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BUSINESS ASSOCIATIONS

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INADVERTENT PARTNERSHIPS

"Inadvertent partnerships" are business relationships that turn out to be treated, legally, as partnerships even though one or more of the parties to the relationship may have had no idea that he was becoming anybody's partner. In *Cajun Electric Power Cooperative, Inc. v. McNamara*,[1] the Louisiana First Circuit Court of Appeal announced a new, seven-element test for the formation of a such partnerships under Louisiana law.[2] This added one more test to the three already in existence[3]

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1. 452 So. 2d 212 (La. App. 1st Cir.), cert. denied, 458 So. 2d 123 (La. 1984).
2. The seven "requisites" are:

(1) A contract between two or more persons;
(2) A juridical entity or person is established;
(3) Contribution by all parties of either efforts or resources;
(4) The contribution must be in determinate proportions;
(5) There must be joint effort;
(6) There must be a mutual risk vis-à-vis losses;
(7) There must be a sharing of profits.

452 So. 2d at 215.

3. The other three are: (a) the Uniform Partnership Act (U.P.A.) approach, utilized in the common law states, of ascertaining "co-ownership" of a business, Penn v. Burk, 244 La. 267, 152 So. 2d 16 (1963) (citing earlier cases that had relied on the U.P.A. theory and had quoted the *Corpus Juris*); compare *Penn*, 244 La. at 294-95, 152 So. 2d at 26 with U.P.A. §§ 7, 16, as reprinted in Selected Corporation and Partnership Statutes, Rules and Forms (West 1985) and Martin v. Peyton, 246 N.Y. 213, 158 N.E. 77, 78 (1927)); (b) a "three-element" approach (which really has more than three elements, and lists as one of the "elements" the very issue to be determined), consisting of (i) mutual consent of the parties to form a partnership and to participate in the profits which may accrue from property, skill, or industry, furnished to the business in determined proportions by them, (ii) a sharing in the losses as well as the profits of the venture, and (iii) the formation of a community of goods in which each party has a proprietary interest, Darden v. Cox, 240 La. 310, 319, 123 So. 2d 68, 71 (1960); Glover v. Sowada, 457 So. 2d 101, 103 (La. App. 5th Cir.), cert. denied, 461 So. 2d 316 (La. 1984); and (c) an "abbreviated three-element" test (which shortens the first element, but which still has more than three elements and still states the issue as an element), consisting of (i) mutual consent to form a partnership, (ii) sharing in the losses as well as the profits of the venture, and (iii) formation of a community of goods in which each party has a

and provided the groundwork for some improvement, but also some further confusion, in this area of the law. The purpose of this discussion is to place *Cajun* in perspective and to suggest a means for predicting results in inadvertent partnership cases that is independent of the tests and elements that the courts recite.

Partnership under the Civil Code is both a particular type of contract and the juridical person created by that contract.[4] Accordingly, the Code's approach to the inadvertent partnership problem is first to "define" a partnership contract by listing its typical, distinguishing characteristics (such as profit-sharing, collaboration, and mutual contributions of value)[5] and then to provide the various rules that are to govern both the contract and the juridical person once the contract has been classified as one of "partnership."[6] Under this scheme, a contract either fits the "partnership" category or it does not, and the rules of partnership either apply in their entirety or not at all.

Although this approach seems at first to create a fairly simple and workable analytical model, it soon leads to the untenable notion that the question in every inadvertent partnership case is wholly abstract and always the same, i.e., "Is this a 'partnership' type of contract?" In practice, of course, the courts are rarely asked to determine anything quite that broad or complicated. The question the courts face is never whether one person is the partner of another for all conceivable purposes, but only whether he should be treated as such for purposes of resolving the particular dispute before the court. That particular dispute might

proprietary interest, Carr v. Masters, 469 So. 2d 1147, 1149 (La. App. 4th Cir. 1985); Butler v. Atwood, 420 So. 2d 742, 745 (La. App. 4th Cir. 1982). There seems to be no recognition in the cases that any question exists concerning what the test really is. This is true even in *Cajun*, which announces a seven-element test while citing U.P.A. and three-element cases. *Cajun*, 452 So. 2d at 215 (citing, e.g., Walker v. Simmons, 155 So. 2d 234, 236 (La. App. 3d Cir. 1963)(U.P.A.) and Marine Services, Inc. v. A-1 Indus., Inc., 355 So. 2d 625, 628 (La. App. 4th Cir. 1978)(abbreviated three-element). *Cajun* seems to have ignored the tests in those cases, and to have made up a new one simply by restating in lengthier form the definition of partnership contained in Louisiana Civil Code article 2801.

4. See La. Civ. Code arts. 2801, 2802.

5. The Civil Code provides that the parties to a partnership contract "combine their efforts or resources in determined proportions and . . . collaborate at mutual risk for their common profit or commercial benefit." La. Civ. Code art. 2801.

6. Generally, the contract is governed by the conventional obligations articles, but special rules are provided in the Partnership title concerning both the contractual arrangement between the parties and the powers and responsibilities of the partnership as a juridical person. See, e.g., La. Civ. Code arts. 2803 (equal participation in profits and losses unless otherwise agreed), 2817 (partnership primarily liable for its debts, partners bound for virile share).

involve principles of contract,[7] tort,[8] or agency[9] law, or require the court to ascertain the intention of the legislature with respect to a wide variety of public-law issues.[10] However, it rarely would require the court to consider every one of those areas, and rarely would the parties have researched or briefed the court on the implications that a "partnership" or "no partnership" decision in one field would have on the law in many other, virtually unrelated fields.[11]

Nevertheless, in order to trigger, or to keep from triggering, any one of the Civil Code's partnership provisions, the courts seem to believe that they must determine whether all or none of the partnership articles should apply, and must do this based solely on abstract "definitional" criteria that often have little or nothing to do with the underlying, fundamental issues that the court really is facing.[12] In *Butler v. Atwood*,[13] for example, the fourth circuit resolved a dispute over the imposition of vicarious tort liability using, supposedly, the same test used in *Carr v. Masters*[14] to determine whether one party had a right of action to partition co-owned business assets without also suing for dissolution under partnership law. Although one would suppose that the tort case would be governed by tort principles and the procedure case by principles of procedure, none of the reported cases have drawn this type of

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7. See Darden v. Cox, 240 La. 310, 123 So. 2d 68 (1960) (whether parties had agreed to an equity-sharing arrangement).

