholders was as consistent with other important interests as economic and legal orthodoxy presumed."). *But see* Booth, *supra* note 345, at 127 (suggesting that there might be hidden benefits to shareholders from control share statutes even though the statutes may support some stakeholders' interests); Richard A. Booth, *The Promise of State Takeover Statutes*, 86 MICH. L. REV. 1635, 1681 (1988) (claiming that control share acquisition takeover statutes represent a "remarkably intelligent approach to the problem of fairness in tender offers" and may aid shareholders in realizing value through tender offers).

348. OHIO REV. CODE ANN. § 1701.59(E) (Anderson 1992 & Supp. 1995).

349. *See, e.g.*, MO. ANN. STAT. § 351.347 (West 1991).

350. Because anti-takeover statutes are designed to prevent "high unemployment and erosion of the State and local economy and tax base," 1987 N.C. Sess. Laws 124, *reprinted in* Johnson & Millon, *supra* note 347, at 849, it is logical to assume that they would be supported by a coalition of local interests, including labor and community groups.

Apparently, this was found not to be the case in Connecticut. One scholar has noted that the state's "second-generation" anti-takeover statute was not generally supported by broad coalitions of local interests, including labor and local community groups, but was supported by one particular corporation. *See* Roberta Romano, *The Political Economy of Takeover Statutes*, 73 VA. L. REV. 111, 122-23 (1987). Romano claims that:

allows directors to consider the short- and long-term effects that their decisions may have upon the corporation's current employees, retired employees,[352] customers, creditors, and its ability "to provide, as a going concern, goods, services, employment opportunities and employment benefits and otherwise to contribute to the communities in which it does business."[353] The groups most frequently listed in stakeholder constituency statutes are employees,[354] suppliers, customers,[355] and local communities.[356] Problematically, none of the statutes provide a coherent framework to guide

---

> The spur behind the passage of the Connecticut [second-generation anti-takeover] statute was not a broad-based political coalition. Rather, the bill was promoted by a corporation incorporated in Connecticut, the Aetna Life and Casualty Insurance Company . . . which enlisted the support of the most important business association in the state, the Connecticut Business and Industry Association . . . .

Id.

On the other hand, Wisconsin's experience in adopting anti-takeover laws in 1987 was found to be consistent with a coalition theory in which state labor groups and other nonbusiness interest groups actively supported the legislation. *See* Kenneth B. Davis, Jr., *Epilogue: The Role of the Hostile Takeover and the Role of the States*, 1988 WIS. L. REV. 491, 496-97. Even though nonshareholder interest groups, such as organized labor or municipalities, may not be the actual sponsors of anti-takeover legislation, they may actively support such legislation once it has been proposed. *See* John C. Coffee, Jr., *The Uncertain Case for Takeover Reform: An Essay on Stockholders, Stakeholders and Bust-Ups*, 1988 WIS. L. REV. 435, 437 n.8 (noting the current debate over the nature of the political coalition supporting anti-takeover legislation and arguing that the silence of labor groups and communities may actually imply consent).

351. New York entitles corporate directors "[i]n taking action . . . to consider, without limitation, (1) both long-term and short-term interests of the corporation and its shareholders and (2) the effects that the corporation's actions may have in the short-term or in the long-term upon [enumerated constituencies]." N.Y. BUS. CORP. LAW § 717(b) (McKinney Supp. 1996).

352. The statute includes "retired employees and other beneficiaries receiving or entitled to receive retirement, welfare or similar benefits from or pursuant to any plan sponsored, or agreement entered into, by the corporation." *Id.* § 717(b)(iii).

353. *Id.* § 717(b)(v) In addition, the statute also allows directors to consider "the prospects for potential growth, development, productivity and profitability of the corporation." *Id.* § 717(b)(i).

354. Employees are mentioned in all of the mixed and specific constituency statutes and are always the first group to be listed in these statutes. *See supra* note 347 and accompanying text.

355. Suppliers and customers of the corporation are often mentioned together. *See supra* note 347.

356. Several of the statutes limit consideration of community interests to those areas in which offices or other establishments of the corporation are located or where the corporation "conducts its business." *See, e.g.*, MO. ANN. STAT. § 351.347.1(4) (West 1995); 15 PA. CONS. STAT. ANN. § 515(a)(1) (West 1995). Other statutes have a broader scope. Kentucky, for example, allows directors to consider the interests of the "economy of the state and nation [and] [c]ommunity and societal considerations." KY. REV. STAT. ANN. § 271B.12-210(4) (Michie Supp. 1996). Creditors are not specifically mentioned in a majority of statutes. *See, e.g.*, Booth, *supra* note 345, at 126 ("Could it be that the only stakeholders who have been targeted in this campaign to project responsibility are those who have relatively little bargaining power and are being exploited by the stake itself?").

directors in satisfying their duties to these constituencies. Corporate directors are left to their own devices to determine the correct balances between the best interests of the stockholders, the corporation, and other constituencies. Conflicting interests have made this determination inherently difficult: in a typical takeover situation, the best interests of nonshareholders, such as employee groups, may be the continued independence of the corporation, while the best interests of stockholders may be a sale or liquidation.[357] One might speculate that because the best interests of stakeholders have not been defined per se,[358] these statutes do nothing more than present directors with an avenue for compensating stakeholders for losses incurred through decisions supporting shareholder wealth maximization.

