Anti-Takeover Statutes, Shareholders, Stakeholders and Risk

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COMMENTS

ANTI-TAKEOVER STATUTES, SHAREHOLDERS, STAKEHOLDERS AND RISK

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I. INTRODUCTION

Corporate takeovers, leveraged buyouts ("LBO's"), and mergers have been the focus of much of the recent corporate research in both the legal and business communities. The rate of mergers and acquisitions in the last decade was at an all time high, and at least thirty-nine states...
including Louisiana have now adopted anti-takeover statutes. This legislation significantly impairs the ability of outside bidders to purchase a corporation. The respective state legislatures, nevertheless, adopted these statutes based on the representations of corporate managers generally, with no public comment or debate.

There is no agreement in the business or academic community on the effects of mergers and acquisitions, or how they should be regulated. But some facts are clear. Managers of public corporations are making astronomical salaries that are not related to corporate performance or any other objective criteria. Shareholders, on the other hand, have received tremendous returns on takeovers and related restructuring, but outside of these transactions have received little of the value that corporations have generated. Finally, the use of leverage, borrowed money, in corporations is at an all time high.

The passage of state takeover statutes effectively removes shareholders from the corporate democracy and entrenches management. Shareholders should have the right to shield their corporate manager's job if they feel it is in their and the corporation's best interest. However, these management protections should not be imposed without shareholder approval. The unilateral imposition of anti-takeover amendments through management lobbying of state legislatures grants corporate management an almost permanent position with no right of removal for shareholders or society.

To solve these problems, without creating further controversy, this paper proposes a moderate course of limited federal preemption of state corporate law. This paper's proposal has three points. First, all state statutes that impose particular requirements before a change of control can be affected, whether through shareholder approval, mandatory redemptions, share purchase prices, or waiting periods, must apply equally to both outside bidders and management. Second, all state anti-takeover statutes that limit the sale of shares in a tender offer or other transaction or restrict the ability of a shareholder to change control of the corporation must be approved by at least a majority of shareholders before the measure is effective. Finally, the use of leverage should be discouraged by equalizing the taxation of debt and equity through at least a fifty percent tax exemption for dividend income, offset by a corresponding increase in corporate rates to make the measure revenue neutral.

Briefly, the paper is broken down into nine parts. Following this introduction, section two discusses the issues involved in corporate takeover transactions and how these issues have been confused to support

7. See infra text accompanying notes 75-83.
anti-takeover statutes. Section three contains a brief overview of the history and types of anti-takeover statutes. Section four describes the workings and effects of anti-takeover statutes. Section five analyzes the politics behind the passage of anti-takeover statutes and compares political justifications offered with the economic effects of the statutes. Section six argues that anti-takeover statutes protect the group needing the least protection, i.e., management, while increasing the divergence between the corporate managers' and shareholders' interest. Section seven recognizes that some of the states' concerns are real, but would be better addressed by reducing the amount of leverage in corporate finance, and section eight suggests possible federal legislation. Section nine is a summation of the previous seven sections.

II. THE ISSUES BEHIND THE STATUTES

Senator Lloyd Bentsen, the Chairman of the Senate Finance Committee, expressed the general feeling around Congress about legislation to regulate corporate takeovers when he stated "I don't want to devise a cure that is worse than the condition." But what the Congress and the public have ignored is that the states have not been afraid and are rapidly changing the shape of America's corporate landscape.

The problem with analyzing state anti-takeover statutes is the lack of agreement in the academic and business community regarding the effects of takeovers, anti-takeover statutes, and the roles of corporations in our society.9 There is no consensus among economists, political scientists, or business professors on effects of takeovers and from where the gains in these transactions derive.10 Many opponents of corporate takeovers and restructuring have vested interests, such as the Business

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Roundtable or leading anti-takeover lawyers. In fact, corporate executives have made a concerted effort both in the state and federal governments and in the popular media to attack corporate takeovers.

The uncertainty regarding anti-takeover statutes is increased because of the confusion of issues surrounding corporate takeover transactions. State anti-takeover statutes are justified on bases that are unrelated to change of control transactions. To simplify the issues, this paper has grouped some of the issues surrounding corporate takeovers into six

11. One of takeovers' most voracious opponents, Martin Lipton, author of some of the "bibles" in takeover defense makes tremendous amounts of money, at rates equivalent to $5,000 an hour, for his advice. Ironically he often advocates tactics in "defending" a corporation that he disparages as hurting the American economy. See Dire Prophecy on Takeovers By One Who Knows Them, N.Y. Times, Nov. 4 1988 at D1. See also Grippo, In Defense of State Takeover Laws, 8 N. Ill. U. L. Rev. 273 (1988) (The author is the name partner of a leading Chicago anti-takeover firm and the former Illinois Securities Commissioner).


This effort is not surprising since corporate managers usually lose their jobs and their generous benefits in a takeover. Jensen, A Helping Hand for Entrenched Managers, Wall St. J., Nov. 4, 1987 at 36. Sixty-two percent of top managers lose their jobs within 3 years of a hostile takeover, compared to 21% in firms with no change in control. Id. See also Life After Redundancy, Mergers and Acquisitions, Nov./Dec. 1989 at 14. (Almost one half of high level executives that are currently looking for work attributed their job loss to a merger, while only 28% of mid level management blamed their job loss on a merger or merger-related acquisition).

13. SEC Commissioner Joseph Grundfest stated that the myths surrounding hostile offers are "so divorced from reality" that it was time to perform a "mythectomy." Hostile Two-Tier Tender Offers Fading From Picture, Grundfest Says, 19 Sec. Reg. & L. Rep. (BNA) 788 (1987).

areas: antitrust;\textsuperscript{15} change of control; insider trading;\textsuperscript{16} the scope of management's fiduciary duty in change of control transactions;\textsuperscript{17} debt/equity ratios and the effect of leverage on the economy; and the role of groups outside management and the shareholders in corporate governance.\textsuperscript{18} These issues are interrelated, but distinct. State anti-takeover statutes are not drafted to address anti-trust and insider trading, and these issues

\textsuperscript{15} Although largely ignored under the Reagan and Bush administrations, the wisdom of allowing increasing corporate concentration is still an important issue in the takeover arena. Out of 10,000 mergers announced during 1980-1985 only 26 were challenged, and only 13 were actually challenged in court. Sullivan, The Antitrust Division as a Regulatory Agency: An Enforcement Policy in Transition in Public Policy Toward Corporate Takeovers 106 (Chilton and Weidenbaum eds. 1988) [hereinafter Chilton]. See also, e.g., Austin, Antitrust Reaction to the Merger Wave: The Revolution v. the Counterrevolution, 66 N.C.L. Rev. 931 (1988). Comment, Takeover Dangers and Non-Shareholders: Who Should Be Our Brothers' Keeper?, Colum. Bus. L. Rev. 301, 333-35 (1988) [hereinafter Takeover Dangers]; Coffee, Regulating the Market for Corporate Control: A Critical Assessment of the Tender Offer's Role in Corporate Governance, 84 Colum. L. Rev. 1145, 1272 (1984) [hereinafter Regulating the Market].

\textsuperscript{16} See Grundfest, Jarrell, Salop and White, Panel Discussion: Corporate Takeovers and Public Policy, in A. Auerbach, Corporate Takeovers 312 (1988). This issue came to the forefront during the trial of Ivan Boesky and is a continuing area of concern. The proprietary rights of information regarding takeovers, nevertheless, is only ancillary to the takeover question. Insider trading is often blamed on change of control transactions. See also Grippo, supra note 11, at 282. The issues are not related except that change of control transactions graphically demonstrate the importance of information regarding the value of a corporation's assets. As anything, this information can be stolen by inside traders.


\textsuperscript{18} See, e.g., R. Nader, M. Green, & E. Seligman, Constitutionalizing the Corporation: The Case for the Federal Chartering of Giant Corporations (1976); Schwartz, Towards New Corporate Goals; Co-existence with Society, 60 Geo. L. Rev. 57 (1971). Initially brought up by Ralph Nader and other consumer and labor activists, this approach was rejected by corporate managers until recently when it was discovered that it could rationalize management defensive maneuvers. See, e.g., Corporate Takeovers, supra note 9, at 48-49. The Chairman of the Control Data Corporation commented:

The debate over hostile takeovers has focused on traditional notions about the "rights" of shareholders, bidders, and the efficient operation of the markets . . . . But today's corporation is much more than that; the constituencies it serves and is responsible to (and who can thus be helped or harmed when it changes hands) reach into the entire fabric of our society. And that fabric is being torn.

Id.
will not be discussed. This paper focuses on the change of control and leverage issues and also addresses the scope of fiduciary duties and corporate governance as they affect and are affected by change of control transactions and leverage.

A. The Importance of Mergers and Acquisitions

Despite the disagreement in the academic and business communities, mergers and acquisitions unquestionably are an important aspect of the American economy. Mergers and acquisitions have been at an all time high in the 1980's. In 1988, more than 3,487 merger transactions, including 318 LBO's, took place worth an estimated $227 billion. The total value of these transactions from 1979-1989 is over $2.142 trillion. The value of the individual transactions can be tremendous. The RJR Nabisco LBO by Kohlberg, Kravis Roberts & Co. (KKR), for example, involved over $25 billion, and the Philip Morris Brothers Inc. acquisition of Kraft Inc. was for $12.6 billion.

Of these transactions, only three and one-half percent were initiated by tender offer, and just less than a third of these transactions were contested by management. In the one percent of all transactions that

<table>
<thead>
<tr>
<th>year</th>
<th># all Mergers</th>
<th># LBO's</th>
<th>value all Mergers ($ millions)</th>
<th>Value LBO ($ millions)</th>
<th>%change value of all mergers</th>
</tr>
</thead>
<tbody>
<tr>
<td>1978</td>
<td>1,452</td>
<td>—</td>
<td>34,197</td>
<td>—</td>
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<tr>
<td>1979</td>
<td>1,530</td>
<td>—</td>
<td>32,883</td>
<td>—</td>
<td>-3.8</td>
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<tr>
<td>1980</td>
<td>1,560</td>
<td>99</td>
<td>70,064</td>
<td>3,091</td>
<td>113.1</td>
</tr>
<tr>
<td>1981</td>
<td>2,391</td>
<td>230</td>
<td>60,698</td>
<td>4,519</td>
<td>-13.4</td>
</tr>
<tr>
<td>1982</td>
<td>2,298</td>
<td>164</td>
<td>52,691</td>
<td>3,451</td>
<td>-13.1</td>
</tr>
<tr>
<td>1983</td>
<td>3,164</td>
<td>253</td>
<td>126,073</td>
<td>18,807</td>
<td>139.3</td>
</tr>
<tr>
<td>1984</td>
<td>3,477</td>
<td>254</td>
<td>145,464</td>
<td>19,633</td>
<td>15.4</td>
</tr>
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<td>1985</td>
<td>4,381</td>
<td>254</td>
<td>204,894</td>
<td>46,429</td>
<td>40.9</td>
</tr>
<tr>
<td>1986</td>
<td>3,920</td>
<td>259</td>
<td>177,203</td>
<td>35,636</td>
<td>-13.5</td>
</tr>
<tr>
<td>1987</td>
<td>3,487</td>
<td>318</td>
<td>226,643</td>
<td>42,914</td>
<td>27.9</td>
</tr>
</tbody>
</table>

*All mergers includes divestitures and LBOs.


20. 1988 Profile, supra note 19, at 53.
22. 1988 Profile, supra note 19, at 47.
23. Fortier, supra note 10, at 2, Table 1. Of course management originally may have objected to many of these transactions and were later bought off or dropped their opposition for other reasons. Furthermore, there is no record of any possible hostile offers which failed to reach the offering stage because of hostile management tactics.
were contested, management was successful in defeating the offer fifty-four percent of the time, either outright or through the intervention of a white knight.

III. ANTI-TAKEOVER STATUTES

At least thirty-nine states now have anti-takeover laws, including Louisiana. It was estimated in 1988 that over eighty percent of American business capital is protected by state anti-takeover statutes. What began as responses to pleas of particular corporations for defenses against pending takeover offers has snowballed into almost a prerequisite for most states to keep their domestic corporations incorporated and operating in their own state. State anti-takeover statutes have provided further defenses for management to resist takeovers. These state-sanctioned statutory defenses increase the transaction cost of taking over the corporation and deter takeovers, therefore allowing more management waste.

State anti-takeover statutes are usually pushed by a single corporation's management that is afraid of being replaced by a takeover. In general, these statutes are passed with no public comment and with very little discussion in the respective state legislature. The statutes are justified as necessary to protect shareholders, employees and local communities. Moreover, these statutes neither protect nor help shareholders, and clear evidence does not exist suggesting that other remaining corporate constituencies such as the employees are adversely affected.

The respective states enacting anti-takeover legislation certainly have valid interests in seeking to protect their local communities and the employees, but statutes that attempt to limit the change of control are not treating the problem. If anything has really affected the states and the United States as a whole, it is the amount of leverage that is used in today's corporate financing. Although definitive evidence establishing

24. Id. Some commentators believe that neither friendly nor hostile takeovers have had a significant impact on the overall United States economy. See Weidenbaum, in Chilton, supra note 15, at 76; Sprinkel, The Real Issue in Corporate Takeovers, Wall St. J., July 17, 1987, at 18.