8. See Butler v. Atwood, 420 So. 2d 742 (La. App. 4th Cir. 1982) (whether "lessor" of service station should be held vicariously liable for personal injuries arising from the tortious conduct of the service station employees).

9. The agency question might arise in the context of vicarious liability for torts, see *Butler*, 420 So. 2d at 742; or vicarious liability for contracts, see La. Civ. Code arts. 2814 (partner as mandatary of partnership), 3021 (principal bound to execute authorized engagements).

10. See *Cajun*, 452 So. 2d at 212 (whether Legislature should be deemed to have intended sales and use tax exemption to apply in respect of exempt entity's share in co-owned enterprises).

11. Rules that are designed to protect the reasonable expectations of parties to consensual transactions would not likely be very effective in implementing the policies of risk-spreading, risk avoidance, and fairness that might be pertinent to nonconsensual personal injury actions.

12. Whether the two parties to a business relationship have actually agreed to share losses (which seems to be required by the three-element tests, see supra note 3) should have little bearing on whether one or both of those parties should be held responsible for the risks posed to third parties by the operation of that business, even though the terms of their loss agreement might be absolutely controlling in an action by one against the other for indemnification. Cf. La. Civ. Code art. 2815 ("no loss" stipulation does not affect third parties). But cf. *Butler*, 420 So. 2d at 746 (even in actions by third parties, intent of contracting parties to share losses is an "indispensable element" in finding a partnership).

13. 420 So. 2d 742 (La. App. 4th Cir. 1982).

14. 469 So. 2d 1147 (La. App. 4th Cir. 1985).

distinction explicitly. Instead, where the square peg seems not to fit the round hole, the courts get out the knife and putty and start shaving here and adding there. But they still claim to be using a square peg. Thus, in one case the parties may be required to show an express agreement to the partnership "elements"[15] while in others, purportedly addressing the very same issue, assent to the elements may be inferred from the circumstances.[16] Similarly, in some cases agreements to share losses "as well as profits" must be shown,[17] while in others the loss-sharing agreement is considered implied by the very fact that the profits themselves, net of debt payments, are to be shared between the parties.[18]

These kinds of cases cannot be reconciled abstractly. Abstractly, they say opposite things. But if the distractions of the abstract classification scheme can be avoided even for a moment, the more fundamental underlying issues are not that difficult to spot. In *Darden v. Cox*,[19] for example, the leading supreme court decision on partnership criteria, the plaintiff was seeking a thirty percent share in the equity of a business. It was established that the parties had agreed that he was to participate in thirty percent of the business' profits and that, over the years, he had left in part of his profits and contributed additional capital to the business.[20] It seems clear that the fundamental issue in *Darden* was whether the parties involved had assented to a contractual arrangement under circumstances that had led the thirty percent participant reasonably to conclude that he owned thirty percent of any increase in the business' value. Nevertheless, the court's rationale suggests that the plaintiff won because, having proven that a partnership existed, he had triggered a suppletory provision in the Civil Code that gave him a share in the equity of the business.[21] To trigger this provision, however, he had to satisfy a partnership test that included as only one of its elements a showing that the parties had assented to the creation of a "community of property" in which each had a "proprietary interest."[22] The court in *Darden* did not seem to see the irony, that the plaintiff had to prove the existence of an actual agreement not only on the very

15. *Glover*, 457 So. 2d at 107; cf. *Butler*, 420 So. 2d at 746 (actual agreement required).

16. See, e.g., *Darden*, 240 La. at 321-22, 123 So. 2d at 73-74; *Carr*, 469 So. 2d at 1149; cf. *Cajun*, 452 So. 2d at 216 (partnership may exist despite clearly expressed intention not to create such an entity); Fossier v. American Printing Co., 130 So. 2d 529, 533 (La. App. 4th Cir. 1961) (parties' stated intention is not controlling; court will determine what they really intended).

17. *Butler*, 420 So. 2d at 746; *Glover*, 457 So. 2d at 103.

18. *Carr*, 469 So. 2d at 1149; *Fossier*, 130 So. 2d at 532-33.

19. 240 La. 310, 123 So. 2d 68 (1960).

20. Id. at 315, 322-26, 123 So. 2d at 70, 72-74.

21. Id. at 330, 123 So. 2d at 75.

22. Id. at 319, 329, 123 So. 2d at 71, 75.

term that he wished to have imposed (based solely on constructive assent) as a result of the suppletory rules of partnership law, but also on the other "elements" of the partnership test, none of which should have been considered important once the actual agreement on community property was established. Fortunately for the plaintiff, the *Darden* court at least was willing to infer an agreement on the "community of assets" element, and did not insist that an express form of actual agreement be proven.[23]

If the notion seems silly that a plaintiff might have to prove an express agreement on the very point that he is trying to have covered by a suppletory provision, then consider *Glover v. Sowada.*[24] In *Glover,* the court denied the plaintiff's *Darden*-like claim to a share in the business assets because she had failed to prove an express agreement on each one of the partnership elements, including the establishment of a community of goods in which each party had a proprietary interest.[25]

The question posed by the disagreement between *Darden* and *Glover* is not really which court's view on inferences is correct, for the "tacit assent" approach clearly makes more sense,[26] but why in contrast to the *Darden* court, the court in *Glover* wanted to choose a rule that was so clearly going to defeat the plaintiff's claim. As usual, the answer lies in the facts. Unlike the pure business relationship in *Darden,* the arrangement in *Glover* seemed to the court to be motivated largely by a personal relationship between the "partners," a woman and her live-in companion.[27] The real question in *Glover,* therefore, was not whether, in the abstract, the arrangement in question had as many partnership elements as did the relationship in *Darden,* but whether the court would allow an end run around the rules on the establishment of marital communities by permitting partnership doctrines to establish analogous rights in "business" communities. Surely, both the court and the lawyers in that case realized that was the real issue. Nevertheless, the cases were written as if one of the decisions, *Darden,* was taking a stand in favor

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23. Id. at 323-29, 123 So. 2d at 73-75.