Importantly, case law interpreting nonshareholder constituency statutes is nonexistent.[359] In related contexts, however, courts have recognized that directors may consider stakeholders' interests. For example, Delaware courts, although Delaware does not have a nonshareholder constituency statute on its books, have considered the issue in a series of cases. In the first of these, *Unocal Corp. v. Mesa Petroleum Co.*,[360] the Delaware Supreme Court, in upholding a target's self-tender that excluded a raider from participation, stated that a target's board of directors may consider "the impact [of a hostile bid] on 'constituencies' other than shareholders (i.e., creditors, customers,

---

357. Outside the legislative arena, several corporations have adopted charter amendments that allow directors to consider stakeholders' interests when making decisions related to a change of control. *See* James J. Hanks, Jr., *Evaluating Recent State Legislation on Director and Officer Liability Limitation and Indemnification*, 43 BUS. LAW. 1207, 1228 (1988) (noting that these charter amendments were the origin of nonstockholder constituency statutes); *see also* Lipton, *supra* note 342, at 41 n.188 ("For example, Control Data Corp. and McDonald's have recently amended their charters in this fashion."). The provisions allow, and in some cases require, that directors consider nonmonetary factors when deciding upon a hostile tender offer, exchange offer, or business combination. The nonmonetary factors often include the social and economic effects of an acquisition on the target's employees, suppliers, customers, and others. Unlike the statutory context, directors in these corporations have been given a basis for decision making that has been approved by the shareholders. This effectively mitigates against any conflict that directors might encounter when making major decisions because the shareholders have already approved a charter amendment explicitly allowing the directors to consider "other interests." *See* 1 SHARK REPELLENTS AND GOLDEN PARACHUTES: A HANDBOOK FOR THE PRACTITIONER 194-211 (Robert H. Winter et al. eds., 1983) (reprinting the provisions of Nortek, Inc., Control Data Corp., Central Bancshares of the South, Inc., McDonald's Corp., and Anchor Hocking Corp.).

358. *See* Hanks, *supra* note 357, at 1229.

359. This may, in part, be a product of corporate activity, or lack thereof, in the states that have adopted the provisions. In addition, New York, a state with a high amount of takeover activity, originally adopted a "watered down" nonshareholder constituency statute which allowed directors to consider the "long-term interests" of the corporation. Only recently, New York amended its statute to enumerate specific stakeholder groups. *See* N.Y. BUS. CORP. LAW § 717 (McKinney Supp. 1996). *See generally* Kenneth B. Davis, Jr., *Discretion of Corporate Management to Do Good at the Expense of Shareholder Gain—A Survey of, and Commentary on, the U.S. Corporate Law*, 13 CANADA-U.S. L.J. 7, 20-48 (1988) (outlining various sources for management's discretion to consider nonshareholder interests, including the business judgment rule and enlightened self-interest doctrine).

360. Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985).

employees, and perhaps even the community generally)."[361] However, one year later, the Delaware Supreme Court held in *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*,[362] that a takeover target's board of directors may not consider the interests of noteholders after a decision has been made to sell the company. The court declared that once the sale of the company had become inevitable, the directors' duty changed from "defenders of the corporate bastion to auctioneers charged with getting the best price for the stockholders."[363] The court did recognize that "[a] board may have regard for various constituencies in discharging its responsibilities, provided there are rationally related benefits accruing to the stockholders."[364] Thus, the Delaware Supreme Court reaffirmed that the primary objective of directors conducting an auction must be to obtain the highest price for shareholders, and that consideration of the impact of a takeover on corporate constituencies may be examined, "provided that it bears some reasonable relationship to . . . basic stockholder interests at stake."[365] If one examines the *Unocal* and *Revlon* decisions together, it seems apparent that directors may consider the interests of nonshareholders before an auction has begun, but any decision related to consideration of nonshareholders must result in some benefit to stockholders, for it is to them that the target's board of directors owe a primary duty.

A handful of decisions in other states have more strongly defended the consideration of nonshareholder interests by directors.[366] *Herald Co. v. Seawell*[367] may be the most frequently cited source of authority to support the

---

361. *Id.* at 955.

362. Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1986).

363. *Id.* at 182. "[C]oncern for non-stockholder interests is inappropriate when an auction among active bidders is in progress . . . ." *Id.*

364. *Id.* (citing Unocal v. Mesa Petroleum Co., 493 A.2d at 955).

365. Mills Acquisition Co. v. Macmillan, Inc., 559 A.2d 1261, 1282 n.29 (Del. 1988); *see, e.g.*, Michael D. Goldman & Peter J. Walsh, *Delaware Courts Revisit Landmark* Revlon, NAT'L L.J., Sept. 25, 1989, at S4 (outlining the future impact of the *Macmillan* decision).

366. *See* Baron v. Strawbridge & Clothier, 646 F. Supp. 690, 697 (E.D. Pa. 1986) (holding that "[i]t was proper for the company to consider the effects the . . . tender offer would have, if successful, on the Company's employees, customers and community. The Company concluded these effects would be detrimental to its success.") (citations omitted); Enterra Corp. v. SGS Assoc., 600 F. Supp. 678, 689 (E.D. Pa. 1985) (asserting that management might consider the takeover concerns of suppliers, customers, lenders, and the stability of the company when considering takeover bids). In upholding defensive measures used by Union Carbide to avoid a bust-up bid by GAF Corporation, Judge Pollack of the Southern District of New York stated:

> 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. . . . The exercise of independent, honest business judgment . . . is the traditional and appropriate way to deal fairly and even-handedly with both the protection of investors, on the one hand, and the legitimate concerns and interests of employees and management of a corporation who service the interests of investors, on the other.

GAF Corp. v. Union Carbide Corp., 624 F. Supp. 1016, 1019-20 (S.D.N.Y. 1985).

367. Herald Co. v. Seawell, 472 F.2d 1081 (10th Cir. 1972).

consideration of takeover effects on stakeholders by directors.[368] In *Herald*, the Tenth Circuit held that the *Denver Post* legitimately used defensive maneuvers against a hostile bid by Samuel I. Newhouse, owner of one of the nation's largest newspaper chains and an owner with a history of labor difficulties.[369] In response to the *Post*'s concerns for its nonshareholder constituencies, the court stated:

> We are fully cognizant of the well established corporate rule of law which places corporate officers and directors in the position of fiduciaries for the stockholders. . . . In this case we have a corporation engaged chiefly in the publication of a large metropolitan newspaper, whose obligation and duty is something more than the making of corporate profits. Its obligation is threefold: to the stockholders, . . . employees, and . . . public.[370]

First amendment and free-press concerns aside,[371] it is important to note that the court found that the *Post*'s establishment of the "Employees Stock Trust Plan" was legitimate, legal, "clearly within the power and authority granted by [state] statute to the corporation,"[372] and was not malevolently motivated.[373] The *Post*'s use of the plan was to "benefit the public, the corporation and the employees."[374]

The directors of the *Post* desired to develop a plan which would provide an opportunity for its employees to participate in stock ownership.[375] In fact, the *Post*'s directors "personally investigated other employee stock ownership

---

368. *See* Alexander R. Sussman & Edna R. Sussman, *Takeover Cases Eye Non-Stockholder Interests*, LEGAL TIMES, Apr. 28, 1986, at 24.