25. A "White Knight" is a party sought out by the target company in an attempt to fend off an unwanted bidder and preserve the current target management's control. Actions by a white knight include launching a competing tender offer or purchasing selected assets, Steinberg, supra note 3, at 320.

26. See supra note 6. As of this writing, the states not having anti-takeover laws are: Alabama, Alaska, Arkansas, California, Montana, North Dakota, Rhode Island, South Dakota, Texas, Vermont and West Virginia. Id.


28. See infra text accompanying notes 87-100.

29. See infra text accompanying notes 148-76.

30. See infra text accompanying notes 179-86.
that the current record amounts of leverage are harmful does not exist, any harm to local communities and corporations results from the increased amounts of leverage, rather than the change of control.

A. History of Anti-Takeover Statutes

1. First Generation Statutes

Virginia enacted the first anti-takeover statute in 1968. At least thirty-six other states soon followed suit. These statutes relied on disclosure provisions similar to the Williams Act, and also required a determination of the fairness of the offer by the state securities commissioner. Some statutes also imposed additional waiting periods to the twenty day period of the Williams Act for tender offers. The first generation statutes were enacted as part of the state securities laws, i.e., Blue Sky laws, as an additional protection to the Williams Act. Even before the great takeover debates of the 1980's, these statutes were recognized as favoring management and actually not designed to help shareholders.

Courts held these statutes unconstitutional in various piecemeal decisions. The United States Supreme Court in Edgar v. MITE Corp. finally deemed the statutes an unconstitutional burden on interstate commerce.

2. Second Generation and Beyond

After the Supreme Court held the first generation statutes unconstitutional, several states quickly began to draft new anti-takeover sta-

32. Id. Louisiana adopted its first anti-takeover statute, a first generation statute in 1976. 1976 La. Acts No. 44, repealed in 1987. The Louisiana statute, La. R.S. 51:1500, was the typical disclosure type first generation statute, and was passed officially to limit the coercive effects of tender offers.
36. Langevoort, supra note 34, at 220, 225.
39. Id. at 643-45, 102 S. Ct. at 2640-41. The court did not hold the law unconstitutional based on preemption by the Williams Act, as had some lower courts.
tutes, the so-called second generation statutes. These new anti-takeover statutes were based on defenses that had been previously adopted by shareholder approval as amendments to a corporation's charter. Furthermore, these statutes were not included as part of the state's securities laws, but were adopted as amendments to the respective state's corporation's code.

After the second generation statutes were upheld in *CTS Corporation v. Dynamics Corp.*, states became bolder and began enacting statutes that applied not only to domestically chartered corporations, but also to out-of-state corporations that had only significant contacts. These statutes have been referred to as fourth generation statutes.

The second generation anti-takeover statutes legislatively enact popular corporate defensive maneuvers. The statutes have been based on five basic forms: (1) the control share acquisition statute, first enacted by Ohio; (2) the fair price statute, first enacted by Maryland; (3) the share redemption statute, first enacted by Pennsylvania; (4) the expanded fiduciary duty statute, also first enacted by Pennsylvania; and (5) the business combination statute, first enacted by New York. States also may enact a package of several different statutes to provide layered defenses to corporations.

IV. HOW ANTI-TAKEOVER STATUTES WORK AND THEIR EFFECTS

A. Louisiana as an Example

Louisiana is a typical example of a state enacting anti-takeover laws. Louisiana previously had enacted a first generation statute in 1976.\(^{40}\)

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\(^{40}\) Hackl, supra note 10, at 1203.

\(^{41}\) See Thompson, Tender Offer Regulation and the Federalization of State Corporate Law, in Chilton, supra note 15, at 78, 87.


\(^{48}\) N.Y. Bus. Corp. Law § 912 (b) (McKinney 1986).

\(^{49}\) This was pioneered by Wisconsin. Malmgren and Pelisek, Take-Overs of Wisconsin Corporations, 57 Wis. Bar Bull. 26, 30 (1984); Warren, supra note 31, at 699. Fourteen states have 4 or more anti-takeover statutes, and 3 states have 6 separate anti-takeover statutes. Most of the remaining 22 states have enacted 2 anti-takeover statutes. See supra note 6, at 1502.

\(^{50}\) 1976 La. Acts No. 189 (repealed).
After *Edgar v. MITE*, Louisiana adopted a second generation takeover statute, a fair price provision, in 1984. After *CTS Corp.*, Louisiana adopted several second generation statutes in a third generation configuration. Finally, Louisiana passed a fourth generation nexus version of the control share acquisition statute in 1988.

Louisiana now has enacted five separate anti-takeover provisions. Louisiana has adopted: a control share acquisition statute, a foreign corporation control share acquisition statute, a fair price statute, an expanded fiduciary duty statute, and a poison pill statute. All of these provisions were adopted with almost no discussion in the legislature or the media and were promoted by single corporations. The provisions were justified as necessary to protect domestic corporations' shareholders, and retain existing businesses.

### 1. Scope of the Statutes

Under Louisiana's anti-takeover statutes, a corporation that has its principal place of business or substantial assets within Louisiana, and either more than ten percent of its shareholders, ten thousand shareholders, or more than ten percent of the corporation's shares are owned by persons residing in Louisiana, is governed by the control share acquisition act. The above requirements were expanded under Louisiana's Foreign Corporation control share acquisition act which allows foreign corporations that have their principal place of business, their principal office or substantial assets or real property within Louisiana, that meet the above ten percent/tenth thousand shareholder requirements

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57. Under La. R.S. 12:51(C) and 12:56(B) (Supp. 1990), management is now allowed to issue securities with unequal rights to shareholders with approval by a simple majority of the board of directors. Under prior law, the issuance of unequal rights or stock had to be approved by two-thirds of the board of directors, and if an insider was involved by a majority of shareholders.
58. Author interview with redactor of one statute.
to be protected by the control share acquisition statute. The only requirement for the application for the fair price, expanded fiduciary duty, and poison pill statutes is a Louisiana chartered corporation.

2. The Application of Statutes

The combination of statutes deters possible takeovers, and provides several layered defenses in response to takeover offers. First, a shareholder who acquires one-fifth, one-third, and a majority of the shares respectively, has no voting rights until a majority of shareholders approve a resolution granting voting rights. The decision whether to allocate voting rights is supposed to be made within fifty days of the acquisition. This vote, however, can be delayed almost indefinitely by management. Furthermore, only shareholders who refused to tender in the first place vote. By definition, these shareholders have indicated they do not want to sell their shares, although generally the outside bidder will make his tender offer conditional on the necessary vote. If the acquiring shareholder does obtain a majority vote, then the corporation's assets will be depleted because the corporation is obligated to buy out all remaining shareholders at the highest acquisition price.

Once the acquiring shareholder has obtained his share votes, he still may not be able to take control of the corporation. Under the fair price provisions, a corporation cannot be merged unless eighty percent of the shares eligible to vote and two-thirds of the disinterested shareholders

60. La. R.S. 12:140.11(4)(a). The Foreign Corporation control share acquisition act also provides an additional qualifying provision of having two thousand employees residing in Louisiana. La. R.S. 140.11(4)(a)(iii)(dd). The act is most likely unconstitutional. See Morris 1988, supra note 53, at 280-85; Pinto, supra note 43, at 755.


63. Under La. R.S. 138(A)(2) (Supp. 1990), the directors do not have to call a meeting unless the acquisition is "lawful," usually certain to be disputed. See Morris 1988, supra note 53, at 295 n.77. Furthermore, they are not required to call a meeting until the acquiring shareholder has furnished copies of all commitments for his cash financing. Id. In addition, if the corporation is a public corporation subject to Section 14 of the Securities Exchange Act of 1934, all applicable proxy materials from the acquiring shareholder and the target's board of directors must be on file with the SEC before the fifty day period begins to run. La. R.S. 12:138(B) (Supp. 1990). These delays protect the incumbent management of the target corporation and make it much more likely that any hostile tender offer would fail. Morris 1988, supra note 53, at 295.


approve the merger. The vote is very difficult to obtain because of
the high quorums required. Absent a vote, the acquiring shareholder
is required to buy out all remaining shareholders at a price calculated
according to a complicated formula, normally resulting in a higher price
paid than the original acquiring price.

The most cynical aspect of the control share acquisition acts and
the fair price act is that management is allowed to waive the requirements
of each statute. If management approves of the takeover, then no
super majority votes, no mandatory redemptions, and no expensive delays
are required. Anti-takeover acts, supposedly enacted to protect share-
holders, place the shareholder’s welfare at the mercy of management,
the group with the most conflicts with shareholders and the ability to
take advantage of those conflicts.

The other Louisiana anti-takeover provisions help insulate the cor-
poration’s officers and board of directors from liability for making
decisions that conflict with their duty to shareholders by either turning
down or obstructing beneficial offers to shareholders. The expanded
fiduciary duty amendment allows management to justify almost any act
on the basis of one or another economic or social rationale.

67. La. R.S. 12:133 (Supp. 1990). An “interested shareholder” is defined under the
statute as a shareholder who beneficially owns 10% or more of the stock of the company
Interestingly enough, employee and pension plan administrators and trustees are normally
appointed by management.


69. La. R.S. 12:134(B) (Supp. 1990). See Morris, Developments in the Law 1985-86,

70. Under La. R.S. 12:134(C)(1) (Supp. 1990), management can waive the protections
of the fair price statute no matter what the consideration, subject only to the very limited
constraints of the business judgment rule, which has been further watered down by the
(Supp. 1990), the control share acquisition act does not apply to mergers approved by
management. Some state versions of anti-takeover statutes do not allow the directors to

71. Pound, The Effects of Antitakeover Amendments on Takeover Activity: Some

72. The theory behind the amendment is that directors in considering these additional
social factors will be able to approve defensive measures against hostile takeovers without
violating the business judgment rule or their fiduciary duty to the corporation or the

73. La. R.S. 12:92(G) (Supp. 1990) reads as follows:

G. The board of directors, when evaluating a tender offer or an offer to make
a tender or exchange offer or to effect a merger or consolidation may, in
exercising its judgment in determining what is in the best interest of the cor-
poration and its shareholders, consider the following factors and any other
factors which it deems relevant:

(1) Not only the consideration being offered in the proposed transaction in
more, the poison pill amendment allows management to issue poison pills that will defeat a proposed tender offer without shareholder approval.

B. The Effect of Anti-Takeover Statutes

The effect of these statutes, as one Louisiana anti-takeover supporter recognized, "virtually forces a person intending to gain control of an issuing public corporation to negotiate his acquisition with the corporation's board of directors." In combination with the liberal business judgment rule, anti-takeover statutes make it very difficult to successfully take over a company.

reduction to the then current market price for the outstanding capital stock of the corporation, but also the market price for the capital stock of the corporation over a period of years, the estimated price that might be achieved in a negotiated sale of the corporation as a whole or in part or through orderly liquidation, the premiums over market price for the securities of other corporations in similar transactions, current political, economic, and other factors bearing on securities prices and the corporation's financial condition and future prospects.

(2) The social and economic effects of such transaction on the corporation, its subsidiaries, or their employees, customers, creditors, and the communities in which the corporation and its subsidiaries do business.

(3) The business and financial conditions and earnings prospects of the acquiring party or parties, including, but not limited to, debt service and other existing or likely financial obligations of the acquiring party or parties, and the possible effect of such conditions upon the corporation and its subsidiaries and the communities in which the corporation and its subsidiaries do business.

(4) The competence, experience, and integrity of the acquiring party or parties and its or their management.

There are strong arguments against this type of provision. These statutes in effect give management the right to allocate resources that traditionally were decided by elected officials. For discussion see Takeover Dangers, supra note 15, at 313-39. Corporate management is selected to maximize returns on invested capital and not to protect "stakeholders" from takeover activity. Id. at 330.


The requirement of a supermajority to accomplish certain changes in the corporation . . . will raise the offeror's cost of acquiring control, will make takeover difficult or impossible when management controls enough stock to block the vote even if the offeror buys out all other shareholders, and may enable management to arrange a friendly acquisition.

Id.

The takeover statutes also dramatically increase the transaction cost of a takeover. The difference in price between a transaction approved by management and one not approved is substantial. The difference in value creates an economic incentive for management to hold out for a side payment before approving the merger. The payment of an incentive to management will be economically rational to the acquiring shareholder as long as it does not exceed the difference between the market price and real value of the corporation's assets.

The incentive can consist, for example, of parachute payments, long term employment contracts, or bonuses. The source for these "incentives" for management is the shareholder's unrealized value in the company. Management is getting payments from value that was not transferred to the shareholders prior to the acquisition because of management's own greed, satisficing, and retention of earnings. The result of anti-takeover statutes is to give at least some of the unrealized value of the target company to the management. These economic incentives to management represent a transfer of wealth to management from the corporation and the shareholders.