24. 457 So. 2d 101 (La. App. 5th Cir.), cert. denied, 461 So. 2d 316 (La. 1984).

25. 457 So. 2d at 104-05, 107.

26. The partnership agreement is to be governed by the provisions of the Louisiana Civil Code concerning conventional obligations, article 2802, and those provide for contract formation through offer and acceptance "made orally, in writing, or by action or inaction that under the circumstances is clearly indicative of consent." La. Civ. Code art. 1927. If express, or even actual agreement to each of the partnership elements really was required for the formation of a partnership, the "elements" would have to be changed, because they otherwise would require, among other things, an actual agreement to be liable for losses and an actual intention to form a partnership. Assent to these elements is more typically established constructively. Accord, *Cajun* 452 So. 2d at 216; *Fossier,* 130 So. 2d at 533.

27. 457 So. 2d at 102-04, 107.

of inferences, while the other, *Glover*, was taking the opposite position.[28]

These two cases, which seem representative, suggest strongly that the courts are willing manipulate the pertinent partnership tests to the extent necessary to rationalize results that make sense in light of the types of issues really involved.

If this view is correct, that narrower, more fundamental issues of law lie hidden beneath the single abstract "partnership" question that the courts always purport to be addressing, then it should be possible in practice to evaluate the strength of one's case more accurately by discounting the court's stated rationales than by following them closely. It should also be possible to improve one's legal arguments by stressing the factors that are pertinent to the fundamental issues, while suggesting the limited relevance of any remaining, abstract definitional criteria. That would not mean that the issues "really" involved would always be easy to resolve. It would have been difficult, for example, to decide the issue of marriage-like communities of assets in *Glover* even if the true issue had been stated explicitly. The fact that it was not so stated, however, should not lead anyone to believe that *Glover* posed any less difficult an issue.

How, then, does *Cajun* fit the old pattern of cases? It fits well, for even though it announces a new, more detailed test, the test it announces still purports to be universal.[29] Indeed, the court seems to have been surprised that the plaintiff would have the temerity actually to suggest that two participants in a common project might well be treated as partners for federal income tax purposes, without also being treated as partners for all other purposes.[30]

The narrow issue in *Cajun* was whether the plaintiff's tax exempt status as an electrical cooperative could be claimed with respect to its thirty percent ownership interest in a power plant that was co-owned seventy percent by Gulf States Utilities Company (GSU), a nonexempt private company.[31] Despite this, the court did not discuss whether sound tax policies would permit this kind of "partial" exemption, considering, for example, the potential it might create for unintended exemption-sharing or transfer arrangements. Instead, the court announced its new, universal seven-element partnership test and, after a fairly cursory discussion of how the Cajun-GSU arrangement satisfied it, ruled that a

28. The court did acknowledge both the similarity between the marriage relationship and the relationship in *Glover*, and the interrelationship of personal and business factors in such relationships. However, the court seemed not to want to explore the question of why, under those circumstances, it might not be appropriate to give some form of community property interests to the plaintiff. See 457 So. 2d at 107.

29. 452 So. 2d at 215-16.

30. Id. at 216.

31. The taxes had already been paid, and Cajun was suing for a refund. Id. at 214.

partnership had indeed been created.[32] The court then ruled that the partnership, as a separate juridical person, would have to have its own exemption in order to avoid payment of the taxes involved. Because it did not possess any such exemption, the court ruled that the contested taxes had been collected lawfully.[33] As in most inadvertent partnership cases, the result in *Cajun* seems more defensible than the analysis supporting it.

From the standpoint of the abstract criteria themselves, *Cajun* did improve on the older tests by changing the "agree to share losses" element to a "mutual risk" requirement.[34] That apparently was based on a 1980 change to the Civil Code that reversed the earlier rule against enforcing "no loss" agreements even between the parties.[35] Unfortunately, however, *Cajun* also kept or invented some other "requisite elements" that could well be missing from an arrangement that might otherwise, abstractly, be considered a partnership. The court in *Cajun* stated, for example, that the parties to a partnership had to provide "joint effort" and that any contributions by the parties of efforts or resources had to be in "determinate proportions."[36] This suggests, unwisely, that a general partnership could not exist with passive, silent partners, and that sloppiness or informality concerning the amount or percentage of each party's contribution to the business could keep the business from being considered a partnership at all.

The impact of *Cajun* is difficult to assess. It is possible that these additional elements will make it more difficult to prove the establishment of a partnership, particularly if express assent to each of the items is

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32. More precisely, the court said that a joint venture was created, but that partnership law governed joint ventures, including questions whether the ventures have been created. Id. at 215-16.

33. The court did support its view that the formal structure of the transaction should govern the applicability of the exemption by noting that tax exemptions were to be construed strictly against the person claiming them. Id. at 217.

34. Compare *Cajun*, 452 So. 2d at 215, with, e.g., *Butler*, 420 So. 2d at 746; Walker v. Delahoussaye, 116 So. 2d 884, 887 (La. App. 1st Cir. 1959) (no partnership because, among other things, agreement between the parties provided that one was to bear no losses).

35. Compare La. Civ. Code art. 2815 (Supp. 1985) ("no loss" stipulations unenforceable only with respect to third parties) with La. Civ. Code art. 2814 (1952) (prior law, "no loss" stipulations between partners void both as to third parties and as between the parties). Under prior law, a court had to find that no partnership existed in order to give effect to an otherwise enforceable "no loss" agreement. See *Walker*, 116 So. 2d at 887. This helps explain Louisiana's emphasis on the "agree to share loss" element of the partnership tests.

36. 452 So. 2d at 215. The court also said that one of the requisites to the formation of a partnership was that "a juridical entity or person is established." That, of course, puts the cart before the horse, for it is the contract that creates the juridical person, not the other way around.

required.[37] However, if the courts use this test as they have the others, it is very likely that the elements of the *Cajun* test will be utilized selectively, and with differing meanings attached, depending on the court's need to rationalize a result it has already reached on a more fundamental, underlying issue.