369. The *Denver Post* is a large newspaper with a long tradition of local ownership through the Bonfils family. *See* Herald Co. v. Seawell, 472 F.2d at 1084. In May 1960, Samuel I. Newhouse purchased 18 percent of the outstanding shares of the *Post* with an intent to acquire the entire newspaper. *Id.* On July 7, 1960, the *Post* purchased about 21 percent of its outstanding stock held by the Denver U.S. National Bank as trustee for the Children's Hospital Association. *Id.* For several years before the purchase, the board of directors of the *Post* considered establishing an employee stock ownership plan. *Id.* After the purchase of the Children's Hospital shares, the board implemented such a plan and transferred 5,000 treasury shares to the plan's trust. *Id.* at 1085. A member of the Bonfils family also donated a number of shares to the trust. *Id.* As of December 1969, 415 of the eligible 1159 employees had purchased shares from the trust. *Id.* More than eight years after the purchase of the Children's Hospital stock by the *Post*, Newhouse brought a derivative action on behalf of the *Post*. *Id.* at 1088. The suit was against the *Post*'s officers and directors for alleged misconduct, breach of trust, and misuse of assets. *Id.* Newhouse claimed that the board and trustee of the employee stock trust had conspired to acquire a sufficient number of shares to vest control of the *Post* in the Bonfils family and employees under its domination. *Id.*

370. *Id.* at 1091.

371. The court stated that "[s]uch a newspaper is endowed with an important public interest. It must adhere to the ethics of the great profession of journalism." *Id.* at 1095. The court also described the newspaper as a "quasi-public institution." *Id.*

372. *Id.* at 1093.

373. *Id.* at 1092.

374. *Id.* at 1095.

375. *Id.* at 1084.

plans" at other newspapers.[376] Apparently, the directors sincerely believed that "employee stock ownership would promote a better employee-employer relationship."[377] The directors also believed that "employee stock ownership would eventually lock control of the corporation in the employees and eliminate . . . outsider . . . control of stock."[378] The court held that because the plan was approved by a substantial majority of stockholders, it would not impose its business judgment on the directors.[379] In addition, the motives for establishing the plan were found to be firmly grounded in the *Post*'s concern for its employees and their benefits, and not in thwarting hostile advances by Newhouse.[380] Furthermore, the plan was conceived well before any takeover events had developed.[381]

B. *"Big Is Beautiful" Versus "Big Is Ugly"*

While anti-takeover legislation varies in form and operation, it serves a common purpose: to dissuade takeovers, unless certain requirements are met. The immediate question, of course, is why? Why do states seek to dissuade takeovers? What interest does a state have in dissuading takeovers? Why have states enacted legislation which seeks to inhibit corporate "largeness" in a manner that hurts so many of us, from every socioeconomic class,[382] as shareholders?

Essentially, two competing theories exist regarding the promulgation of anti-takeover statutes. One theory, usually promoted by those who favor such statutes, posits that the statutes exist in order to protect shareholders and stakeholders. The second competing theory, primarily promoted by those who disfavor anti-takeover statutes, contends the statutes exist not to protect shareholders, but rather as a result of political pressures imposed by incumbent management. As this theory contends, anti-takeover statutes exist to protect and insulate incumbent management from takeovers and ultimately preserve their management jobs.

Proponents of the first theory posit that the interests of stockholders are promoted by anti-takeover statutes. As they argue, anti-takeover statutes protect shareholders in a number of ways. Statutes which include "supermajority/fair price" provisions, for example, protect shareholders by combating perceived inequities resulting from front-end loaded partial tender offers by regulating the second step of a two-tier transaction. Control share acquisition statutes, which allow shareholders to decide whether a merger is to occur, protect shareholders by giving them the ability to restrict an acquirer's voting rights. Fair value statutes, proponents assert, provide that shareholders must be paid a fair value for their shares, thus eliminating low-priced freeze

376. *Id.*
377. *Id.*
378. *Id.*
379. *Id.* at 1096.
380. *Id.*
381. *See id.* at 1095-97.
382. Shareholders increasingly include even the lowest employee ranks through profit-sharing, pension, and discounted stock purchase plans.

out mergers. Finally, statutes imposing limitations on certain business combinations protect shareholders by assuring that no business combination is possible with an interested shareholder unless, as these statutes typically provide, the board of directors approves the combination or unless additional shares are purchased at a fair price or in a fashion prescribed by statute.

Proponents of anti-takeover legislation generally, and stakeholder constituency statutes specifically, argue that such legislation also protects stakeholders. As proponents contend, anti-takeover legislation often prevents corporations from being dissolved or merged into an acquirer with a corresponding loss in jobs which is likely to accompany such an action. Proponents of anti-takeover legislation also advance four other rationale in support of their view. First, they maintain that shareholder wealth is not synonymous with social wealth in the takeover context. Rather, a premium paid to shareholders in a takeover usually consists of a transfer payment from other groups (stakeholders) to the shareholders. Second, they assert that such statutes are needed because contingent contracts do not protect stakeholders. As they insist, this is because: (a) stakeholders often lack bargaining power; and (b) it is impossible to devise contracts which adequately address every contingency. Third, they assert that stakeholders frequently suffer from a collective action problem. They cannot organize to address problems resulting from a takeover, and therefore, a board should have an opportunity to address such issues. Finally, they suggest that if economic efficiency is the goal in the takeover context, it should be Pareto efficiency that is sought, not Kaldor-Hicks efficiency. Characteristically, economic efficiency is measured in two ways: (a) Kaldor-Hicks efficiency and (b) Pareto efficiency. A change is Kaldor-Hicks efficient where winners win more than losers lose. A change is Pareto efficient if it makes someone better off and no one worse off. As proponents of anti-takeover legislation maintain, Pareto efficiency should be the goal. Thus, a board should reject a proposal that is Kaldor-Hicks efficient and seek to convert Kaldor-Hicks efficient proposals into Pareto efficient ones.