The increased transaction costs also create a cushion for management. As long as management keeps corporate waste and inefficiency below the transaction costs of a takeover, there is almost no way to replace them. The anti-takeover statutes insulate management from shareholders and remove any remaining accountability that might have remained. Furthermore, the broad fiduciary duties assigned management give management a much broader role in our society than simply controlling the corporation. Management which is not responsive to the shareholders or any other constituency is granted the power to make decisions for the good of our society as a whole. The problem is that management is not qualified to make these policy decisions; moreover, management was never elected and lacks political legitimacy.

77. See Hackl, supra note 10, at 1203.
80. See infra notes 226-29; Morris 1988, supra note 53, at 313.
82. See supra note 73.
The directors and officers of the corporation in fact become a political institution making decisions traditionally made by elected leaders in the United States, but with no similar accountability. Devices such as the board of directors and outside directors have failed to interject independence from management or make corporations publicly accountable. Although impartial evaluation of non-shareholder interests is possible, the target directors lack political legitimacy.

1. Economic Effects

The economic effects of anti-takeover amendments are clear. Shareholders lose money. Takeover attempts are deterred, and higher premiums for offers for companies are required. The overall effect is the increase of management power and the increase in the required level of management waste of corporate assets before fear of being replaced will moderate management behavior.

Anti-takeover statutes increase the transaction costs of taking over a corporation. Studies have calculated that the Williams Act increased the average premium paid to shareholders to acquire a corporation twenty percentage points, while corresponding first generation state legislation increased the necessary premium another twenty percentage points. This conclusion was supported by another study that found the Williams Act

84. Takeover Dangers, supra note 15, at 316-17 (citing M. Friedman, Capitalism and Freedom 133-34 (1962)). See Gilson, supra note 79, at 862-65.

85. It is commonly recognized that the board of directors for all intents and purposes is controlled by management. See Brudney, The Independent Director—Heavenly City or Potemkin Village?, 95 Harv. L. Rev. 597, 610-11 (1982); Palmiter, Reshaping the Corporate Fiduciary Model: A Director’s Duty of Independence, 67 Tex. L. Rev. 1351, 1438-40 (1989); Eisenberg, Legal Models of Management Structure in the Modern Corporation: Officers, Directors, and Accountants, 63 Calif. L. Rev. 375, 382 (1975); Takeover Dangers, supra note 15, at 317. See also Gilson, supra note 79, at 865. Sometimes management’s control of the outside board is less discrete. In the RJR Nabisco-KKR LBO an “outside” director’s compensation as a “consultant” was increased from $250,000 to $500,00 three weeks before the management group made an LBO offer for RJR Nabisco. The “outside” director was a top advisor to F. Ross Johnson, the CEO of RJR that bid for the company. Wall Street J., Dec. 8, 1988, at A4.

86. Takeover Dangers, supra note 15, at 316.

87. The Williams Act regulates the tender offer process, and was enacted to curb perceived takeover abuses in the 1960’s. Johnson and Millon, Misreading the Williams Act, 87 Mich. L. Rev. 1862, 1893-97 (1989).

increased the premium thirteen percent and state anti-takeover legislation increased the required premium another twenty percent.\(^8\)

Four studies of the effects of recent anti-takeover amendments on shareholder welfare in individual states have been made. All have found significant decreases in shareholder wealth as a result of the enactment of the statutes. An SEC study found that Ohio shareholders lost $1.45 billion, a 3.24% average decline in share value, with the passage of Ohio’s anti-takeover bill.\(^9\) Another study for the Federal Trade Commission found that the enactment of New York’s anti-takeover statute created an average one percent across the board decrease in share value of New York firms causing a $1.2 billion loss to shareholders.\(^9\) The same results were found in an Indiana study; shareholders lost $2.65 billion or six percent of the total value of Indiana companies when Indiana adopted a control share acquisition act.\(^9\)

Studies of anti-takeover corporate amendments have found similar evidence that particular anti-takeover amendments to corporate charters reduced the share price of the firm and increased the success of companies in resisting tender offers.\(^9\)

In a study of cash tender offers for 242 target corporations from June 1, 1981 through December 31, 1986,\(^9\) the authors found, as expected, the number of successful as well as the number of total bids also decreased as a result of anti-takeover legislation.\(^9\) In addition, the

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94. Hackl, supra note 10, at 1212.

95. Id at 1231. There is also some evidence of anti-takeover statutes between 1972-1978 that found that states with these statutes had 8.5% fewer tender offers, but the these results are subject to criticism. Id. at 1209 (citing Smiley, The Effect of State Securities Statutes on Tender Offer Activity, 19 Econ. Inquiry 426 (1981)). This is also consistent with earlier studies of anti-takeover amendments to corporate charters. See Direct Evidence, supra note 71, at 367.
same study found that anti-takeover statutes did not increase the number of auctions where more than one offeror bid for the company.96 The study concluded at best that the second generation statutes did not help shareholders and at worse caused a significant decline in shareholder welfare.97

The study showed that the number of tender offers increased in all states; however, in absolute terms, the offers increased approximately twice as fast in states without second generation statutes.98 Even when calculated as a percentage of publicly traded firms, the rate of increase still remained about forty percent higher in states without anti-takeover statutes.99 The raw data also suggests that the enactment of second generation statutes also increased the likelihood that a tender offer would fail.100

Anti-takeover statutes may increase premiums paid to shareholders, but the overall increase in premium is probably offset by the decreased number of successful offers and the higher transaction costs induced by the anti-takeover statutes. The statutes do not further goals such as encouraging auctions for firms and protecting shareholders. To the contrary, the statutes entrench management and encourage the waste of corporate assets through inefficiency and side payments to management.

V. THE IMPETUS FOR ANTI-TAKEOVER STATUTES

A. The Real Politics

1. Corporation Specific Statutes

Almost universally, states initially adopted anti-takeover statutes in response to a single local corporation that was the target of a hostile
bid or was apprehensive that it could become a target.\textsuperscript{101} In at least nineteen states, anti-takeover statutes were passed at the behest of a single corporation.\textsuperscript{102} These statutes are usually not discussed or debated and are adopted with no support or opposition from business, labor, or other groups.\textsuperscript{103} They usually are drafted by the target corporation’s attorneys at the behest of management.\textsuperscript{104}

Indiana is a good example of this trend. Indiana passed its version of a control share acquisition statute with no debate in direct response to a hostile offer for Arvin Industries by Belzberg Brothers. The statute was drafted, enacted, and signed into law in four weeks.\textsuperscript{105} Pennsylvania, another example, adopted its second generation statute between Thanksgiving and Christmas of 1983 in response to a bid for Scott Industries.\textsuperscript{106} The lack of public discussion and the speed of its passage were characterized as necessary to prevent political opposition.\textsuperscript{107} There are literally dozens of examples.\textsuperscript{108}

\begin{itemize}
\item 102. See id. at 461; Davis, Epilogue: The Role of the Hostile Takeover and the Role of the States, 1988 Wis. L. Rev. 491, 492. A list of the states and the responsible corporation follows: Ariz. (Greyhound), Conn. (Aetna), Fla. (Harcourt Brace Jovanovich), Ill. (unidentified), Ind. (Arvin Industries), Ky. (Ashland Oil), La. (unidentified, author interview with redactor), Me. (unidentified), Md. (Martin Marietta), Mass. (Gillette), Minn. (Dayton Hudson), Mo. (TWA), N.Y. (CBS), N.C. (Burlington Industries), Ohio (Goodyear Tire & Rubber, Federated Dept. Stores), Okla. (Unocal), Pa. (Scott Paper), Wash. (Boeing, Weyerhauser), Wis. (Heileman Brewing Co.). Id.; Romano, supra note 101, at 462 n.11.
\item 103. Butler, Corporation-Specific Anti-Takeover Statutes and the Market for Corporate Charters, 1988 Wis. L. Rev. 365, 366. For example, in Louisiana the Louisiana Association of Business and Industry (the LABI) took no position on the various anti-takeover statutes passed. Author interview. The Connecticut statute was likewise not supported or opposed by anybody except for Aetna, CBIA, and the corporate bar. See Romano, supra note 78, at 134. There are exceptions. See, e.g., Davis, supra note 102, at 493-97 (describing Wisconsin's experience in enacting anti-takeover statutes). More recently other groups outside the immediate corporation have lobbied for anti-takeover statutes as the competition to provide the most protection for corporate management has increased.
\item 104. See, e.g., Kimmins, Private Decisions Speed Federated Bill Through the House, Business First-Columbus, Feb. 15, 1988, at 10; Cusick, Bill Allows Pa. Firms to Add to Defenses, Philadelphia Inquirer, Mar. 24, 1988; Author interview with bill's drafter (Louisiana).\textsuperscript{105}
\item 107. Id.
\item 108. Ohio's latest takeover bills (February 1988), passed to protect Federated Department Stores from a hostile bid from Campeau Corp, were debated in two hearings for four and eight minutes respectively. Kimmins, supra note 104, at 10. All talks regarding the bill were held in private. Eventually, only one bill was passed, but this was because the Ohio legislature was afraid that one of the bills was so expansive that Ohio's other anti-takeover statutes would be made unconstitutional. Id.
\end{itemize}
2. "Race to the Bottom"

Recently the impetus for most states' adoption of anti-takeover statutes is the fear that a domestic corporation will choose to reincorporate or even move its headquarters to take advantage of another state's anti-takeover protection. The greed of states in trying to attract other states' corporations also is influential. For example, State A enacts a takeover statute that provides more protections for corporate management because State B has enacted a more protective statute. If State A does not enact a tougher statute, then State A may lose some of its corporations. Furthermore, if State A does enact a tougher statute, then State A has the potential to attract some of State B's corporations. This is the classic "race to the bottom" that has occurred in state corporate law since the early twentieth century.

For example, Delaware enacted an anti-takeover statute because Delaware corporations threatened to reincorporate in other states if Delaware did not enact the statute. In addition, Delaware's state government saw the enactment of the statute as a way to attract revenues for the state. Ohio also adopted its second takeover statute as a way of avoiding corporate flight, and Connecticut passed anti-takeover legislation in response to direct threats by firms located there to move their state of incorporation if the laws were not passed. The competition for state corporate charters has become so fierce that it prompted the American Bar Association (ABA) and the North American Securities Administrators Association (NASAA) to adopt a model control share acquisition act to limit the competition and stop the "race to the bottom."
Unfortunately, the model act has had little influence to date. States are not shy in expressing the purposes behind the statutes. A Wyoming state senator, selling his state's most recent anti-takeover law allowing a subsidiary to retain up to forty percent of the stock of its parent, claimed "just 10 percent more shares, [and] management can firmly control the shares of [their] corporation." The senator explained the measure as a way to attract corporate business to Wyoming. One state even kept a running tally of how many domestic corporations had taken over outside corporations and vice versa. A Wisconsin newspaper jubilantly proclaimed that Wisconsin corporations had taken over $250 million more worth of out-of-state corporations than out-of-state corporations had taken out of Wisconsin.

3. Anti-takeover Statutes as Amendments to the Corporate Charter

As with previous "races to the bottom" in corporate law, the state competition in anti-takeover laws has increased the power and control of management and at the same time limited the power of shareholders. The evidence supports that states have again abdicated any responsibility to shareholders in response to pressure from management. What is most disturbing, however, is that management could have obtained the same protections from amendments to their corporate charter. Management instead chose the legislative process because it did not require a vote of their own shareholders.