ANTITAKEOVER PROVISIONS

The 1984 Louisiana Legislature enacted a fairly complicated set of provisions, Louisiana Revised Statutes (La. R.S.) sections 12:132-134, that are supposed to protect the interests of dissenting shareholders in connection with business combinations that involve publicly-held, Louisiana-incorporated companies.[38] The purpose of this brief discussion is to untangle these convoluted provisions and to suggest that the Act will more likely help incumbent management than protect the victimized shareholder. Questions concerning the constitutionality of this type of legislation will also be mentioned.

The legislation has three sections. The first, section 132, lists definitions; the second, section 133, imposes a supermajority vote requirement with respect to business combinations involving Louisiana companies; and the third, section 134, lists exemptions from this voting requirement. The key to understanding the new legislation is to see how the interplay of the statute's voting requirement and exemptions is likely to affect the behavior of bidders for control of Louisiana-incorporated businesses.

The acquiror who is content to obtain working control of a company and to operate it indefinitely as a subsidiary, without ever effecting a merger or other combination, is likely not to be affected at all. The statute seems designed not to regulate the simple acquisition of a controlling percentage of voting stock but instead the "mop up" or "freeze-out" transaction that often follows such an acquisition.[39] For takeover

37. See supra text accompanying note 15.

38. La. R.S. 12:132-134 (Supp. 1985). The Legislature entitled the new provisions "Dissenting Shareholders' Rights and Fair Price Protection." The requirements do not apply to companies with fewer than 100 beneficial shareholders. La. R.S. 12:134 E(1)(a) (Supp. 1985).

39. Because of the very broad definition of the "business combinations" to which the new provisions purport to be applicable, it is conceivable that the statute could be construed to apply even to the consummation of tender offers for stock that take place in the secondary markets. The definition of "business combination," the event for which a vote or exemption is required, includes

> the issuance or transfer by the corporation or any subsidiary, in one transaction or a series of transactions, of any equity securities of the corporation or any subsidiary which has an aggregate market value of five percent or more of the total market value of the outstanding stock of the corporation . . . .

La. R.S. 12:132(4)(c) (Supp. 1985). If this reference to a "transfer" of stock by the corporation was interpreted to include the record transfers of stock needed to cause the efforts that depend on the availability of these follow-up devices, however, the new statute could well prove devastating.

In the typical two-stage acquisition, the bidder obtains control of the target company in the first stage of his takeover by announcing a tender offer that provides generous premiums to shareholders who are willing to sell him their stock. Because of the premiums involved, most noncontrolling shareholders are perfectly happy, even eager, to sell their shares in this first stage offer.[40] As announced in his offer, however, the bidder will normally be willing to accept and pay only for that part of the tendered stock necessary for him to secure control.[41] The remaining stock will be acquired in the second stage of the takeover. In that stage, the bidder will merge the target into another company that he already controls.[42] Because the bidder controls both parties to this merger, he is able to adopt a plan of merger that forces the target's minority shareholders to sell him their stock at any price he chooses,[43] subject

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corporate books to reflect the changes of beneficial ownership that occurred in the secondary markets, then the purchaser of a substantial block of stock (five percent by a ten percent or greater shareholder) would either have to subject himself to the statute or rely solely on proxies and assignments of rights, rather than on record transfers, to obtain the rights and benefits associated with the shares he had purchased. This construction is highly unlikely in view of the statute's emphasis on beneficial ownership, see La. R.S. 12:132(3), (6), (9), and would very likely be considered unconstitutional. See infra text accompanying notes 66-71. Some commentators seem simply to have assumed that this type of enactment would not regulate tender offers. See Kramer, Tender Offer Developments, in 1 Hostile Battles for Corporate Control 59, 68 (1985) (discussing Maryland provision on which the Louisiana enactment is based, see infra note 73); Warren, Developments in State Takeover Regulation: MITE and Its Aftermath, 40 Bus. Law. 671, 696-98 (1984) (discussing Maryland law).

40. Indeed, the federal rules on tender offers are designed to prevent shareholder stampedes in these offers by requiring a minimum offering period and the pro rata acceptance of shares tendered, regardless of the time during the offering period at which they were tendered. See 15 U.S.C. § 78n(d)(6) (1982); 17 C.F.R. § 240.14d-8 (1985).

41. This is lawful, as long as the offeror pro-rates the acceptance of the stock that is tendered. Id.

42. If this second, acquiring corporation is itself a substantial, publicly-traded company, the controlling person of the company will often avoid the trouble and expense of a merger vote among that company's shareholders by forming a new, thinly-capitalized, wholly-owned subsidiary to carry out the merger. This new company has only one shareholder, the corporate parent, whose shares are voted by the parent company managers, people whose jobs depend on their obedience to the parent company's controlling person. This merger-through-a-subsidiary approach is called a "triangular" merger if the new subsidiary is the survivor and a "reverse triangular" merger if the target survives. Control is not affected, of course, by the nominal survival of the target. The target becomes a wholly-owned subsidiary, and will have been made to survive simply to keep its licenses, contracts, or regulatory approvals in place, undisturbed by the combination. See R. Hamilton, Corporation Finance 507-09 (1984).