Opponents of anti-takeover statutes disagree with these conclusions. As they contend, anti-takeover statutes are adopted with but one purpose in mind: to protect incumbent managers. The purpose of such statutes is not to protect shareholders or even stakeholders but to assure incumbent managers that their positions are not put in jeopardy as the result of a merger.

Opponents of anti-takeover legislation trace their arguments to theory-of-the-firm literature that first made its appearance over sixty years ago in a famous article written by Berle and Means.[383] Berle and Means argued that the corporation as it existed was in serious trouble because of a separation of ownership and control. This separation of ownership and control was, they believed, the result of 1) widely diversified risk bearers who did not have the incentive to monitor managers in the firm in which they were invested, and 2) corporate managers who owned very little of the stock of their own corporation and only wanted to maximize their own utility. This separation, in turn,

383. *See* ADOLF A. BERLE & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY (1932).

resulted in managers and shareholders having widely divergent interests, with managers having both the opportunity and incentive to exploit stockholder wealth. As Berle and Means reasoned, outside regulation was necessary to halt this exploitation.

The modern theory of the firm views the corporation as a different being than Berle and Means suggested. To modern theorists the corporation is essentially an agency relationship in which shareholders are the principals, who are to receive the benefits of the firm's profits, growth, and management, with managers acting as their agents.[384]

Under this theory, shareholders are the risk bearers, while managers run the corporation. The advantages of this separation are substantial. Through this separation, skilled managers are able to run the corporation, although lacking the capital to finance the firms' investment decisions, and shareholders can invest in the corporation, although lacking managerial skills. Additionally, this specialization of functions allows investors to diversify their portfolios, thereby reducing risk and making investment more attractive.

While this separation allows risk bearers to capture benefits of specialization, it also exposes them to the risk that managers will use investors' funds for their own benefit. The costs incurred in reducing those risks are agency costs—the costs paid by the principals to obtain faithful and effective performance by their agents. From this perspective, the problems of corporate governance are viewed as those of reducing agency costs that shareholders must incur to monitor their agents and prevent either fiduciary abuse or indolent "shirking."

Jensen and Meckling hypothesize that the owners of the firm can align management's interests with their own through contractual devices—such as performance-based compensation or stock options—so as to give management a strong incentive to maximize the value of the firm.[385] More recently, however, Eugene Fama has argued that this fractional ownership by managers does not alone solve the conflict of interest occasioned by the separation of ownership and control.[386] Viewing the firm as a nexus of contracts, Fama argues that market forces, such as competition in labor markets, production markets and, importantly, the market for corporate control, limit the manager's ability to engage in nonwealth—maximizing behavior.[387]

The importance of Fama's view cannot be understated. It suggests, as others have recognized, that the market for corporate control provides the

384. *See* Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305 (1976).

385. *Id.* at 323-38.

386. Eugene F. Fama, *Agency Problems and the Theory of the Firm*, 88 J. POL. ECON. 288 (1980); *cf. American Ideology*, *supra* note 25, at 835-36 (noting how efforts to vest farmers with interests in their farmland in the guise of "stewardship" have not yielded superior land management and environmental behavior).

387. Fama, *supra* note 386, at 292-93; *see also* William A. Klein, *The Modern Business Organization: Bargaining Under Constraints*, 91 YALE L.J. 1521 (1982). Klein does not see managers as the agents of shareholders but rather views them both as coventurers. *Id.* at 1525.

optimal mechanism for reducing agency costs.[388] According to the market for corporate control theory, whenever a corporation's value sinks below its potential value under existing management, an incentive arises for a superior management to purchase the company at this discounted price and realize the turnaround profit. The constant search for these discounted bargains, it is argued, both motivates the managements of marginal firms toward increased performances, lest they become targets, and deters conduct injurious to shareholders—all without the need for any type of regulatory reform.

In short, as proponents of this theory argue, the market for corporate control[389] performs a desirable disciplinary function by replacing inefficient management, deterring fiduciary abuse, and enforcing greater sensitivity on the part of management to the market's judgment. As noted by Jensen and Ruback, "competition among managerial teams for the right to manage resources limits divergence from shareholder wealth maximization by managers and provides the mechanism through which economies of scale or other synergies available from combining or reorganizing control and management of corporate resources are realized."[390]

By forcing the efficient use of corporate resources, the market for corporate control can also provide substantial benefits to consumers. Efficient management of society's resources insures that the real cost of the goods and services consumers purchase are as low as possible and thus, in this sense, maximizes consumer welfare.

Not unexpectedly, critics of the market for corporate control do exist. Takeover critics generally posit six, not necessarily competing, explanations for takeovers. First, they argue takeovers are the result of corporate raiding in which the firm is purchased by raiders and its assets are expropriated without giving shareholders a fair return on their capital. Second, proponents of anti-takeover legislation view takeovers as simply corporate empire building, with managers seeking to buy up other firms, whether such a purchase is efficient or not, to increase the size of their own corporate structures and thus expand their influence. Third, under the "hubris theory," managers engage in take-

---

388. Easterbrook and Fischel contend unqualifiedly that tender offers can discipline inadequate performance and self-dealing. Frank H. Easterbrook & Daniel R. Fischel, *The Proper Role of Target Management in Responding to a Tender Offer*, 94 HARV. L. REV. 1161, 1169-71 (1981). In their analysis, Easterbrook and Fischel explicitly use the term "agency costs," and view the primary motivation for takeover activity to be the expected "reduction in agency costs, which makes the firm's assets worth more in the hands of the acquirer than they were worth in the hands of the firm's managers." *Id.* at 1173. They argue that both shareholder monitoring and intra-firm monitors, such as independent directors, are inadequate to reduce such costs. *Id.* Thus, they conclude that a hostile bidder is the best monitor because it can surmount the free rider problem that leaves individual shareholders without substantial incentives to expend resources on monitoring and enforcing. *Id.*

389. The root source of the notion of a market for corporate control is the classic article by Henry Manne, written over 30 years ago, which identified the market for corporate control as a major constraining force on managerial discretion and inefficiency. Henry G. Manne, *Mergers and the Market for Corporate Control*, 73 J. POL. ECON. 110 (1965).