Management has essentially lobbied their respective state governments to legislatively amend their corporate charter to avoid the required

119. Id.
122. Sell, supra note 81, at 479. This is essentially what happened previously. See Winter, supra note 121, at 255 n.14, citing Corporation Law Reform Commission of New Jersey, Report, in N.J. Stat. Ann., tit. 14A, at x-xi (1969) ("It is clear that the major protections to investors . . . have come, and must continue to come, from Federal legislation, . . . Any attempt to provide such regulations . . . through state incorporation acts . . . would only drive corporations out of the state to more hospitable jurisdictions.")
shareholder approval. An important implication of the state anti-takeover laws is that corporate management can obtain protection from replacement that would not have been adopted by the shareholders if they had the opportunity to vote.\textsuperscript{123}

Some states originally considered statutes that would have required shareholder approval before the corporation's management would have been protected, but these statutes have been rejected after strong lobbying by management groups. For example, the first draft of the Delaware anti-takeover law would have only applied to corporations after the shareholders had voted to opt into the statute's coverage.\textsuperscript{124} The legislature, however, rejected the bill after strong pressure from management groups.\textsuperscript{125} The next year the shareholder approval provisions were written out and the bill passed.\textsuperscript{126}

Also, anti-takeover statutes that would subject management to the same controls as outside bidders are usually rejected. The Maryland legislature's first version of their "fair price" anti-takeover statute would have regulated friendly mergers and acquisitions. Corporate management pressured Maryland's Governor Hughes to oppose the bill and he responded with his veto.\textsuperscript{127} The amended "fair price" bill was passed later that year without requiring shareholder approval of management-led mergers.\textsuperscript{128}

In one study of Connecticut's adoption of an anti-takeover statute, the author found that the introduction of a "fair price" anti-takeover statute by management of Aetna Life Insurance Company may have been less expensive and had a higher chance of success than trying to get shareholder approval.\textsuperscript{129} The legislature probably passed the bill more quickly than shareholder approval could have been obtained. Moreover, Aetna avoided the probability that shareholders would not have passed the charter amendment.\textsuperscript{130}

\begin{footnotesize}
\begin{enumerate}
\item[123.] Romano, supra note 78, at 113.
\item[124.] Romano, supra note 101, at 463.
\item[125.] Id.
\item[126.] Id.
\item[128.] Bainbridge, supra note 127, at 744-45.
\item[129.] Romano, supra note 78, at 128-31.
\item[130.] Id. at 129-31. Aetna also avoids looking hypocritical as it is also a large investor in other corporation's stocks and may have voted down anti-takeover charter amendments. Id.
\end{enumerate}
\end{footnotesize}
The role of corporate management in promoting anti-takeover statutes cannot be denied. In many cases the sole sponsor of an anti-takeover statute is a single corporation.\textsuperscript{131} It is also clear that anti-takeover statutes are nothing more than legislative enactments of typical anti-takeover charter amendments.\textsuperscript{132} Management is using the state legislative process to provide management job protection presumably not provided by their own shareholders.\textsuperscript{133} Management is able to prevail in the state legislature because the concentration of management in the state will always outnumber the dispersed shareholders.\textsuperscript{134} These initial forays led by management have now led to a "race to the bottom," and states are now almost compelled to adopt management protective legislation to keep local corporation charters and headquarters.\textsuperscript{135}

\section*{B. Justifications Offered for Such Bills}

The economics behind anti-takeover statutes vividly demonstrates the influence and bias of management in these statutes. Even though many state statutes were passed because of the influence of a single corporation, the legislatures usually adopt some political rhetoric supporting the respective statute.\textsuperscript{136} This rhetoric does not reflect the economic realities

\begin{itemize}
  \item \textsuperscript{131} See supra text accompanying note 102.
  \item \textsuperscript{132} See Hackl, supra note 10, at 1203.
  \item \textsuperscript{133} See Coffee, The Uncertain Case for Takeover Reform: An Essay on Stockholders, Stakeholders and Bust-Ups, 1988 Wis. L. Rev. 435, 460; Macey, State Anti-Takeover Legislation and the National Economy, 1988 Wis. L. Rev. 467, 471; Butler, supra note 103, at 367.
  \item \textsuperscript{134} Butler, supra note 103, at 367.
  \item \textsuperscript{135} Id.
  \item \textsuperscript{136} See, e.g., Preamble to Wisconsin Control Share Acquisition Act, 1983 Wis. Act 200 1:

Tender offers are coercive because of individual shareholder concern that a majority of shareholders will tender their shares, leaving those who do not in a vulnerable minority position. Shareholders thus feel compelled to tender their shares, regardless of their position on corporate control. The opportunity for reasoned decision making is further hindered by the short time tender offers may remain open and the fact that individual shareholders typically receive or obtain tender offer materials much later than institutional shareholders. This structuring of tender offeres is designed to coerce individual shareholders into tendering their shares quickly and without deliberation. Successful tender offers often disrupt existing businesses, causing unemployment, relocation of business operations and other economically depressing effects on the affected community.

It is in the public interest to provide protections for domestic corporation shareholders in the transfer of corporate control, regardless of the method of transfer. These protections must afford the shareholders the opportunity to consider tender offers in a deliberate manner, free from coercion, similar to current law providing for shareholder approval in other transfers of control.
of mergers and acquisitions and disguises the fact that the one group that needs no special protection, management, is receiving the benefits from these statutes.

1. **Public Opinion**

Generally, public opinion has played a very small role in the passage of anti-takeover statutes. Overall, the public has very little cognizance of takeovers, and the little awareness they may have is usually incorrect.\(^1\) There is, nevertheless, a slight negative tilt to public opinion regarding takeovers, which is probably reflected in state elected officials’ own opinions. The public is generally confused regarding the economics and effects of mergers and acquisitions.\(^2\)

The public is generally indifferent to takeovers, but leans towards a negative opinion.\(^3\) The public usually identified shareholders and

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1. See Future of Hostile Takeovers, supra note 101, at 497-98. This misinformation has been created, in part, through the active public relations campaigns corporate management has waged. See supra note 12; see also Future of Hostile Takeovers, supra note 101, at 495.

2. See Future of Hostile Takeovers, supra note 101, at 495. This misinformation has been spread throughout by popular media. See, e.g., Brickey, Storm of Take-Overs and Buy-Outs Has Hit Toledo Often in Last 5 Years, The Blade (Toledo, Ohio) Feb. 11, 1987 (Bus. 17:B5) (Toledo newspaper described local takeovers as a battle and each company that was taken over or restructured as a loss. The newspaper characterize payments to shareholders as costs, not as positive cash flows to shareholders.).

3. These negative responses are probably heightened because the surveys typically refer to large mergers and big corporations—both of which tend to elicit a negative response from the general public. Future of Hostile Takeovers, supra note 101, at 493-94. A summary of the poll’s results regarding public feelings toward takeovers is included in the table below. Id. at 493.

<table>
<thead>
<tr>
<th>Poll Responses (%): Mergers and the Country/Economy</th>
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<tbody>
<tr>
<td>Poll</td>
</tr>
<tr>
<td>1. 1988, Penn &amp; Schoen#</td>
</tr>
<tr>
<td>2. 1987 ABC/Money Mag.</td>
</tr>
<tr>
<td>3. 1987 Harris/Bus.Wk.</td>
</tr>
<tr>
<td>4. 1987 NBC/Wall St.J.</td>
</tr>
<tr>
<td>5. 1986 ABC/Wash. Post</td>
</tr>
<tr>
<td>6. 1985 Opinion Research*</td>
</tr>
<tr>
<td>7. 1984 Roper</td>
</tr>
<tr>
<td>8. 1983 Opinion Research*</td>
</tr>
</tbody>
</table>

*# Poll was conducted for the Coalition to Stop the Raid Against America.

\(*\) The Opinion Research polls used slightly different terms than the other polls cited. Opinion Research answer qualifiers were respectively: “Beneficial”, “Hinders,” “No effect” and “Don’t Know.”
executives as winners and workers as losers in takeovers. Over three-quarters of the public surveyed had little or no knowledge of takeovers.

The results from a Louis Harris poll in 1987 graphically illustrate the confusion in the public's mind. Seventy-one percent said that realizing full potential value for shareholders should be the top priority for American industry, seventy-six percent said takeovers keep management on its toes, and forty-nine percent said that hostile takeovers often result in real improvements of management. Yet fifty-eight percent said hostile takeovers do more harm than good, seventy-eight percent said that employees, the community, and the economy are more important than shareholders. The general public tends not to trust corporate management or shareholders, and seems to like takeovers for their regulatory effects on management, but dislikes them because of the possibility of economic dislocations.

Public perceptions, however, are out-of-line with economic realities. A substantial majority, over sixty percent, believed that the shareholders and management of the acquiring corporation benefited from a merger, while only forty-five percent thought that shareholders and management of the target firm benefited. Most importantly, a majority of respondents believed that mergers reduced employment. With the majority of the public either indifferent or negative to takeovers, there is little opposition to anti-takeover legislation by local electorates.

2. Protection of Shareholders

What is clear is that, although most anti-takeover statutes are justified as protecting shareholders, anti-takeover laws are the antithesis

140. Id. at 491. Romano examined twenty-four polls. Twenty-three were conducted in the 1980's and one was conducted in the 1950's. The accuracy of the polls ranged between 3% and 5%.
141. Id.
143. Id.
144. See Future of Hostile Takeovers, supra note 101, at 495.
145. Id.
146. Id.
147. Id. at 497.
148. See, for example, Indiana's Governor, Robert D. Orr's defense of anti-takeover statutes in an editorial in the Wall Street Journal. Governor Orr defended his state's enactment of the anti-takeover statute in defense of Arvin Industries. In a letter, Governor Orr offers no less than six separate defenses of his anti-takeover bill: one, limit short-term focus of management and encourage long term investment, two, protect shareholders from partial tender offers, three, protect shareholders from the "prisoner's dilemma" in
of shareholder protection. The evidence is uncontroverted that takeovers, leveraged buyouts, and related transactions provide large premiums to shareholders. Furthermore, the whole market for corporate control has increased the market value of corporate stock. Corporate takeovers, despite the rhetoric of anti-takeover statutes, have consistently produced significant gains for shareholders.

Shareholders of target corporations that were acquired or restructured generally have done very well. Shareholders of target corporations have received a minimum of $167 billion between 1981 and 1986 from takeovers and takeover related transactions. The average premium above the market price received by shareholders in these takeovers has ranged from seventy-one percent to thirty-six percent, depending on the year, and have generally been the same whether the tender offer was

tendering their shares, four, the internal affairs doctrine, five, the need to create a “playing field level for all players in a hostile takeover,” and six, the need to protect minority shareholders. Although his primary focus was on coercive two step takeovers. In the words of the Governor, “The Indiana law is the first in America to give long term growth a fighting chance against short term ‘profiteering.’” Orr, Shareholders Need a Knight-Errant, Wall St. J., May 27, 1987, at 30, col. 3.

149. Butler, supra note 103, at 367; Sell, supra note 81, at 479; Davis, supra note 102, at 512-13. See also, Roll, Empirical Evidence on Takeover Activity and Shareholder Wealth, in Coffee, supra note 9, at 241.

150. See infra text accompanying notes 152-61.

151. See infra text accompanying notes 162-69.

152. A “target” company refers to a company that is the subject of a takeover bid, Steinberg, supra note 3, at 260.


154. Grundfest Says Study Shows Takeovers Sharply Increase Shareholder Wealth, 19 Sec. Reg. & L. Rep. (BNA) No. 39, at 1487 (Oct. 2, 1987). A good example is Mesa Petroleum’s defeated bid for Unocal. The price for Unocal’s common stock increased 38% from twenty days before Mesa’s offer to the day Mesa announced its intention to acquire the company, $34.63 to $48.


Average Premiums over Stock Prices 1980-Sept. 1989
(1 month before announcement of deal)

<table>
<thead>
<tr>
<th>Year</th>
<th># of deals</th>
<th># w/Premium</th>
<th>Avg. Premium</th>
</tr>
</thead>
<tbody>
<tr>
<td>1980</td>
<td>1,558</td>
<td>107</td>
<td>70.53</td>
</tr>
<tr>
<td>1981</td>
<td>2,328</td>
<td>221</td>
<td>61.36</td>
</tr>
<tr>
<td>1982</td>
<td>2,298</td>
<td>228</td>
<td>49.92</td>
</tr>
<tr>
<td>1983</td>
<td>2,393</td>
<td>219</td>
<td>48.19</td>
</tr>
<tr>
<td>1984</td>
<td>3,172</td>
<td>405</td>
<td>37.02</td>
</tr>
<tr>
<td>1985</td>
<td>3,474</td>
<td>392</td>
<td>42.24</td>
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<tr>
<td>1986</td>
<td>4,435</td>
<td>450</td>
<td>36.40</td>
</tr>
<tr>
<td>1987</td>
<td>4,003</td>
<td>380</td>
<td>37.85</td>
</tr>
</tbody>
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an any-or-all or two-tier offer, with the premium paid only slightly reduced in partial offers. Shareholders received similar premiums in corporations taken over in a LBO.

Acquiring corporation shareholders did not have the same returns as the target corporation shareholders, but generally there were some gains. The average return for acquiring corporation shareholders after the acquisition was four percent. Studies have indicated no evidence that other security holders of the target or acquiring corporation, such as bondholders, have losses from takeover transactions, although bond prices have been depressed after the completion of individual transactions.

The 1980's increase in takeovers and mergers also coincided with record stock market gains. The Standard and Poor 500 Stock Index has

<table>
<thead>
<tr>
<th>Year</th>
<th>Value 1</th>
<th>Value 2</th>
<th>Value 3</th>
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<tbody>
<tr>
<td>1988</td>
<td>3,793</td>
<td>404</td>
<td>42.65</td>
</tr>
<tr>
<td>1989</td>
<td>3,692</td>
<td>339</td>
<td>38.52</td>
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</tbody>
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Id.

156. A "two-tier offer" is two-step acquisition technique in which the first step (front-end) is a cash tender offer and the second step (back-end) often is a merger in which remaining shareholders of the target company receive securities of the bidder valued below the cash consideration offered in the first-step tender offer. Steinberg, supra note 3, at 261.


158. Shareholders received an average premium of 40%, although the individual premiums accrued on individual offers differed between 1.7 and 120%. Lehn and Poulsen, Leveraged Buyouts: Wealth Created or Wealth Redistributed, in Chilton, supra note 15, at 52-53.