43. Louisiana law, like the Model Business Corporation Act (M.B.C.A.), imposes only procedural requirements with respect to merger agreements; the substantive terms

only to the loose strictures of fiduciary duty and, sometimes, to the dissenters' rights that may be afforded by statute.[44]

While there is considerable disagreement over the fairness and effects of the two-stage takeover in actual practice,[45] the bidder's control of the second-stage price may, theoretically, make it possible for him to pay for the premiums he offered in the first stage simply by stealing the necessary money, plus a profit, in the second stage.[46] If this is true,

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are left to negotiation. See La. R.S. 12:112(A) (1969) (the agreement is to prescribe the terms of the merger and to contain any other provisions deemed necessary); La. R.S. 12:112(C) (1969) (agreements to be approved by vote of shareholders); compare M.B.C.A. § 71 (1982). Because a person that controls both parties is negotiating only with himself, he has the power to establish the terms of the merger, including a requirement that minority shareholders relinquish their stock in exchange for cash or property, rather than stock in the surviving company. This "cashing out" of investors is expressly allowed in the M.B.C.A., § 71 (c), and is implicitly permitted in Louisiana both by the absence of substantive restraints and by language in the "short form" merger and dissenter rights provisions that seem to sanction it. See La. R.S. 12:112(A) (1969) (mergers in accordance with agreement), La. R.S. 12:112(H) (1969) (short form merger in which ninety percent parent adopts plan to exchange cash or other consideration for the remaining shares of the subsidiary held by others), La. R.S. 12:131(C) (1969) (shareholder entitled only to cash value of his share in the event he dissents).

44. La. R.S. 12:131 (1969). Compare, M.B.C.A. §§ 80, 81 (1982). Curiously, Louisiana protects dissenters' rights in a short-form merger, where a parent has ninety percent control, but not where the proponents of a merger control, or are able to obtain approval from, only eighty percent or more of a company's shares. Compare La. R.S. 12:112(H) (1969) with La. R.S. 12:131(A) (1969). The ninety percent parent who wishes to avoid dissenters' rights would be wise, therefore, to avoid the short form approach, and to go ahead with the charade of holding a full-fledged vote.

45. Although no conclusive data exists, some empirical studies suggest that target shareholders realize premiums whether or not they go along with the first-stage tender, for the target's market price often remains elevated even after completion of the offer. See Lowenstein, Pruning Deadwood in Hostile Takeovers: A Proposal for Legislation, 83 Colum. L. Rev. 249, 289-90 (1983); Easterbrook & Fischel, Takeover Bids, Defensive Tactics, and Shareholders' Welfare, 36 Bus. Law. 1733, 1739-40 (1981). This suggests that the market, on the average, does not anticipate that the bidder will be capable of squeezing out the minority at prices below those prevailing prior to the commencement of his takeover efforts. The squeeze out is therefore not considered unfair. Others believe that the squeeze out permits the bidder to exploit short-term market conditions to seize the long-term, "intrinsic" value of the targeted business from minority investors powerless to stop the takeover. These commentators suggest that it is principally the fear of the second-stage freeze out that motivates many shareholders to respond so favorably to the first-stage offer. See Lipton, Takeover Bids in the Target's Boardroom, 35 Bus. Law. 101, 114-15 (1979). There is no question that the involuntary, second-stage price is often much lower than that offered in the first stage to shareholders under no compulsion to sell. See M. Lipton & E. Steinberger, Takeovers and Freezeouts § 1.07[4][c] (1984) (describing two-stage acquisitions in which the prices were, e.g., $125 cash, first stage, $76 in notes second stage, $41 cash, first stage, $29 in preferred stock, second stage).

46. The two-step takeover can also be used to force the target to pay off the debt that the bidder's company incurred to take it over. Under this strategy, a bidder forms

even the savvy shareholder, one who knows perfectly well what is going on, cannot protect himself. He can either help the bidder in the first stage by selling him as much stock as he can, knowing that any premiums paid, plus a profit, will be stolen back, or he can refuse to cooperate, let someone else take the premiums and simply wait for the inevitable merger. He will get nothing for his recalcitrance but the loss of his share of the first-stage premiums.[47]

The new takeover provisions purport to attack this abusive type of acquisition financing by prohibiting any nonexempted merger (or other business combination) unless the proposed combination is approved not only by the target's board of directors, but also by eighty percent of the shares eligible to vote and by two-thirds of the voting shares not held by any "interested" shareholder, i.e., any owner of ten percent or more of the company's stock.[48] That last, "two-thirds disinterested" requirement is the critical one. It essentially causes the bidder to lose his vote with respect to nonexempted transactions as soon as he passes the ten percent level of ownership. This means he can never acquire a controlling vote for merger purposes and so can never hope to consummate the squeeze-out that he is depending on to make his takeover profitable.[49] It also means that shares in excess of ten percent are

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a new, thinly-capitalized acquisition company and causes it to borrow the money it needs to purchase a controlling interest in the target. Someone substantial, perhaps one of the bidder's existing, creditworthy companies, usually has to guarantee this obligation, but that works out once the takeover is completed, for the second-stage merger causes the acquisition debt to become payable out of the earnings produced by the assets of the target. The survivor of a second-stage combination under these circumstances looks pretty much like the target in its pre-takeover days, except that it now has more debt and is now controlled by someone else.

47. He could also sell all his shares in the open market, of course, but if the market was as smart as he was, its prices would already be discounted in anticipation of both the limits on first-stage premiums and the likelihood of second-stage losses. A sell-out under those circumstances would simply hasten the day of reckoning. But see supra note 45.

48. La. R.S. 12:133 (Supp. 1985). These supermajority requirements override any provisions in the articles which may purport to reduce the vote normally required for these combinations unless one of the exemptions to the supermajority requirement is satisfied. La. R.S. 12:134(F) (Supp. 1985).

49. The bidder could engage in a proxy fight to obtain the two-thirds vote, but if he expects to do that, even after purchasing a majority of the company's stock, he might just as well save his stock purchase money and invest it in a proxy fight to begin with. The proxy fight, though, will generally seem less attractive to a bidder than a tender offer, for a proxy fight requires the acquiror to invest his money in little more than a public relations campaign. It is easy to see why a prospective acquiror, despite the higher cost of the tender offer, prefers the relative certainty of buying votes (attached to shares, of course) to the unpredictability of a campaign to talk shareholders into giving them away (on a revocable basis) free of charge. But see Bialkin, Attura & Gottlieb, Proxy Contests for Corporate Control, in 1 Hostile Battles for Corporate Control 9, 13-16 (1985)

worthless to him for merger purposes, so that he is very unlikely to pay very much for them if he wants them principally for that reason.