390. Michael C. Jensen & Richard S. Ruback, *The Market for Corporate Control*, 11 J. FIN. ECON. 5, 6 (1983).

overs because they overestimate their ability to add value to a target. In short, excessive pride on the part of managers leads to a corresponding overestimation of their ability to add value to the target and therefore leads to unproductive acquisitions. Fourth, takeover opponents argue that takeovers are not done to achieve economies of scale or other efficiencies but for tax purposes. Fifth, opponents often contend that takeovers lead to an inefficient creation of market power by which firms, through a near monopoly, control the entire market. Finally, opponents argue that takeovers are the result of market myopia. The market myopia theory is based on three plausible premises if considered separately: a) the majority of corporate stock is held by institutional investors; b) institutional investors are short term oriented; and c) investor myopia requires managers to concentrate on short-term profits, sacrificing long-term value. From these premises, the market myopia theory concludes that firms which do not maximize short-term profits are not favored by investors and thus become takeover targets—a result bad for the economy as a whole because it is precisely these firms that are often economically most sound.

Proponents of takeovers advance numerous arguments in support of takeovers. First, they argue that takeovers assure that undervalued resources are purchased by the corporation that can use them most efficiently. Second, takeovers lead to asset or financial restructuring for the benefit of the target and the acquirer. Third, takeovers result in the replacement of inefficient management. Finally, proponents of takeovers argue that synergies result from mergers. In short, as they maintain, the market for corporate control assures that inefficient managers are replaced and resources are used to their optimal potential both for the benefit of shareholders and consumers.

Empirical studies lend great support to the view of takeover proponents. A powerful and elaborated study by Bradley, Desai, and Kim,[391] for example, finds compelling proof that takeovers are beneficial. The Bradley study found that takeovers create important synergistic gains.[392] They may result from more efficient management, economies of scale, improved production techniques, or any number of value-creating mechanisms that result from the combination of firms. According to the Bradley study, synergistic gains are not the mere result of wealth transfers but are the result of value-creating combinations. The empirical data generated by the Bradley study supports the notion that takeovers are beneficial, particularly for the shareholders of the target firm.

---

391. Michael Bradley et al., *Synergistic Gains from Corporate Acquisitions and Their Division Between the Stockholders of Target and Acquiring Firms*, 21 J. FIN. ECON. 3 (1988); *see also* Gregg A. Jarrell et al., *The Market for Corporate Control: Empirical Evidence Since 1980*, J. ECON. PERSP., Winter 1988, at 49, 54-58; Jonathan R. Macey, *State Anti-Takeover Legislation and the National Economy*, 1988 WIS. L. REV. 467, 478. *But see* F.M. Scherer, *Corporate Takeovers: The Efficiency Arguments*, J. ECON. PERSP., Winter 1988, at 69.

392. Many commentators contend that such gains do not come at the expense of other groups. CHARLES BROWN & JAMES L. MEDOFF, *The Impact of Firm Acquisitions on Labor*, *in* CORPORATE TAKEOVERS: CAUSES AND CONSEQUENCES 23 (Alan J. Auerbach ed., 1988) [hereinafter, CORPORATE TAKEOVERS]; Coffee, *supra* note 350, at 451-54.

For example, from the period of 1963-1984, takeovers led to a cumulative abnormal return to target shareholders over preoffer prices of the targets' shares of over 31%, with 95% of the targets receiving positive gains and an average change in the preoffer market value of the target equity of a positive $107.08.[393] Moreover, the synergistic gains of tender offers for both targets and acquirers have averaged 7.43% from 1963-1984[394]—indicating that both society, and especially target shareholders, benefit from takeovers.

The empirical evidence equally demonstrates that legislation which hampers takeovers, such as stakeholder constituency statutes, deprives shareholders of the discipline the market for corporate control imposes on corporate management. Moreover, affirmative defensive actions may have even more drastic effects on shareholder wealth. As Easterbrook and Fischel suggest, "[t]he detriment to shareholders is fairly clear where defensive tactics result in a defeat of a takeover, causing shareholders to lose the tender premium. Even where resistance leads to a higher price paid for the firm's shares, however, shareholders as a whole do not necessarily benefit."[395] Easterbrook and Fischel then add:

> The value of any stock can be understood as the sum of two components: the price that will prevail in the market if there is no successful offer (multiplied by the likelihood that there will be none) and the price that will be paid in a future tender offer (multiplied by the likelihood that some offer will succeed). A shareholder's welfare is maximized by a legal rule that enables the sum of these two components to reach its highest value. Any approach that looks only at the way in which managers can augment the tender offeror's bid, given that a tender offer has already been made, but disregards the effect of a defensive strategy on the number of offers that will be made in the future and the way in which the number of offers affects the efficiency with which corporations are managed, ignores much that is relevant to shareholder's welfare.[396]

Notwithstanding the Bradley study, proponents of defensive tactics argue that shareholders often benefit from the increased ability of management to resist a takeover that defensive tactics and legislation afford. Proponents contend that such tactics give management the required leverage to negotiate a higher price, for example, in a control contest. Poison pills, for instance, may enable incumbent management to delay a bid and begin an auction contest for their firm. Defensive stock repurchases may also serve a useful function.[397] There may, indeed, be some substance to this argument.

Bradley and Rosenzweig concluded that so long as defensive stock repurchases are regulated to preserve a competitive balance, with the same

---

393. *See infra* Table 1 in Appendix.