159. The Market for Corporate Control, supra note 153, at 53.

160. Cook, What the Economics Literature Has to Say About Takeovers, in Chilton, supra note 15, at 5 (citing Jensen and Ruback, The Market for Corporate Control, 11 J. Financial Econ. 5 (1983)). There were many cases in which there was no increase in return at all. Id. In some cases firms lost money as a result of the takeover or merger. Nevertheless, some commentators believe that the increased value of the acquisition is already reflected in the share price before the actual acquisition takes place. Id. at 6-8 (citing Schipper and Thompson, Evidence on the Capitalized Value of Merger Activity for Acquiring Firms, 11 J. Financial Econ. 85 (1983)). A 1986 study found that when values of senior securities is considered that acquiring firms had net gains as a result of a merger. Jensen, The Takeover Controversy: Analysis and Evidence (hereinafter the Takeover Controversy), in Coffee, supra note 9, at 314, 316.

Earlier studies found that acquiring firms almost universally reduced their earnings ratios after an acquisition. E. Magenheim and D. Mueller, Are Acquiring-Firm Shareholders Better Off after an Acquisition, in Coffee, supra note 9, at 171-89. Magenheim and Mueller's article studied 78 acquisitions from 1976 through 1981, and also reviewed nine other studies of the effect of acquisitions.

161. See The Market for Corporate Control, supra note 153, at 56-57; see also Lehn & Poulsen, Sources of Value in Leveraged Buyouts, in Chilton, supra note 15, at 55-58.
consistently risen throughout the 1980's. Nevertheless, these gains have been mostly attributable to the effects of mergers and acquisitions. As a result of the stock market gains, stock prices now reflect seventy-five percent of American corporation's actual asset replacement value due to takeovers, as opposed to representing forty percent of the replacement value before the wave of current takeovers began.

Without takeovers many shareholders would not have realized these gains. The increase in the stock market and in the premiums paid through takeovers and related restructuring has not been accompanied by an increase in the amount of normal dividends paid to shareholders. Dividends no longer constitute "the primary vehicle for transferring corporate profits to individual stockholders." In the early 1970's "stock buybacks and cash mergers equaled about fifteen percent of total dividend payments." In 1985 these devices constituted one hundred and fifty percent of total dividend payments. Dividends, on the other hand, have remained static, and the dividend price ratio decreased in the 1980's even while corporate profits continued to increase.

A major rationalization for anti-takeover statutes is protection of shareholders from "coercive" two-tier tender offers. Even though most
offers today are cash,\textsuperscript{171} even when two-tier offers were commonly used shareholders still received substantial gains.\textsuperscript{172} Furthermore, some commentators believe that a prisoner's dilemma never develops because the market will always develop a competing bid if an offeror tries to under-value a firm.\textsuperscript{173} In fact, shareholders may now be in danger of coercive offers by management.\textsuperscript{174} What is clear is that the deterrence and defeat of takeovers by anti-takeover statutes is reducing that premium to zero,\textsuperscript{175} and shareholders on average actually lost ten percent of their shares' value when a tender offer was defeated.\textsuperscript{176}

The bottom line, nevertheless, is that these statutes cannot be shareholder protective, otherwise management simply would have obtained shareholder approval instead of going behind the shareholders' back and having state legislatures amend the corporate charters.

3. Protection of Stakeholders

No evidence shows that hostile takeovers increase economic dislocations. Individual communities may face some dislocations, but no evidence indicates charitable giving, employment, or quality of life goes down because of a corporate acquisition. The popular opinion that takeovers cause harm to communities is probably the consequence of


\textsuperscript{171} 171. Hostile Two-Tier Tender Offers Fading From Picture, Grundfest Says, supra note 13.

\textsuperscript{172} 172. Shareholders received a premium of 63.4\% in any or all offers, an average premium of 55.1\% in two-tier offers and 31.3\% in partial tender offers. SEC, The Economics of Partial and Two-Tier Tender Offers, reprinted in [1984 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,637 (June 21, 1984).


\textsuperscript{174} 174. A SEC Commissioner maintains that most coercive two-tier tender offers originate with management in either self-tenders or through the solicitation of a friendly merger. See supra note 13. See for example the selective self-tender by Unocal for only 29\% of the outstanding shares, which was upheld by the Delaware Supreme Court, Unocal v. Mesa, 493 A.2d 946, 954 (Del. 1985). Unocal's management denied over $1.1 billion in premiums to Unocal's shareholders, and in effect made a two tier offer where the front-end of the offer was for $72 for 29\% of the shares and the back-end price of the remaining 71\% was only $35. Furthermore, Boone Pickens' attempted takeover generated $2.1 billion in payouts to Unocal's shareholders. See Takeover Controversy, supra note 160, at 345-46.

\textsuperscript{175} 175. Restricting Takeovers, supra note 64, at 70. See also supra text accompanying notes 87-100.

\textsuperscript{176} 176. Ruback, Do Target Shareholders Lose in Unsuccessful Control Contests?, in Auerbach, supra note 16, at 150.
widespread public relations work by corporations as well as the impact a lay-off announcement has on an individual's perception, regardless of its frequency.\textsuperscript{177} Furthermore, takeover opponents often neglect to consider that the proceeds from a takeover or acquisition are normally reinvested by target shareholders or used to retire other loans.\textsuperscript{178}

\textit{a. Employment}

One of the primary concerns regarding takeovers is their effect on employment. Nevertheless, there is almost no evidence regarding the effects of takeovers on employment.\textsuperscript{179} Much of the evidence that takeovers reduce employment is anecdotal, and there is no hard evidence that takeovers cause reduced employment.\textsuperscript{180} Many of the industries where there were in fact job losses were already facing a restructuring in response to a decline in market demand, international competition, or government deregulation.\textsuperscript{181}

In fact, some evidence shows that takeovers increase employment. One study found that actual employment increased about two percent as a result of a merger, even though wages dropped about four percent.\textsuperscript{182} Most studies finding decreased employment have focused on LBO's, and the loss appears due to the effects of leverage rather than change of control.\textsuperscript{183} But overall, there seems to be no difference in the effects

\textsuperscript{177} See Future of Hostile Takeovers, supra note 101, at 497.
\textsuperscript{178} Takeover Dangers, supra note 15, at 308 (Citing Economic Report of the President (1985) at 201).
\textsuperscript{179} Corporate Takeovers, supra note 9, at 49.
\textsuperscript{181} Corporate Takeovers, supra note 9, at 50-51.
\textsuperscript{182} Brown and Medoff, The Impact of Firm Acquisitions on Labor, in A. Auerbach, supra note 16, at 23. This study was limited to small firms, however, and did not differentiate between friendly and hostile mergers. Id. See also Macey, State Anti-Takeover Legislation and the National Economy, 1988 Wis. L. Rev. 467, 478.
\textsuperscript{183} Three other studies have found level or moderate declines in unemployment after LBO's and one study found steep declines in unemployment. Long and Ravenscraft, the Record of LBO Performance (July 11 1989), in Corporate Restructuring, supra note 183, at 58, 60 [hereinafter Record of LBO Performance]. A study by KKR, nevertheless, found that LBO's actually created 37,000 new jobs, Presentation on Leveraged Buy-Outs by
on employment between management approved and unsolicited outside mergers bids.184

Another area of concern relating to employees is the target's pension plans that provide for the worker's retirement. According to the Pension Benefit Guarantee Corporation about 1,200 pension plans with excess assets of at least $1 million each were either terminated or pending termination between January 1980 and June 1986.185 A study of these plans from 1980-1987, however, found that out of 327 terminations of overfunded pension plans by companies listed in the New York or American exchanges, only five were terminated within a year of an actual or attempted hostile takeover.186

b. Effect on the Community

Horror stories abound regarding the terrible effects a takeover will have on suppliers, a community's tax base, and corporate charitable giving.187 But again, the evidence that takeovers hurt communities is only antidotal, and some evidence even indicates that takeovers do not hurt the community.188 Furthermore, many of the stories regarding the effects of takeovers on communities usually involve takeovers or takeover defenses in which there are massive increases in the corporation's lev-


184. See infra note 208.

185. Leverage Buyouts and the Pot of Gold: Trends, Public Policy, and Case Studies, A Report for the Use of the Subcommittee on Oversight and Investigations of the Committee on Energy and Commerce, House of Representatives, 100th Cong., 1st Sess. at 41 (1987). These plans covered more than 1.4 million participants and had about $14 billion in excess assets. Id.

186. Study Finds Pension Plan Terminations often not Caused Directly by Takeovers, 21 Sec. Reg. L. Rep. 1826 (BNA) (1989). 17 terminations were the result of leveraged buyouts, however. Id.

187. For example when Gulf Oil was acquired by Chevron community leaders were concerned because Gulf gave 3% of the contributions to the local United Way and an additional $2 million to fifty other charities. Furthermore, Allegheny County faced the loss of $2 million in personal and corporate property taxes. See Romano, supra note 78, at 121.

verage, not an actual change of control. For example, the most common story regarding the effects of takeovers on communities is regarding Bartlesville, Oklahoma, the headquarters of Phillips Petroleum. Phillips, in an effort to stave off a hostile takeover, initiated a massive restructuring in which the corporation borrowed $5 billion and returned it to the shareholders in a stock buyback.\textsuperscript{189} The alleged economic dislocations were not the result of a change of control; there was none. There is simply no evidence that takeovers systematically have a negative impact on communities.

4. Corporate Efficiency

The final justification offered to support anti-takeover statutes is the protection of corporate efficiency. According to detractors of takeovers and mergers, takeovers force companies to cut research and development (R&D), adopt short term perspectives, and generally run inefficiently.\textsuperscript{190} No evidence supports this thesis. Companies that are taken over are usually less efficient and have lower than average capital expenditures than other companies in their field. Companies that are taken over are usually in businesses that are not research intensive, such as retailing, and there is evidence that research and development expenditures decrease in a change of control. Some evidence, however, shows that takeovers create more efficient corporations and create more growth.

a. Effect of Takeovers on Corporations

No evidence indicates takeovers decrease the economic performance of targets. On the contrary, the evidence supports that takeover targets are usually not using their assets efficiently, and that takeovers increase their efficiency. Corporations that are targets of hostile offers usually are operated at below industry norms in all respects. Targets of hostile takeovers had below industry income-to-asset ratios.\textsuperscript{191} The ratio of the


\textsuperscript{190} See, e.g., Orr, supra note 148, at 30. The Governor of Indiana advocated antitakeover statutes because they provided more profitable utilization of assets and better long term corporate growth.

\textsuperscript{191} Morck, Shleifer, and Vishny, Characteristics of Targets of Hostile and Friendly Takeovers [hereinafter Characteristics of Targets], in A. Auerbach, supra note 16, at 118, Table 4.3a. Record of LBO Performance, supra note 183, at 41. Corporations that were targets of friendly mergers, on the other hand, were on average operating at twice the respective industry norm for income-to-asset ratios. Id.
target's market value to the replacement value of its tangible assets also was markedly lower.\textsuperscript{192} Hostile targets in addition had lower R&D expenditures than the industry standard\textsuperscript{193} and also tended to have lower capital expenditures per share.\textsuperscript{194} Furthermore, evidence based on a variety of economic indices shows takeover targets tend to be characterized by a history of declining performance relative to firms in the same industry.\textsuperscript{195} Finally, there is evidence that once firms do change owners they have higher productivity ratios than firms that did not change control.\textsuperscript{196}

\textit{b. Research and Development}

One of the primary criticisms of hostile takeovers and related transactions is that they force management to adopt a short term focus.\textsuperscript{197} There is no evidence of this, although takeovers in some instances could cause management to concentrate too much on the financial rather than production aspects of running their business.\textsuperscript{198} Furthermore, there is evidence that shareholders see through plans designed to increase short-term earnings, at the expense of long-term profits and expansion, and do not offer increased prices for firms that adopt short-sighted business policies.\textsuperscript{199} In addition, studies have found that the stock market, and

\textsuperscript{192} The ratio of market value to replacement value of assets in the sample, all Fortune 500 companies, was 8.48; for targets of friendly mergers, 7.96, and targets of hostile mergers it was only 5.24.
\textsuperscript{193} See Restricting Takeovers, supra note 64, at 64. See infra text accompanying notes 202-05. Firms that are usually targets of LBO's and hostile takeovers are usually in industries with low R&D expenditures anyway.
\textsuperscript{194} Restricting Takeovers, supra note 64, at 64.
\textsuperscript{195} Id. at 64-65.
\textsuperscript{196} One study of 18,000 relatively large plants throughout the manufacturing sector in the United states found that about 19% of these plants changed owners at least once during a nine year period, and of the plants that changed, most changed ownership more than once. The study found that the least productive plants are most likely to be acquired, on average 2.8% less productive, and that plants that did change owners had higher productivity. Lichtenberg, Productivity Improvements from Changes in Ownership, 23 Mergers and Acquisitions 48, 50 (1988). Nevertheless, one study found that the hostilely acquired corporation usually failed to increase in performance after the acquisition. Record of LBO Performance, supra note 183, at 43. But this study neglected to include the value created by the money that was distributed to shareholders when the company was taken over. Takeover Dangers, supra note 15, at 308 (citing Economic Report of the President (1985) at 201).
\textsuperscript{197} See, e.g., Ribstein, supra note 4, at 89-90.
\textsuperscript{198} See id.; Weiss, Comment—Mergers and Takeovers: Taxes, Capital Structure, and the Incentives of Managers, in Coffee, supra note 9, at 363.
hence the shareholders, normally appreciate long term investments, such as R&D, and stocks on average jump one percent in value with each R&D announcement.\footnote{200}

Most studies indicate that R&D has not been affected by takeovers and related restructuring.\footnote{201} This is probably because most corporations that are considered ideal targets have low R&D budgets.\footnote{202} A large study by the University of California at Berkeley found no evidence of reduced R&D spending at the 320 firms involved in deals out of a total sample of 2,500 firms that were tracked between 1976 and 1985.\footnote{203} This same result was reached in a similar study of acquisitions in 1986 and 1987.\footnote{204} In addition, a study by the Office of Technology Assessment found firms that had been subject to a takeover or related restructuring did not reduce corporate R&D because of a change in control.\footnote{205}

C. The Political Truth

Despite public and legislative misconceptions about corporate mergers and acquisitions, the legislatures do have logical reasons for passing
anti-takeover legislation. First, takeovers may instigate local economic dislocations that directly affect a respective state official’s constituents. Second, any harm from an anti-takeover statute is dispersed to shareholders and the national economy while protecting domestic constituents.