Despite the depressing effect these provisions might have on first-stage premiums, however, the new statute might very well make sense as a means of preventing abusive two-stage takeovers if it did not contain exemptions so clearly inconsistent with those aims. Of the three exemptions pertinent to this discussion,[50] only one is reconcilable with a shareholder-protection policy. The other two seem designed simply to strengthen management's hand in negotiating with hostile bidders.

To satisfy the one shareholder-oriented exemption, the bidder must, among other things,[51] provide payment for the stock to be acquired or extinguished in the squeeze-out not only in the same form as paid in any earlier transactions in which he acquired the majority of his stock,[52] but also in an amount equal to the highest price produced by a sophisticated series of standards which are designed to capture premiums for the minority stockholders at least as large as those paid in earlier, voluntary transactions.[53] Thus, if no other exemptions were available,

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(proxy fight may be reemerging as takeover device less expensive and less susceptible to defensive maneuvering than tender offers).

50. Other exemptions make the voting requirement inapplicable where (i) the corporation has fewer than one hundred beneficial owners of its stock, or (ii) the corporation is an investment company registered under the Investment Company Act of 1940, i.e., a mutual fund. La. R.S. 12:134(E)(1)(a), (c) (Supp. 1985). Also, a new company may "opt out" of the provision by including in its articles of incorporation a provision to that effect. Once incorporated, however, the company cannot opt out except by the same eighty percent/two-thirds vote required for the covered business combinations themselves. La. R.S. 12:134(E)(1)(b) (Supp. 1985).

51. The bidder is also required to avoid self-dealing with the target, La. R.S. 12:134(B)(5) (Supp. 1985) to send written objections to the company concerning any dividend reductions, La. R.S. 12:134(B)(4)(a)(ii), 12:134(B)(4)(b) (Supp. 1985), and to refrain from acquiring any further stock on any transaction occurring after the one in which he became a ten percent or greater owner. La. R.S. 12:134(B)(4)(a)(iii) (Supp. 1985) ("interested shareholders" may not become the beneficial owner of any additional stock after the transaction in which he became an "interested shareholder"); La. R.S. 12:132(9) (Supp. 1985) ("interested shareholder" is a beneficial owner of ten percent or more of the voting power of the corporation or an affiliate of the corporation that in the preceding two years had been beneficial owner of ten percent of the voting stock then outstanding). The "standstill" part of the exemption essentially allows a gradual increase of ownership to just below ten percent, but then allows only one more "bite." If the acquiror wishes to obtain control, therefore, he will generally have to announce a public tender offer in order to get as much of the remaining stock as he needs for control in one final transaction. This restriction does not apply, of course, to nominal acquisitions of "additional" shares as the result of proportionate stock dividends or stock splits. La. R.S. 12:134(B)(4)(a)(iii) (Supp. 1985).

52. La. R.S. 12:134(B)(3) (Supp. 1985).

53. La. R.S. 12:134(B)(1) (Supp. 1985) (price standards for common stock); La. R.S. 12:134(B)(2) (Supp. 1985) (price standards for stock other than common stock). Both

the bidder would be forced by the new statute either to pay at least

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subsections, (1) and (2), establish three minimum prices. The price paid must be at least as great as the highest of these three minimums. The three minimums are: (i) the highest price (including transaction costs such as brokerage fees) paid by the ten percent holder at any time within the two years preceding the date that he publicly announced, or communicated generally to shareholders, his intention to effect the business combination (or, without regard to the two-year period, the price paid in the transaction in which he became a ten percent holder, if that price was higher), (ii) the "market value" of the shares to be acquired as of the "announcement date" mentioned in (i), above, or on the date on which acquiror passed the ten percent level of ownership; and (iii) the "market value" as determined in (ii), above, times a market appreciation factor equal to the ratio of the two-year high described in (i) over the acquiror's "beginning price," the price at which he first bought stock within that two year period.

In simpler terms, the minority shareholders must be offered the highest of (i) the stock's two-year high, (ii) the stock's market value, as it may be affected (usually upward) by the bidder's taking a ten percent stake or announcing his plans to effect a combination, or (iii) the market value in (ii), plus a premium based on a two-year market appreciation ratio.

The treatment of stock other than common (preferred or preference stock) differs from the common stock requirements only in its addition of a fourth minimum, the highest preferential amount to which the holders of those shares would be entitled in the event of a liquidation, dissolution, or winding up of the company. La. R.S. 12:134(B)(2)(b) (Supp. 1985).

As complicated as this may seem, it is far simpler, and more valuable to minority shareholders, than the approach traditionally taken in dissenters' rights statutes. The traditional statutes generally require the dissenting shareholders first to survive a series of substantive exemptions and procedural traps, see La. R.S. 12:131(B)-(E) (Supp. 1985) and then give them the right only to litigate the "true" value of their stock as of one point in time, just before the approval of the combination from which they are dissenting. See La. R.S. 12:131(C) (Supp. 1985). By then, of course, the market will already have discounted its prices for the stock in anticipation of the squeeze-out. But see supra note 45. Accordingly, the judge in the appraisal proceeding, who by the way is probably not as sophisticated financially as the acquiror or other price-affecting participants in the market place, will have to come up with a price that strikes him as fair, and then will have to rationalize his conclusion with a series of highly speculative calculations designed to demonstrate the "true" value of the stock. Accord, Peimonte v. New Boston Garden Corp., 377 Mass. 719, 387 N.E.2d 1145 (1979) (Delaware block approach, combining asset value, earnings value, and market value, in the proportions the judge determined to be appropriate under the circumstances, including in this case the popularity of certain hockey players on the team that played in this stadium owned by the company, and the chance that a new hockey league might be successful enough to affect the company's earnings).

The new provisions do away with this "litigated value" approach. The dissenter need not convince a judge in litigation that he actually was cheated. Indeed, he need not file a lawsuit at all; his rights under the new provisions will be triggered automatically by the bidder's own activities. It is the acquiror, not the dissenter, who must be careful under the new provisions, for if he slips, he will have to persuade two-thirds of the noncontrolling shareholders that the deal he is proposing really is to their advantage.