394. *Id.*

395. Easterbrook & Fischel, *supra* note 388, at 1164.

396. *Id.*

397. *See generally* Michael Bradley & Michael Rosenzweig, *Defensive Stock Repurchases*, 99 HARV. L. REV. 1377 (1986).

pro-rata and delay requirements as interfirm tender offers, they will: 1) eliminate corporate raiders who would take without competition and at a blended price below the preoffer market price; 2) allow target managers who can effect leveraged buyouts at a lower cost than the bidder to do so; and 3) assure that an efficient value-increasing allocation of resources takes place.[398] The negotiating power in the hands of management as a result of poison pills or the ability to engage in defensive stock repurchases and other defensive measures means shareholders have an agent who can "act collectively" for them, thus avoiding the prisoner's dilemma they often face when an acquirer seeks them out to tender their shares.[399] Proponents also argue that by providing some safety from hostile takeovers, defensive tactics allow management to concentrate on business and not on takeovers, which can divert management's attention, thus creating inefficiency and waste.[400]

In addition to these arguments concerning defensive measures, two different hypotheses exist regarding who benefits and who loses from state incorporation codes and changes in those codes. Dodd and Leftwich argue that state incorporation codes are designed to advance the interests of shareholders because states compete in their incorporation codes to attract firms to their states.[401] Because the motivation for investment is wealth maximization, this argument implies that the purpose of corporate law is to increase, or at least not decrease, the value of a corporation's stock price.[402] Therefore, statutory changes to corporate codes, including restrictions on takeovers, should not decrease stock prices of firms chartered in that state but, as the argument suggests, increase them.

Alternatively, Romano has argued, using a public choice framework, that state anti-takeover legislation can favor incumbent management to the detriment of their shareholders.[403] As she reasons, incumbent managers have a high probability of being displaced in takeovers and thus they have a strong incentive to press for laws which serve to impede the takeover process.[404] Romano concludes that the impetus for passage of takeover legislation in a state is frequently "the concern of a local firm that it might be acquired."[405] Thus, passage of a state takeover law would in all likelihood lower stock prices of firms chartered in that state.

---

398. *Id.*

399. *Id.*

400. ROBERT B. REICH, THE NEXT AMERICAN FRONTIER 140-72 (1983).

401. Peter Dodd & Richard Leftwich, *The Market for Corporate Charters: "Unhealthy Competition" Versus Federal Regulation*, 53 J. BUS. 259, 281 (1980).

402. Dodd and Leftwich found that when firms changed their state of incorporation the change itself was only associated with a small positive excess return. *Id.* at 277. They concluded that "[t]he evidence is consistent with our [cost avoidance] hypothesis that managers of a firm take advantage of the competition among states to locate in a state which offers an efficient set of restrictions on the firm, given the firm's anticipated production-investment and financing decisions." *Id.* at 282.

403. *See* Romano, *supra* note 350, at 116.

404. *Id.* at 119.

405. *Id.* at 137.

Once again, empirical studies reveal some powerful evidence regarding the welfare effects of poison pills and defensive measures in general, and more specifically, the welfare effects of anti-takeover legislation. Two widely accepted studies concerning the welfare effects of poison pills are the Easterbrook and Jarrell study and the Jarrell and Poulsen study.[406] Easterbrook and Jarrell begin by citing three recent studies of postoffer movements in prices of target stocks which show that successful defensive tactics by management have deprived target shareholders of appreciation gains worth between fifteen and fifty-two percent.[407] They then introduced the results of their own study which shows that had these gains been realized and reinvested in equity securities, shareholders would have fared considerably better during the past decade.[408] Finally, the authors argue that a similar study by Kidder, Peabody & Co. reaches a seemingly contrary result because it erroneously compares the postoffer performance of these target stocks to the rate of inflation rather than to the equity market.[409] In short, Easterbrook and Jarrell stress that the cost of defensive tactics is very real. Even the most conservative estimate, in the authors' minds, places the loss to shareholders at fifteen percent which the authors conclude "represents an enormous loss in shareholders' equity."[410]

The Jarrell and Poulsen study, similar to the Easterbrook study, finds that stockholders "experienced a significant wealth loss, on average, when management proposed the adoption of poison pills as well as certain (though not all) forms of antitakeover amendments."[411] In their study, Jarrell and Poulsen examine the effects of both "shark repellents," which is the "popular term for amendments to corporate charters that condition and restrict the transfer of managerial control," and poison pills on shareholder welfare.[412] Their study examines the market reaction to the adoption of take-over amendments by over 600 companies, and the adoption of poison pills by thirty-seven companies, during the period 1979-1985.[413]

From their study, they conclude, regarding "shark repellents," that as a general rule fair price amendments do not appear to reduce stockholder value (the subsample of 408 fair price amendments had an average return of negative 0.65%, a result not statistically significant from zero),[414] while some of the other anti-takeover amendments, especially the supermajority with a board-out clause, seemed to provoke a pronounced negative market reaction (the

---

406. Frank H. Easterbrook & Gregg A. Jarrell, *Do Targets Gain from Defeating Tender Offers?*, 59 N.Y.U. L. REV. 277 (1984); Gregg A. Jarrell & Annette B. Poulsen, *Shark Repellents and Poison Pills: Stockholder Protection—from the Good Guys or the Bad Guys?*, 4 MIDLAND CORP. FIN. J. 39 (1986).

407. Easterbrook & Jarrell, *supra* note 406, at 283.

408. *Id.* at 288-91.

409. *Id.* at 287-88.

410. *Id.* at 292.

411. Jarrell & Poulsen, *supra* note 406, at 40.

412. *Id.* at 39.

413. *Id.*

414. *Id.* at 44.

negative return was 4.92%)[415]—indicating that such measures are viewed by the market as signs of managerial entrenchment and, as a consequence, lower shareholder wealth.[416]

As Jarrell and Poulsen anticipated, poison pills also had a negative effect on shareholder welfare. Using a sample of thirty-seven firms that had implemented poison pills, Jarrell and Poulsen studied the average net-of-market stock return over the two-day period surrounding the public announcement of poison pills.[417] They found, first, that the two-day excess return over all firms averaged a negative 0.93% following the adoption of a poison pill, which was not statistically significant from zero.[418] They then removed five cases from the sample which had other pertinent events occurring during the window period, such as bid increases.[419] When they did this, they were left with thirty-two poison pills, with an average excess return of negative 1.42%, which was significantly different from zero.[420] Finally, because they expected poison pills to have the largest effect in cases of firms subject to takeover speculation, they computed net-of-market returns for just the twenty companies subject to takeover speculation.[421] For this smaller sample of twenty firms, the average excess net return was a negative 2.39%, again highly significant.[422]

The results of the Jarrell and Poulsen study are important. The fact that the net-of-market stock return averaged over the entire sample of anti-takeover amendments was a negative 1.25%, while poison pills adopted by firms subject to takeover speculation were associated with an average 2.39% drop in stock prices, lends statistical support to the argument that such defensive measures harm target shareholders by deterring valuable takeover bids. Studies done to determine specifically the empirical effects of anti-takeover legislation reach similar conclusions.