Corporate mergers can dislocate workers, suppliers, and of course corporate management. The management, the workers, and the suppliers are located in the state, and are of concern to the state elected officials. However, shareholders are dispersed all over the country, and many, if not all, are not constituents and have little influence on state elected officials.

The state anti-takeover laws are in part passed because of this political externality “in which state legislatures are able to provide benefits to local interests by imposing costs on politically disorganized individuals who do not reside within the state.” The irony is that the statutes still allow takeovers if approved by management and there is no evidence that changes in control approved by management result in fewer dislocations than hostile takeovers.

VI. JOINING OF OWNERSHIP AND CONTROL IN MANAGEMENT

A. Controlling Corporate Management

The market for corporate control is the only serious mechanism for limiting management opportunism, and management through the state anti-takeover legislation has effectively stripped it from the shareholders

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207. Impact of Mergers, supra note 12, at 22 (Testimony of Geoffrey Miller, Associate Dean and Professor of Law, University of Chicago Law School).
208. However, there is no evidence that acquisitions result in greater job loss, except at the highest levels. Future of Hostile Takeovers, supra note 101, at 497 (citing Brown & Medoff, The Impact of Firm Acquisitions on Labor, Corporate Takeovers: Causes and Consequences 9 (A. Auerbach ed. 1988)). See also Bamonte, supra note 109, at 262.
210. Bamonte, supra note 109, at 262.
212. Bamonte, supra note 109, at 263.
213. Gilson, supra note 79, at 841.
without their consent. Not only are shareholders hurt by these proposals, but our entire economy is affected. Other mechanisms to control management such as limited charter executive authority, incentive compensation, legislative amendment of corporate charters and judicial review of management actions, have failed.\textsuperscript{214} Corporate charter limitations limit the corporation's flexibility and have not been effectively enforced by the courts.\textsuperscript{215} Incentive compensation plans have also not worked.\textsuperscript{216} The boards of directors have been unable to establish management benefits that are related to corporate performance, risk, and size of the corporation.\textsuperscript{217}

The third method of controlling management, legislative amendments of the corporate charter, has been used very effectively by management in anti-takeover statutes. Unfortunately, the dispersed shareholders are unable to exercise effective political influence and the state legislatures have been dominated by management. The final method, judicial review of management acts, is also completely ineffective, as is evidenced in recent Delaware case law.\textsuperscript{218} The relaxed interpretation of fiduciary duties through the business judgement rule coupled with state anti-takeover laws has allowed management broad discretion to run their corporation, even for their own benefit.\textsuperscript{219} Broad fiduciary duties as a means of control are also very expensive because of the litigation, inefficiency, and uncertainty of expenses that arise out of ex post judicial determinations of management conduct.\textsuperscript{220}

\begin{thebibliography}{9}
\bibitem{215} See, e.g., Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985); Moran v. Household Int., Inc., 500 A.2d 1346 (Del. 1985); Ribstein, supra note 4, at 103.
\bibitem{217} See infra text accompanying notes 236-40 and 304. Management’s domination of boards of directors also prevent the board from effectively monitoring management compensation. Absent a substantial equity interest in the firm, the manager through his salary is an implicit debt holder, looking to a future stream of salary payments and thus has an incentive to reduce his firm’s stock volatility through inefficient behavior to make it less risky. Shareholders versus Managers, infra note 268, at 26 (citing Note, The Executive Compensation Contract: Creating Incentives to Reduce Agency Costs, 37 Stan. L. Rev. 1147, 1174 (1985)).
\bibitem{218} See supra note 215; Comment, The Misapplication of the Business Judgement Rule in Contests for Corporate Control, 76 N.W. U.L. Rev. 980 (1982); Carney, supra note 214, at 392-402; Davis, supra note 102, at 512; Takeover Controversy, supra note 160, at 342.
\bibitem{219} Steinberg, supra note 1, at 38.
\bibitem{220} Ribstein, supra note 4, at 111-19; Gilson, supra note 79, at 834-35; see Takeover Controversy, supra note 160, at 346-47. Courts lack the experience and information to make business decisions, and plaintiffs also lack the requisite information to know whether they have a good suit or not. See Easterbrook and Fischell, supra note 10, at 1195-96.
\end{thebibliography}
Without effective mechanisms for the monitoring and removal of management through tender offers, management is free to increase corporate waste through inefficiency and the appropriation of corporate profits. The American corporate system has divorced management's interest from shareholders so that shareholders have not only lost control of their corporations, but they have lost their right to participate in the fruits of ownership.  

Management has appropriated the fruits of ownership both through incredible compensation packages and perks and through satisficing behavior in which management chooses low risk investments or refuses to adapt to changing market conditions, so that there is little risk of management either losing their job or having to work too hard. These agency problems and the likelihood management will try to transfer wealth from shareholders to themselves decrease when management has an ownership position in the firm.

B. The Effect of Hostile Takeovers On Management

Shareholders, because they are dispersed and own too little stock, cannot usually justify active involvement in corporate governance. Key to most corporate theorists was that the market for the control of the corporation would keep management efficient and honest even if shareholders no longer were able to directly participate in the corporation and control management. The increase in management compensation,
at the same time that shareholder compensation through regular distributions has decreased, strongly suggests that the neoclassists were correct in predicting that management’s power was increasing at the same time the shareholder’s power was decreasing.\textsuperscript{227} Takeovers were the one factor that would keep management efficiently fulfilling its management roles.

The threat of a possible takeover puts pressure on management to use the firm’s assets more economically.\textsuperscript{228} This is critical to understanding the effect of state corporate anti-takeover statutes. Any impediment in the market for corporate control reduces any remaining shareholder control and allows management to act inefficiently without fear of being replaced.\textsuperscript{229}

Most corporate anti-takeover statutes do not eliminate the market for corporate control completely. State anti-takeover statutes do, however, increase the transaction cost of a takeover transaction.\textsuperscript{230} As long as incumbent management does not waste more than the premium required by the state anti-takeover statute, management is free to continue wasting the firm’s assets.\textsuperscript{231} “This lost premium reflects a foregone social gain from the superior employment of the firm’s assets.”\textsuperscript{232}

Corporate anti-takeover statutes force outside bidders to either get management’s consent, usually through liberal compensation packages and employment guarantees to management, or to bid such a high amount that management can no longer refuse the bid without worrying that they may have violated a fiduciary duty.\textsuperscript{233} In effect, anti-takeover statutes restrict the market for corporate control. The restricted market allows management greater discretion to self-deal and act inefficiently. Management, without the monitoring effect of takeovers, can take more than promised by either taking more of the corporation’s income stream.

\textsuperscript{227} See, e.g., A. Berle & G. Means, The Modern Corporation and Private Property 120-21 (1932).
\textsuperscript{228} Easterbrook and Fischell, supra note 10, at 1171-74. See also Hackl, supra note 10, at 1198-99.
\textsuperscript{229} See Manne, supra note 226, at 1430-31; Ribstein, supra note 4, at 109.

The requirement of a super majority to accomplish certain changes in the corporation . . . will raise the offeror’s cost of acquiring control, will make takeover difficult or impossible when management controls enough stock to block the vote even if the offeror buys out all other shareholders, and may enable management to arrange a friendly acquisition.

Id. For more detailed analysis, see supra text accompanying notes 87-100.
\textsuperscript{231} See Hackl, supra note 10, at 1197-99.
\textsuperscript{232} Easterbrook and Fischell, supra note 10, at 1175.
\textsuperscript{233} It has been recognized that fiduciary duties are not effective in monitoring manager performance. See supra notes 218-220.
than economically necessary or by satisficing and other types of uneconomical risk-averse behavior.\textsuperscript{234}

C. Executive Compensation

Anti-takeover statutes are passed to protect the group that needs the least economic protection, management. Management compensation is at an all time high—120 times what the average American earns.\textsuperscript{235} In 1988, the average chief executive officer’s (CEO) salary was $1.14 million and the average total compensation jumped to more than $2 million, an average increase of seventeen percent.\textsuperscript{236} That increase was three times the 5.1\% gain by middle managers and professional employees. The average CEO compensation in 1988 was ten times what it was in 1960 and rose approximately twice as fast as the average American professional’s salary.\textsuperscript{237}

American CEO compensation also does not correspond with what foreign corporations pay their CEO’s.\textsuperscript{238} In fact, American executive compensation does not appear to be market-based. A leading executive compensation analyst found that rational economic factors, such as the size of the corporation, performance, the risk of the company, and industry, only accounted for thirty-nine percent of the variation in

\begin{footnotesize}
\begin{enumerate}
\item See Comment, The 1983 Amendments to Pennsylvania’s Business Corporation Law: Unconstitutional? \textit{MITE} Be, 89 Dick. L. Rev. 401, 435 (1985); Winter, supra note 121, at 287-88; Gilson, supra note 79, at 837; Easterbrook and Fischell, supra note 10, at 1170.
\item Average CEO compensation, see infra note 236, compared with the average weekly gross non-agricultural earnings. Economic Indicators, supra note 168, at 15 (the average annual salary was $16,763).
\item Byrne, Grover, and Vogel, Is the Boss Getting Paid Too Much?, Bus. Wk., May 1, 1989, at 46, 47-48. The increase in 1987 was 8\%. Id. at 46.
\item Id. In 1960 the average executive compensation was $191,383. This was 41 times the average pay of a factory worker, 38 times the pay of a average school teacher, and 19 times the pay of an average engineer. In 1988, the average CEO’s compensation was 93 times the average factory worker’s, 72 times an average teacher’s salary, and 44 times an engineer’s salary. Id. at 48.
\item See Tully, American Bosses are Over Paid, Fortune, Nov. 7, 1988 at 123, 124-26. For example, only about an estimated 30 chief executives in all of Europe made $1 million in 1987. Some comparisons for approximately same product groups: General Electric: CEO salary $12.631 million, sales $39.3 billion, profits $2.9 billion; Siemens (W. Germ.): CEO salary $930 million, sales $27.5 billion, profits $649.6 million; Electrolux (Sweden): CEO salary $4.37 million, sales $10.6 billion, profits, $288.8 million; JVC (Japan): CEO salary $290 million, sales $5.5 billion, profits $50.7 million; Chrysler: CEO salary $17.656 million, sales $26.3 billion, profits $1.3 billion; Daimler-Benz (W. Germany): CEO salary $1.2 million, sales $37.5 billion, profits $970.2 million; Peugeot (France): CEO salary, $250,000 sales, $19.7 billion, profits $1.1 billion; Honda (Japan): CEO salary $450,000, sales $17.2 billion, profits $516.2 million. Id.
\end{enumerate}
\end{footnotesize}

Not only do corporate executives receive huge compensation packages for working, but they also receive mandatory severance pay, called “golden parachutes” if the company is taken over or merged. Golden parachute payments can be tremendous. For example, F. Ross Johnson, the former CEO of RJR Nabisco, received $54 million after his company was taken over by a partnership led by KKR. Golden parachutes even 239. Crystal, Seeking the Sense in CEO Pay, Fortune, June 5, 1989, at 88. Mr. Crystal believes that CEO compensation has gotten so out of line with company performance because corporate boards of directors always want to pay higher than the “average” executive compensation. The boards usually hire a “compensation consultant” who gives the board the average executive salary. The board then votes to pay a salary higher than average which, of course, raises the average, forcing the next board to pay an even higher salary. Id.

240. Some boards have even reduced the bonus incentive targets after poor corporate performance to ensure that top management still received their bonus. See id. at 104; Byrne and Vogel, supra note 236, at 51.

241. Traditionally golden parachute payments were only effective if the corporation was taken over in a hostile takeover. Now, these parachute payments are even payable in friendly mergers in which the executive negotiated the merger himself. For example, Gerald Tsai, the former chairman of Primerica Corp., along with nine other executives received $98.2 million in golden parachute payments. Primerica was taken over in a friendly merger. The golden parachutes originally were only effective after a hostile merger, but 3 months after the merger was agreed to the board modified the parachute agreement to pay after friendly mergers. The “outside compensation committee” contained some members who received up to $5.2 million in legal fees from the corporation. Byrne, supra note 236, at 49-50.