Another advantage for the minority shareholders is that the new legislation is much more sophisticated in its listing of the types of business combinations to which the voting/

the same premium to involuntary sellers as he had to the voluntary ones[54] or to face the prospect of trying to persuade the owners of two-thirds of the remaining, noncontrolled shares that the combination he is proposing is really in their best interests. It would be virtually impossible under these circumstances to steal money from the minority investors.[55]

Facing this Hobson's choice, though, the rational acquiror is likely to look for another exemption. Fortunately for him, he still has the other two left.

Under the first, a company that had stockholders owning ten percent or greater blocks of its stock as of January 1, 1985, is exempt from the voting requirements unless the board of directors of that company "opts in" to the new provisions by resolution.[56] The board may choose in its resolution to opt in generally or with respect only to one or more specified ten percent holders or types of ten percent holders.[57] Once the board opts in, though, the company may opt out only by the eighty percent/two-thirds vote required for business combinations.[58] Under the second exemption, for companies that had no ten percent (or greater)

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pricing provisions are applicable. Compare La. R.S. 12:132(4) (Supp. 1985) ("combinations" under the new statute include mergers, triangular mergers, share exchanges, noncash liquidations, stock issues, or recapitalizations that increase holder's stake by five percent or more, and asset sales out of the ordinary course of ten percent or more of total value) with La. R.S. 12:131(A) (1969) (traditional dissenters' rights apply only to mergers, consolidations, and sales of substantially all assets, to which the corporation is a party). This makes it much less likely that an acquiror can avoid the dissenters' rights simply by rearranging the formal structure of the transaction. The new provision also leaves out the "80% approval" and "exchange-listed stock" exemptions provided under the traditional dissenters' rights provisions. Compare La. R.S. 12:134 (new provision's exemptions) with La. R.S. 12:131(A) (1969) (traditional dissenters' rights unavailable if combination approved by eighty percent or more of the total voting power), La. R.S. 12:131(B)(3) (Supp. 1985) (rights unavailable, except in squeeze outs, if company's stock is listed on a national securities exchange).

54. Indeed, there is a good chance under item (ii) or (iii) of the pricing standard, see supra note 53, that the bidder would be forced (if he wished to avoid the eighty percent/two-thirds vote) to offer a premium whose size was determined in large part by the market activities of others.

55. Because of the pricing "overkill," see supra note 54, the new provisions are also likely to increase the uncertainties over second-stage prices so much that they will discourage takeovers that are expected to be only marginally profitable. Even without uncertainty, the new provisions are likely to depress first-stage premiums by forcing the bidder to spread out his premiums among all shareholders, rather than loading most of them on the front end of the takeover.

56. La. R.S. 12:134(D)(1) (Supp. 1985). Although it is only the board, and not the shareholders, that adopts this resolution, it is nevertheless treated as an amendment to the articles of the company, La. R.S. 12134(D)(4) (Supp. 1985), and can be rescinded only by supermajority vote. La. R.S. 12:134(D)(3) (Supp. 1985).

57. La. R.S. 12:134(D)(1) (Supp. 1985).

58. La. R.S. 12:134(D)(3) (Supp. 1985).

shareholders on January 1, 1985, the board has to "opt out" of the voting requirements by means of a resolution adopted before the date that the particular bidder involved reached or passed the ten percent level of ownership.[59] The resolution may specify the particular bidder or types of bidder covered,[60] and unless the resolution is made irrevocable by its terms, it may be altered or repealed at the pleasure of the board.[61]

Although the company involved must opt in under one provision and opt out under the other,[62] the thing that both of these exemptions have in common is that they permit the target company's existing board, its incumbent management, to control whether and against whom the supermajority vote requirement is to be imposed. This means that acquirors will have more reason than ever to purchase management's cooperation by means of control premiums, long-term employment contracts, golden parachutes, and the like, and that management will have more power than ever to demand that these kinds of arrangements be offered. By eliminating the bidder's incentive to buy votes from shareholders, and instead giving him a good reason to pay managers[63] for theirs, the statute effectively takes the economic value of the voting rights normally attached to the shareholder's stock (and normally purchased in tender offers)[64] and gives it to the company's managers.[65]

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59. La. R.S. 12:134(C)(1)(b) (Supp. 1985).

60. La. R.S. 12:134(C)(1) (Supp. 1985).

61. Id.

62. The very difference in the statute's treatment of controlled and noncontrolled companies helps preserve existing control structures. Existing ten percent holders, if they control a company, can exempt themselves, but deny similar exemptions to others, while the "professional managers" of a company without ten percent holders know that any bidder has to talk to them before crossing the ten percent level of ownership (if he ever expects to effect a business combination involving "their" company). Although fear of a "taking property" argument may have played some role in the decision to exempt existing ten percent holders, that fear would not explain why the existing control persons are given the power to "fine tune" the application of the statute with respect to other prospective bidders.

The organizers of companies incorporated after January 1, 1985, control whether the supermajority vote requirements of § 133 are to apply to those companies. See note 50, supra. The statute does not explicitly condone the "fine-tuning" of these "new company" decisions.

63. The term "manager" as used in the discussion is meant to refer to the person or body of persons that actually has the ability, as distinguished from the formal legal power, to select the majority of a company's board of directors. For a company dominated by a single person or family, the controlling shareholders would for purposes of the discussion, be considered the company's managers. For companies without any major shareholders, the executives of the company would be its managers. See W. Klein, Business Organization and Finance 126-29 (1980).

64. On the normal role of the noncontrolling vote in corporate takeovers, see W. Klein, supra note 63, at 131; M. Eisenberg, The Structure of a Corporation 66-68 (1976).

65. The bidder will not likely be interested in buying a vote that disappears for

Although the managers and bidders will undoubtedly prove capable of dividing up this transferred value on a mutually satisfactory basis, it is difficult to see how this diversion of the bidder's money from shareholders to managers is in the noncontrolling shareholders' best interests.