Two leading studies have explored the shareholder welfare effects of anti-takeover legislation. Schumann explored the wealth effects of New York anti-takeover legislation[423] and Ryngaert investigated the wealth effects of Ohio anti-takeover legislation.[424] Schumann examined the shareholder welfare effects of 1985 New York legislation which regulated "corporate combinations."[425] Using an event study method, a method whereby capital market return data is employed to measure the impact of events which may affect the value of securities, the effects of a legislation announcement were explored

---

415. *Id.* at 45.
416. *Id.*
417. *Id.*
418. *Id.*
419. *Id.*
420. *Id.*
421. *Id.*
422. *Id.*
423. LAURENCE SCHUMANN, FEDERAL TRADE COMM'N, STATE REGULATION OF TAKEOVERS AND SHAREHOLDER WEALTH: THE EFFECTS OF NEW YORK'S 1985 TAKEOVER STATUTES (1987).
424. OFFICE OF THE CHIEF ECONOMIST, SEC, SHAREHOLDER WEALTH EFFECTS OF OHIO LEGISLATION AFFECTING TAKEOVERS (1987) [hereinafter RYNGAERT STUDY].
425. SCHUMANN, *supra* note 423.

over a three-day window on the stock prices of firms potentially affected by the legislation.[426] The results, while not overwhelming, are significant. Over the three-day window encompassing the announcement of the New York statute, the value of the firms sampled fell by approximately one percent—a decline indicating a capital loss to shareholders of $1.2 billion.[427] From this evidence, Schumann concluded that "[d]espite the political rhetoric advocating the regulation of takeovers on behalf of stockholders, the evidence presented here indicates that on average this very strong statute does not protect shareholders; rather, the law protects managers at the expense of shareholders."[428]

Ryngaert's study methodology was similar to that employed in the Schumann study. Using a sample of thirty-seven firms that were incorporated in Ohio and met other selection criteria, the study concluded that "[t]he passage of the Ohio takeover law resulted in a wealth decrease to shareholders of firms incorporated in Ohio."[429] As the study demonstrated, "the passage of the Ohio takeover law was accompanied by a net-of-market decrease in the share prices of Ohio firms of approximately 1.68 to 3.24 percent."[430]

C. *Big Is Unavoidable, Inevitable, and Desirable*

What does all this mean? In short, the empirical studies indicate conclusively that anti-takeover legislation destroys wealth. Feudalism in the corporate setting, like in the agricultural setting, is a good thing. Big, often, is better. The empirical evidence demonstrates statistically that defensive measures and takeover legislation, in particular, rather than aiding shareholders, seems to harm them. These results are compelling. Indeed, if anything, they actually ignore the even greater potential negative wealth effects legislation may have on shareholders. That is, the possibility that legislation may decrease takeover activity to the detriment of all shareholders—a potentially enormous cost. In addition to these empirical arguments, we might advance other equally imperious arguments against stakeholder constituency statutes.

Foremost, we maintain that such legislation is contrary to generations of corporation law, which has directed shareholders to serve one goal—the maximization of shareholder wealth. Moreover, if, as their proponents maintain, these statutes are so useful, we question why these statutes are only generally operative in the takeover setting. Surely, wealth-redistribution arguments can be made as to events in a corporation's life other than takeovers—for example, discontinuation of a product line. If so, do not the proponents' arguments create a slippery slope where in every business decision, the interests of stakeholders must be considered?

It is also difficult to understand why proponents of such legislation are convinced that stakeholders need such protection. Most significant nonstock-

426. *Id.*
427. *Id.* at 40.
428. *Id.* at 46.
429. RYNGAERT STUDY, *supra* note 424, at 22.
430. *Id.*

holder constituencies can and do protect themselves by contract—for example, loan documents, collective bargaining agreements, and the like. Creditors know very well how to contract for equity participation (for example, equity kickers) and so do employees (for example, profit-sharing plans). Moreover, it does not make sense to ignore the shareholders' contract—the charter—according to which the shareholders are entitled to the residual wealth of the corporation. If we fail to require stakeholders to seek a contractual resolution to their dilemma, do we not distort their behavior, causing them to seek to achieve through pressure on the board of directors goals which they might otherwise have sought to achieve through other means—for example, contractual or increased performance?

Even accepting proponents' arguments, we contend that these statutes are difficult, if not impossible, to comprehend on a practical, or implementation, level. How, exactly, are directors supposed to consider the interests of constituencies other than shareholders, including groups whose interests will be adverse to shareholders? What is the balancing test that should be employed? Should directors take nonshareholder constituencies into account if their interests (1) promote shareholder interests; (2) are not inconsistent with shareholder interests; (3) conflict with shareholder interests? Does the "may consider" language used in most of these statutes mean that the board can try to obtain benefits for a nonshareholder constituency group, but does not have to disapprove of the entire transaction? Or does "may consider" mean the board may reject the entire transaction if it cannot achieve the same or a positive level of benefits for nonshareholder constituencies, even though the transaction would have been in the shareholders' interests? Additionally, most statutes do not provide standards for determining how to "consider" nonstockholder constituencies' interests. Should the directors appoint a committee, create constituency directorships, retain experts, conduct public surveys, or engage in impact statements? The possibility that such ambiguous statutes may expose shareholders to liability by plausibly giving nonstockholder groups standing to sue directors creates another problem: why would anyone want to serve as a director if they are thereby exposed to liability on this basis? Obviously, this is likely to make it even more difficult to find directors because of the real or perceived fears of a lawsuit.