242. Id. at 49-50 (It is interesting to note that Mr. Johnson started the takeover war for RJR Nabisco with his own bid for the company.) See also Johnson & Morris, Beatrice Cos. Grants Golden Parachutes Totaling $23.5 Million to Six Officials, Wall St. J., Nov. 25, 1985, at 4, col. 1; Allied-Signal Ties Proves Lucrative to Executives, N.Y. Times, Aug. 13, 1985, at D2, col. 5.

This is not to say that golden parachutes are not useful. Executives invest substantial amounts of their “human capital” in their firm, and much of their economic return depends on deferred compensation. Golden parachutes can help protect the executive and allow her to worry less about job security. See Coffee, Shareholders versus Managers: The Strain in the Corporate Web, in Coffee, supra note 9, at 73-77 [hereinafter Shareholders versus Managers]; Takeover Controversy, supra note 160, at 340. Some other top golden parachutes:

<table>
<thead>
<tr>
<th>Name</th>
<th>Firm</th>
<th>Amount (In thousands)</th>
</tr>
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<tbody>
<tr>
<td>F. Ross Johnson, CEO</td>
<td>RJR Nabisco</td>
<td>$53,800</td>
</tr>
<tr>
<td>E. A. Horrigan, V. Ch.</td>
<td>RJR Nabisco</td>
<td>45,700</td>
</tr>
<tr>
<td>Gerald Tsai, Jr., Ch.</td>
<td>Primerica</td>
<td>46,800</td>
</tr>
<tr>
<td>Michael C. Bergerac</td>
<td>Revlon</td>
<td>35,000</td>
</tr>
<tr>
<td>Edward P. Evans, Ch.</td>
<td>Macmillan</td>
<td>31,900</td>
</tr>
<tr>
<td>Kenneth A. Yarnell, Pres.</td>
<td>Primerica</td>
<td>18,400</td>
</tr>
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have been amended to give management the parachute payment after a friendly offer is consummated.\footnote{243}

In addition to large salaries and golden parachute payments, executives today also are making large sums of money taking their companies private through LBO’s. Management has taken full advantage of the loophole in most state anti-takeover laws that allows managers to bid for their own companies without meeting the requirements of the applicable anti-takeover statutes. Through the institution of the management LBO, management is realizing even more of their corporations’ earnings. In the Metromedia LBO, for instance, Metromedia’s assets increased in value four hundred and ninety percent from $1.6 billion at the time of the buyout in mid-1984 to $6.5 billion in early 1987.\footnote{244} The CEO, John Kluge, made over $3 billion in two years, and management overall received $4.65 billion.\footnote{245} In the process of the leveraged buyout his official ownership increased from twenty-five percent to ninety-three percent.\footnote{246} The Metromedia case is not an isolated episode.\footnote{247}

\begin{table}[h]
\begin{tabular}{|l|l|l|}
\hline
John D. Martin, Ex. VP & RJR Nabisco & 18,200 \\
Sanford C. Sigoloff, Ch. & Wickes & 15,900 \\
Whitney Stevens, Ch. & J. P. Stevens & 15,700 \\
Philip L. Smith, Ch. & Pillsbury & 11,000 \\
Wilhelm A. Mallory, Sr. VP & Wickes & 7,500 \\
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\caption{Byrne, supra note 236, at 47.}
\end{table}

\footnote{243}{See supra note 241.}

\footnote{244}{There is evidence that Metromedia management purposefully used improper accounting measures to artificially devalue the company. The value of the assets of Metromedia increased in value 490\% from $1.6 billion to $6.5 billion at the time of the sale. Id. In the Metromedia LBO the stock was at a six year low allegedly because of poor management accounting practices which some believe was intentional. Id. See also Stein, Shooting Fish in A Barrel: Why Management Always Makes a Bundle in a LBO, Barrons, Jan. 12, 1987, at 6.}

\footnote{245}{Hector, Are Shareholders Cheated by LBO’s, Fortune, Jan. 10, 1987, at 98, 100.}

\footnote{246}{Id. at 100.}

\footnote{247}{Donald Kelly, the CEO of Beatrice Foods made $400 million from the LBO of his company in 1986. Id. at 98, 104. Another example, Fred Meyer is a regional discount store that was publicly held in 1981, but closely controlled by the Fred Meyer family. Management in combination with KKR proposed to take the company private. Management was aware of the huge value of the real estate that was carried on Fred Meyer’s books at cost. This unrealized difference was $110 to $140 million. The value of this property was never disclosed to shareholders. An “outside” committee of three outside directors met six hours to discuss management’s bid, and did not solicit any other bids or even consider a French bid at $2 a share higher than the management bid. No independent appraisal was taken, and the investment bankers and lawyers that the management normally used were hired to write the fairness opinions. Management bid $55 a share for a total of $420 million. The actual value was estimated to be at least $70 a share, and the company was sold in 1987 for $900 million or over $100 a share. Id. at 100, 104.}

Or consider the firm SFN, a publisher and media corporation. The management led takeover was opposed by three of the board of directors and an independent appraisal
D. Retained Earnings

The source for this unrealized value retained by management is the corporation’s retained earnings and under or mis-utilized assets and information. A recent study found a strong relationship between the decision to go private and retained earnings in the years 1984 through 1987. The higher the retained earnings, the more likely management would realize these undistributed earnings through a management LBO. The satisficing behavior of management in not adopting riskier, higher return investments is evident in another study that found firms in which management did not have a significant ownership interest had a rate of return fifty percent lower than firms where ownership and control was united.

Management has traditionally justified retaining earnings and not distributing them to shareholders on two bases: federal tax laws and the corporation’s high internal rate of return. The two main tax reasons for not distributing earnings to shareholders customarily have been the lower capital gains rate applied when value is realized through the sale of stock rather than by dividends and the lower corporate taxation that was obtained that found management’s bid to be too low. The investment bank further recommended that an auction be held for the firm and several bids solicited. In addition several large corporations contacted SPN interested in making a bid for the company. Nevertheless, the management-controlled board refused to consider other bids and approved the sell-out. (Evidently the terms were so good that one of the interested suitors joined the LBO partnership.) The management LBO then sold the company one year later for twice what they paid for it. Id.

Other “reverse” LBO’s include: Blue Bell, Dr. Pepper, Leslie Fay, Lily Tulip, and Uniroyal. The value of these companies’ assets increased from between 55% and 1031% after being brought public. Id. 248. Retained earnings are the net profits which have not been paid out as dividends. Black’s Law Dictionary 1183 (5th Ed. 1979).

249. Lehn and Poulsen, Free Cash Flow and Stockholder Gains in Going Private Transactions, 44 J. Fin. 771, 772 (July 1989). The use of going private transactions eliminates any gains that could be attributed to synergy or a better management team. A going private transaction is where the public shareholders are bought out and the bidder takes a concentrated ownership in the new privately held firm. Id. at 771.

250. Id. at 772.

251. Shareholders versus Managers, supra note 242, at 84, 121 n.37 (citing W. McEachern, Managerial Control and Performance 39-51 (1975)). See also Ferenbach, The Birth of the Financial Entrepreneur, Wall St. J., March 4, 1987, at 30, Col. 4 (A partner in a leveraged buyout firm unconsciously recognized this new division of ownership, “In my experience, most leverage buyouts are not about financial risk, junk bonds, or unwanted takeovers—although one or all of these elements may be present. Instead, they are about ownership, which translates into dedication, commitment, focus and eventually a better company.’”) Id.
Both these reasons were eliminated by the 1986 tax reform.\(253\) The other reason management retained earnings rather than distributed them was that they could increase the shareholders' rate of return.\(254\) The corporation could invest the retained earnings providing a lower cost of capital to the corporation and give the shareholder an effective return on the earnings. A recent study, however, found that corporate performance and the return to shareholders by the means of capital appreciation and dividends were completely unrelated.\(255\)

The study conducted of the fifty largest United States corporations from 1970-1984 found that over half of the corporations in the sample actually lost money for shareholders through retained earnings and poor investments. This means that the shareholders received less than the company earned by either dividends or capital appreciation over any five year period.\(256\) Companies in the bottom of the survey actually lost more money for the shareholder than the company earned.\(257\) The shareholders simply did not gain from the retained earnings and could have actually made more money by taking the earnings and depositing them in the bank.\(258\) An average of sixteen percent of the retained earnings simply disappeared; they were neither realized in dividends nor capital appreciation.\(259\)

The above evidence regarding management compensation and retained earnings supports Michael Jensen's thesis that the source of premiums in takeovers is the corporation's excess cash flow that is either absorbed in management's salaries or unproductive investments.\(260\) The premium turned over to shareholders is not at the expense of employees


\(253\) Id. Other tax reasons remain. For example, by retaining earnings the corporation allows the individual shareholder to control when he will realize income by selling the stock when he wants rather than earning regular dividends. Id. at 1073.

\(254\) Ball, The Mysterious Disappearance of Retained Earnings, Harv. Bus. Rev. July-August 1987, at 57. This by no means is a novel idea. A recent Wall Street Journal article dramatically illustrates this point. The article discussed what several companies were going to do with large cash surpluses. At no point in the article did one of the corporation's managers suggest returning the surplus to shareholders. Smith, Money Talks Loudest in Takeovers Now, Wall St. J., Mar. 9, 1990, at Cl. Some of the corporations and the amount of cash: Ford, $5.7 billion, CBS, $3 billion, Paramount, $2.5 billion, General Cinema, $1.1 billion, Walt Disney, $1.05 billion.

\(255\) Ball, supra note 254, at 60.

\(256\) Id. at 57-58.

\(257\) Id. at 58. For example shareholders of Xerox actually lost $1.19 for every $1.00 in Xerox's earnings. Likewise the shareholders of Coca-Cola only received 12% of Coca-Cola's earnings.

\(258\) Id. at 60.

\(259\) Id. at 58.

or the corporation's economic performance. If management does not use the corporation's cash surplus efficiently by either returning the firm's profits to the shareholders or investing the earnings in an economically competitive investment once management's waste exceeds the transaction cost of a takeover, the firm would be taken over in a free market and the surplus given to shareholders.\textsuperscript{261} Payment of the firm's earnings to shareholders reduces the resources under management's control, limiting management's discretionary authority over free cash flow.\textsuperscript{262} Furthermore, because there is less retained earnings, management is forced to rely on the capital markets, increasing the monitoring of the firm.\textsuperscript{263} What the threat of takeover accomplishes is the alignment of the shareholder's and management's interests.\textsuperscript{264}

VII. LEVERAGE AND SOCIETY'S CONCERNS

A. The Importance of Leverage

Many of the states' policy concerns expressed in passing anti-takeover statutes could be addressed by monitoring or limiting leverage. Leverage is simply the term used to describe when debt is used to finance a corporation. The higher the amount of debt in the corporation, the more leveraged the corporation.\textsuperscript{265}

1. Leverage In Our Economy Today

The amount of leverage in the corporate, as well as the public\textsuperscript{266} and other private sectors,\textsuperscript{267} is at an all time high. Corporate debt, not including financial institutions, is also at record levels and stood at $1.8 trillion in 1988, double the level that existed just six years earlier in 1982.\textsuperscript{268} In the stock markets, over $96 billion worth of equity was

\textsuperscript{261} Manne, supra note 226, at 1430-31.
\textsuperscript{262} Takeover Controversy, supra note 160, at 321-22.
\textsuperscript{263} Id.
\textsuperscript{264} Hackl, supra note 10, at 1198-99.
\textsuperscript{266} The gross federal debt in 1989 was $2,866 billion. Economic Indicators, supra note 168, at 32.
\textsuperscript{267} The average American paid in 1988 90% of his earnings, after essentials to debt service. In 1975 this figure was only 65%. Going for the Broke, Newsweek, Apr. 2, 1990, at 40.
\textsuperscript{268} Farrell, Learning to Live with Leverage, Bus. Wk., Nov. 7, 1988, at 138. Much of this leverage was incurred to either purchase corporations or used as an anticipatory defense. See Shareholders versus Managers, supra note 242, at 41-44.
withdrawn in 1988, and a total of $444 billion in equity has been extinguished between 1983 and the first half of 1989. Total debt in the American economy rose two hundred and fifty percent from 1977 to 1984.

Corporate debt of non-financial companies expanded at a rate of 85.4% in comparison to the United States gross national product (GNP), which from 1976 to 1982 grew by 77.6%. From 1982 to 1987, the corporate debt climbed 73.9% and the GNP grew 41.7%; the gap between GNP and corporate debt growth expanded from eight to thirty-two percentage points. This amount of leverage has become so great that corporate non-operating expenses, four-fifths of which are interest expenses from borrowing, rose from eighteen percent in 1976 to over fifty percent of corporate expenditures in 1988.