As suggested at the beginning of this discussion, the constitutionality of this type of provision is uncertain. The United States Supreme Court has already held older-style, pro-management antitakeover acts unconstitutional on grounds that they impose an undue burden on interstate commerce.[66] Three Justices, and several lower courts, have also been willing to strike down these types of statutes on grounds of preemption by federal legislation concerning tender offers.[67] Louisiana's version of the older-style statute was held unconstitutional in 1979[68] but was amended later that year[69] and still remains on the books.[70] It is very unlikely that it could now withstand a challenge, for the Louisiana legislation is very much like the antitakeover statute that the Supreme Court expressly declared unconstitutional.[71]

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merger purposes as soon as he acquires it. Only the directors have the power under the new provisions to cut a deal with the bidder that works. Accordingly, it is only the directors that will have the power to demand compensation for their cooperation. The compensation will have to be structured with some subtlety, of course, as the directors will have their fiduciary duties to consider. But cf. Jarrell, The Wealth Effects of Litigation by Targets: Do Interests Diverge in a Merge? 28 J.L. & Econ. 151 (1985). Mr. Jarrell concludes from an empirical study that management resistance to takeovers usually results in higher premiums for shareholders, as a result of the competitive bidding and "white knight" efforts that typically are stimulated. The Louisiana provision, however, probably would work against this result, for it takes away the shareholder's ability to sell the bidder his vote at any price. Bidding wars in a two-stage takeover would become useless because none of the shares purchased could be counted in approving the second-stage business combination.

66. Edgar v. MITE Corp., 457 U.S. 624, 102 S. Ct. 2629 (1982).

67. Justices White, Burger, and Blackmun joined in the portion of the opinion in *MITE* that found the Illinois law involved to be preempted. 457 U.S. at 626. For lower court preemption decisions, see, e.g., National City Lines, Inc. v. LLC Corp., 687 F.2d 1122 (8th Cir. 1982)(decided after *MITE*); MITE Corp. v. Dixon, 633 F.2d 486 (7th Cir. 1980), aff'd sub nom., Edgar v. MITE Corp., 457 U.S. 624, 102 S. Ct. 2629 (1982); Great Western United Corp. v. Kidwell, 577 F.2d 1256 (5th Cir. 1978), rev'd on other grounds sub nom., Leroy v. Great Western United Corp., 443 U.S. 173, 99 S. Ct. 2710 (1979).

68. Brascan Ltd. v. Lassiter. Fed. Sec. L. Rep. (CCH) ¶ 98,247 (E.D. La. 1979) (Louisiana antitakeover law, La. R.S. 51:1500-1512, prior to 1979 amendments, violative of both commerce and supremacy clauses).

69. 1979 La. Acts No. 401.

70. La. R.S. 51:1500-1512 (Supp. 1985).

71. Compare La. R.S. 51:1501(A), 1500.1(12), (13) (Supp. 1985) with Ill. Rev. Stat. ch. 121 1/2, §137.52-10(2) (1979) as cited in *MITE*, 457 U.S. at 642, 102 S. Ct. at 2640 (repealed following *MITE*, Ill. Rev. Stat. ch. 121 1/2 §§ 137.51-.70 (Supp. 1985); and La. R.S. 51:1501(A), (B), & (E) (Supp. 1985) with Ill. Rev. Stat. ch. 121 1/2 § 137.54(A)(B)(E)

States have responded to the loss of their antitakeover statutes in several ways.[72] In enacting La. R.S. 12:132-134, Louisiana was copying the Maryland approach.[73] This approach was apparently thought to conflict less directly with the federal scheme for regulating tender offers than did the older-style statutes,[74] and also to fit a perceived loophole in the Supreme Court decision on the older-style statutes, an explicit recognition that rules concerning internal corporate governance, unlike the regulation of securities trading in the secondary markets, are matters traditionally governed by the laws of the incorporating state.[75]

Without question, the newer type of statute is not as clearly unconstitutional as its ill-fated predecessors. Even this new statute, however, is likely to impose substantial burdens on interstate securities trading, based solely on formal connections to the enacting state, and will tend to favor corporate management contrary to the policy of neutrality underlying federal regulation of this field. There is a good possibility, therefore, that these new statutes will also be declared unconstitutional. The questions posed by these second generation enactments are much closer, though, and the courts are much more likely to be divided on these issues than they were on the subject of the constitutionality of the older, more straightforward antitakeover schemes. It would be ironic, though, if the very success of earlier efforts to strike down the pro-

(1979) as cited in *MITE*, 457 U.S. at 635, 102 S. Ct. at 2637 (since repealed); and La. R.S. 51:1501(E) (Supp. 1985) with Ill. Rev. Stat. ch. 121 1/2, §137.54(E) (1979), as cited in *MITE*, 457 U.S., at 639, 102 S. Ct. 2639 (since repealed).

72. One commentator has identified three different types of enactments, in Ohio, Maryland, and Wisconsin. Warren, supra note 39, at 694-700 n.39. According to Warren, Ohio's legislation regulates tender offers, but in a fashion closer to that utilized under federal law. Maryland does not regulate the tender offer itself (but see supra note 39) but instead imposes supermajority or fairness requirements on the second-stage business combination. Wisconsin uses a combination of tender offer and business combination regulations. Id.

73. Compare La. R.S. 12:132-134 (Supp. 1985) with Md. Corps. & Ass'ns Code Ann. §§ 3-601 to 603 (1985).

74. The tender offer itself is not regulated, but only the second-stage transaction on which the profitability of the takeover may depend. Thus, the new statute does not interfere directly with the federal scheme for regulating tender offers, but only with the policy of neutrality that underlies it.

75. See Warren, supra note 39, at 698 n.39. In *MITE*, in the one portion of the opinion containing the holding with which a majority of the Justices concurred, Justice White conceded that choice of law principles did recognize that "only one state should have the authority to regulate a corporation's internal affairs—matters peculiar to the relationships among or between the corporation and its current officers, directors, and shareholders—because otherwise a corporation could be faced with conflicting demands." 457 U.S. at 645, 102 S. Ct. at 2642. Justice White did not suggest that this choice of law principle was of constitutional import, or that this form of putative local interest would justify the kinds of burdens on commerce that the new-style statutes impose.

management, first generation statutes served as the impetus for giving managers even greater controls over takeovers, and doing so in a constitutionally-permissible fashion.