Directors are usually chosen and well-equipped to maximize shareholder profits. As a rule, we anticipate they are ill-suited to make decisions regarding which, if any, stakeholder group should benefit or how that group might be harmed. If anyone is equipped for such a task, it is politicians who are more suited to assuring that wealth redistribution takes place (the wisdom of which we certainly dispute) and better situated to adopt external measures designed to eliminate takeover externalities. In short, we believe enhanced shareholder wealth inures to the benefit of all the various corporate constituencies—this is particularly true when many employees of the corporation are, in fact, shareholders. Moreover, we contend that allowing corporate takeovers is merely a recognition that bows to the inexorable march of time. Corporate feudalism is inevitable. Efforts to thwart it are likely to do nothing more than harm shareholder wealth.

VI. THE ROAD TO SERFDOM

Like a splash of rubbing alcohol, the family farm system in America has already served its brief purpose and since evaporated. The industrialization and subsequent integration of agriculture into the larger American economy suggest that the family farm system envisioned in 1862 will not be capable of surviving in the economic biosphere of the twenty-first century. The temporal niche of the family farm in American agricultural law was, in retrospect, that of a single, generously apportioned human lifespan. In the seventy-one years between 1862 and the onset of the New Deal, America's family farm policy drove a certain view of Western settlement and territorial consolidation. Regardless of the success or normative assessment of that effort: the myths of the family farm and of the family firm have outlived their usefulness. It is time to expunge the final vestiges of nepotistic protectionism from American law.

Much the same can be said for anti-takeover legislation. Statutes of this ilk arose during a moment of perceived crisis in corporate America, only to shackle this nation's capital markets in a future of increasing capital mobility worldwide. Unlike the agricultural setting, where the complex economic, environmental, and social factors at stake elude easy measurement, publicly traded corporations (and their numerous stakeholders) can assess corporate performance according to share prices reported on the stock exchanges. In this setting, a rich bank of empirical data has confirmed the prevalence of feudalism throughout all phases of American life. The descriptive case for the inevitability of feudalism stands on its own. It is but a short step thence to our normative battle cry: Let feudalism reign, unmodified, from sea to shining sea.

In our Republic's third century, the designers of American industrial policy face a clear choice. The United States, the world's leading economic power, may choose to adapt and thrive.[431] That decision will likely accelerate the extinction to which the publicly shielded, family-owned farm is already doomed. Moreover, it all but foreordains a restoration of the 1980s' *ancien régime*, when greed was good and mergers were the mania of the moment. On the other hand, any resistance to economic evolution tempts the fate that swallowed whole the mighty Hittite Empire of our fanciful parable. But this much is clear: continued coddling of small enterprise for smallness' sake—whether the family farm or the corporation targeted in a hostile takeover—is an indulgence no society can long spare in a fiercely competitive world of diminishing resources and increasing expectations. That way lies penury, for the road to serfdom is paved with misplaced compassion.[432]

Against the corrosive forces of competition, the regulation of market structure in specific industries can do little. Let us march instead toward an

---

431. *Cf. American Ideology*, *supra* note 25, at 857 (describing the central but unspoken slogan of agricultural production as "Adapt *and* die").

432. *See generally* F.A. HAYEK, THE ROAD TO SERFDOM (Milton Friedman intro., 1994).

industrialist theory of the state.[433] We need and ask little: give us freedom of entry and freedom of exit, and we shall feed the world. Among the many dazzling constellations of the economic firmament, competition is the lone fixed star.[434] Beneath that star the "sea of competitive behavior" rolls on:[435]

> Roll on, thou deep and dark blue Ocean – roll!
> Ten thousand [laws] sweep over thee in vain;
> [Farms] mark[] the earth with ruin – [their] control
> Stops with the shore. . . .[436]

433. *Cf. loosely* CATHERINE A. MACKINNON, TOWARD A FEMINIST THEORY OF THE STATE (1989).

434. *Cf.* West Virginia State Bd. of Educ. v. Barnette, 319 U.S. 624, 642 (1943) ("If there is any fixed star in our constitutional constellation, it is that no official, high or petty, can prescribe what shall be orthodox in politics, nationalism, religion, or other matters of opinion or force citizens to confess by word or act their faith therein.").

435. WILLARD W. COCHRANE, FARM PRICES: MYTH AND REALITY 106 (1958); *cf.* *American Ideology*, *supra* note 25, at 876 ("Full fathom five the farmer lies; of his bones are fortunes made. Let this, then, be the requiem for the American Ideology: home is the farmer, home at sea." (footnotes omitted)).

436. GEORGE BYRON, *Childe Harold's Pilgrimage, IV, in* CHILDE HAROLD'S PILGRIMAGE AND OTHER POEMS 93, 137 (John D. Jump ed., John M. Dent & Sons Ltd. 1975) (1815).

APPENDIX

Table 1[a]

Mean percentage and dollar synergistic gains to 236 successful tender offer contests effected between 1963 and 1984 for combined, target, and acquiring firms. All dollar figures are stated in millions of 1984 dollars.[b]

	Subperiod			Total
	7/63—6/68	7/68—12/80	1/81—12/84	7/63—12/84
No. of Contests	51	133	52	236
Combined				
% *CARC*	7.78	7.08	8.00	7.43
$ $\Delta\Pi$	91.08	87.45	218.51	117.11
% Positive	78	74	73	75
Targets				
% *CART*	18.92	35.29	35.34	31.77
$ ΔW_T	70.71	71.59	233.53	107.08
% Positive	94	98	90	95
Acquirers				
% *CARA*	4.09	1.30	— 2.93	0.97
$ ΔW_A	24.96	31.80	— 27.28	17.30
% Positive	59	48	35	47

a. This table was borrowed from Bradley et al., *supra* note 391, at 11.

b. $\Delta W_T = W_T * CART$; $\Delta W_A = W_A * CARA$; and $\Delta\Pi = (W_T + W_A) * CARC$; where W_T = preoffer market value of target equity, excluding shares held by the acquirer; W_A = preoffer market value of equity of acquiring firm; *CART* = cumulative abnormal return from five days before the first offer to five days after the last offer made for this target; *CARA* = cumulative abnormal return from five days before the first offer to five days after the last offer made by this bidding firm; *CARC* = cumulative abnormal return to the value-weighted portfolio of the target and the acquiring firm, measured over the same interval as *CART*.