2. The Effects of Leverage

Traditional financial theorists believe that leverage increases the return available to the owners of the corporation, but also increases the risk and magnitude of the loss. This effect is magnified by the double taxation of dividends, which makes debt-financing less expensive than equity financing, and consequently gives a higher return to a more highly leveraged corporation.

Leverage can also aid corporate governance by performing valuable signaling and bonding functions. Leverage can be viewed as a method

269. Slater, Stock Market Faced Massive Exodus in '88, Wall St. J., Dec. 29, 1988, at Cl, col. 1. In 1983 $60 billion in debt was issued and $28 billion in new equity was issued. In 1984 $196 billion in debt was issued and $75 billion in equity withdrawn. In 1985 $167 billion in new debt was issued and $84 billion in equity withdrawn. In 1986 $190 billion in debt was issued and $81 billion in equity withdrawn. In 1987 $154 billion in debt was issued and $77 billion in equity was withdrawn, and in 1988 $207 billion was issued and a total of $140 billion in equity was withdrawn. Farrell, supra note 268, at 138-43 (citing Federal Reserve Board Figures).


271. Weidenbaum, supra note 25, at 69.


273. Id.

274. Id.

275. Durand, Costs of Debt and Equity Funds for Business: Trends and Problems of Measurement, (National Bureau of Economic Research). The traditional approach to the effects of leverage has been attacked for years beginning with Modigliani & Miller, The Cost of Capital, Corporation Finance and the Theory of Investment, 48 Am. Econ. Rev. 261 (1958). However, many of the assumptions made by Modigliani and Miller such as the ignoring of tax effects, to reach their conclusion have been recognized as unrealistic. See Bagwell and Shoven, Share Repurchases and Acquisitions [hereinafter Bagwell], in Auerbach, supra note 16, at 194.

of making management more accountable because the interest payments must be made.\textsuperscript{277} The leverage bonds management to the shareholders and the market’s interest because it reduces the discretion of management to spend the corporation’s cash flow in unproductive means.\textsuperscript{278} In addition, leverage forces management to concentrate on the bottom line, because of the risk of default and the fact that their job depends upon the continued solvency of the firm.\textsuperscript{279}

A high amount of leverage also acts as a signaling device telling the market that management is confident of its future, and of necessity makes the corporation more sensitive to market shifts and cycles since this constant interest payment must be made.\textsuperscript{280} Nevertheless, management’s constant devotion to financing and investment may detract from actual management of the corporation’s affairs.\textsuperscript{281}

Furthermore, there are strong arguments that the increase in risk is borne disproportionately by the employees and managers of the corporation, not the shareholders.\textsuperscript{282} Both employees and managers have invested their human capital, hard work, and knowledge in the firm for which they work, and cannot easily withdraw their “investment.”\textsuperscript{283} While shareholders are also at risk and do own the corporation, they can never lose more than the money they paid for their shares, and shareholders can diversify their risk by investing in a balanced portfolio of different corporations.\textsuperscript{284}

\begin{itemize}
\item \textsuperscript{277} Shareholders versus Managers, supra note 242, at 28; Jensen, supra note 260, at 323. The more leverage a corporation has incurred, the more earnings that must be devoted to interest payments. Because of the mandatory payments required to creditors, less cash flow of the corporation is available for spending at the discretion of managers, reducing the amount of retained earnings available for corporate waste. Id.
\item \textsuperscript{278} Jensen, supra note 260, at 320-24. On the other hand, a corporation that depends on equity or the use of retained earnings has no mandatory payments and can pay when business is good, and not pay when business is bad and gives management greater discretion.
\item \textsuperscript{279} See, e.g., Jensen, supra note 260, at 323; Shareholders versus Managers, supra note 242, at 27 (citing Easterbrook, Two Agency-Cost Explanations of Dividends, 74 Am. Econ. Rev. 650 (1984)).
\item \textsuperscript{280} Roughly two-fifths of merger and acquisition activity as well as LBO’s has involved companies in cyclically sensitive industries that are liable to run into trouble in an economic downturn. Leveraged Buyouts and Corporate Takeovers: Hearings Before the House Committee on Banking, Finance and Urban Affairs, House of Representatives, 101st Cong., 1st Sess. 130 (1989) (Statement of Alan Greenspan).
\item \textsuperscript{281} Weiss, supra note 198, at 363; Shareholders versus Managers, supra note 268, at 63.
\item \textsuperscript{282} Coffee, supra note 9, at 105; Shareholders versus Managers, supra note 242, at 17-19.
\item \textsuperscript{283} Takeover Dangers, supra note 15, at 305. Of course layoffs, plant closings and relocations are a result of the American free market system and result in the most efficient use of resources and the highest optimum employment. Regulating the Market, supra note 15, at 1221. For discussion see Shareholders versus Managers, supra note 242, at 17-19.
\item \textsuperscript{284} Shareholders versus Managers, supra note 242, at 19-20.
\end{itemize}
The shareholder's interest also will diverge from that of the firm's employees when the corporation is financed with a high degree of debt. Leverage increases the potential for extraordinary gains, but at some point the amount of debt will surpass the value of the firm's assets in the account of default. At this point any increase in leverage, and consequently in the firm's possible returns, can only benefit the shareholder, while the possibility of a decrease in the firm's earnings or default does not appreciably affect the shareholder's zero return anyway. The value of being able to transfer worthless assets at a fixed price is more valuable than being able to transfer valuable assets at a fixed price, and the incentive is for shareholders to increase the amount of leverage.\(^{285}\)

The actual evidence of the effects of leverage is limited. But if one examined every example that opponents of takeovers offer as proof of the harm caused by takeovers, one would see that it was not the cost of defending against the takeovers or the actual change of control that caused the harm, but the large amounts of leverage that required debt service.\(^{286}\)

There is evidence that R&D is reduced in takeovers only where the debt-equity ratio is high.\(^{287}\) In a subjective study, the Office of Technology Assessment (OTA), after interviewing the corporate managers of R&D of 19 corporations that had been taken over or subject to takeover related restructuring, found that whether or not control had shifted did not determine whether R&D would be cut; how much debt had been incurred was the determinative factor.\(^{288}\) This conclusion is also in line

\(^{285}\) See Coffee, supra note 9, at 103; Burnham, Limits on Liability Actually are What Invite the LBO's, Wall St. J., Feb. 1, 1989, at A14, col. 6.


\(^{287}\) Corporate Restructuring and R&D: Hearing before the Subcomm. on Science, Research and Technology of the House Comm. on Science, Space, and Technology, 101st Cong., 1st Sess. 7 (1989) [hereinafter Corporate Restructuring] (Statements of Julie Gorte, Senior Analyst, Office of Technology Assessment).

with the results of individual corporate restructuring, and a National Science Foundation study found that "R&D declined between 1986 and 1987 by 12.8% for the 8 out of 200 leading U.S. R&D performing companies which had undergone" an LBO or non-merger restructuring.

Furthermore, there is some evidence that LBO's, which by definition involve a significant amount of debt, reduce employment, and one study found that on average LBO's reduced employment 15.3%. Nevertheless, many commentators believe the increased use of leverage has not had any ill effects and characterize both debt and equity as claims on a corporation's income stream with little distinction.

B. Leverage and State Policy Concerns

1. Leverage and Risk

The states and the federal government have a legitimate interest in protecting against unnecessary economic dislocations and reduced productivity of American corporations. The restriction of corporate change of control transactions, however, does not further those goals. The evidence supports that corporate change of control transactions do not reduce employment, R&D, community support, or other state interests. If anything has caused any societal or economic detriment, the evidence indicates it is the increasing use of debt financing.

The evidence is not clear and this paper does not so suggest, but if anything is to be regulated it should be the use of leverage. High levels of leverage have been implicated in numerous stories of lay-offs and cuts in productive corporate spending, such as R&D. Furthermore, it seems clear that at some point the benefits of the monitoring function of the leverage are overcome by the costs of distracted management and employees.
For commentators such as John C. Coffee who do not believe that a completely open market for corporate control should exist, their concerns have focused on the risk that managers and stakeholders face as compared to shareholders. This risk is created by the large amounts of leverage either used to finance a takeover or required by the market as an efficient allocation of assets in order to avoid a takeover. Efforts to attribute all the recent trend to increase the leverage to change of control and related transactions put the cart before the horse. Corporations are taken over because, in part, the market perceives that the corporation would be more valuable if it increased its leverage. To the extent that management ignores the market’s demands, its corporation is taken over and restructured to increase its leverage.

Coffee advocates that part of the tension between shareholders and management is the difference in preference toward risk. Since management, employees, and other stakeholders may invest their entire human capital with a firm and cannot diversify their risk, they are risk averse. By definition, leverage increases the risk for the firm. Concerns about employment loss and corporate productivity can be better addressed by trying to reduce the market’s preference for leverage, rather than limiting the market for corporate control. There is no evidence that change of control in itself increases the risk of economic dislocation. The restructuring of the corporation using debt is just a symptom of the market’s preference for leverage.

The record amounts of leverage in the American economy also have systemic effects. Roughly two-fifths of merger and acquisition activity, as well as LBO’s, has involved companies in cyclically sensitive industries that are liable to run into trouble in an economic downturn. The high amounts of leverage may make some firms unable to withstand market downturns and force bankruptcies. The high degree of borrowing also makes American corporations dependent on foreign suppliers of capital, subjecting corporate finance to the whims of overseas capital markets.

295. Id. at 42-44.
296. Id. at 41-42.
297. Of course the innovations in the financial markets and the ability to finance transactions such as the RJR Nabisco LBO have made takeover transactions easier.
298. In fact, management’s preference for large retained earnings can be attributed to this risk averseness.
299. See supra notes 189 & 275.
300. See Canellos, supra note 276, at 100. It is true that without the continuing increase in efficiency in financial markets, leverage would not be available in the large transactions taking place today. Blackwell, supra note 173, at 164.
As discussed above, leverage has several beneficial functions in corporate governance, such as signaling, bonding the managers to the shareholders, and reducing the free cash flow.\textsuperscript{302} Leverage is usually less expensive than equity financing, and easier to arrange. Artificial restrictions on the use of leverage could hurt the American economy, especially by retarding developing industries, and reduce American world-competitiveness.\textsuperscript{303}

2. \textit{Leverage and the Double Taxation of Dividends}

The Internal Revenue Code's double taxation of dividends from equity is perceived as one of the reasons for the market's preference for debt financing.\textsuperscript{304} Interest payments on debt are tax deductible as an expense for businesses and are only taxed once as income to the lender, while dividend payments to shareholders are taxed once as corporate earnings and a second time as income to the shareholder.\textsuperscript{305} Because of the double taxation, a corporation's cost of capital decreases, and consequently its value increases, when debt is substituted for equity,\textsuperscript{306} and dividend payments are discouraged.\textsuperscript{307}

The double taxation of dividends requires more of the firm's earnings to pay the same real rate of return on equity. A company must earn $1.50 of pre-tax earnings to pay out $1.00 in dividends, while it only takes $1.00 of pre-tax earnings to pay $1.00 of interest payments.\textsuperscript{308} The

\textsuperscript{302} See supra notes 276-81.
\textsuperscript{303} See Tax Panels to Consider Curbs on Corporate Debt, Cong. Q., Jan. 21, 1989, at 118 [hereinafter Tax Panels].
\textsuperscript{304} See Canellos, supra note 276, at 100; Leveraged Buyouts and the Pot of Gold: Trends, Public Policy, and Case Studies: A Report for the Use of the Subcomm. on Oversight and Investigations of the House Comm. on Energy and Commerce, 100th Cong., 1st Sess. 35 (1987) [hereinafter Leveraged Buyouts]; LBOs and Corporate Takeovers, supra note 301, at 3 (Statement of Allen Sinai, Chief Economist and Executive Vice President, the Boston Co.); Blackwell, supra note 173, at 176; Weidenbaum, supra note 24, at 18 (citing Federal Income Tax Aspects of Mergers and Acquisitions, Joint Committee on Taxation at 4 (1985)). However, some commentators believe that the difference in taxation has only a limited effect on the market for corporate control. See, e.g., Auerbach and Reishus, The Effects of Taxation on the Merger Decision, in A. Auerbach, supra note 16, at 178.
\textsuperscript{305} Van Horne, supra note 265, at 260. See, e.g., Coffee, supra note 9, at 294.
double taxation makes debt less expensive than equity as a means of financing.\textsuperscript{309}

The double taxation of dividends also discourages the payment of dividends because shareholders would prefer distributions through either capital gains or eventual takeovers.\textsuperscript{310} In addition, the double taxation of dividends makes it relatively more attractive to distribute earnings in share repurchases or some form of restructuring other than dividends.\textsuperscript{311} The deduction for interest payments is also an incentive in restructurings, where payments on the new debt can shield corporate earnings.\textsuperscript{312}

The double taxation of dividends has forced the market to disguise basically equity instruments as debt instruments like "junk bonds," and the artificial taxation structure built on the nomenclature of the respective financing instrument just creates further distortions.\textsuperscript{313} The problem of accurately distinguishing between debt and equity is impossible.\textsuperscript{314} The new debt financing of corporations has resulted in an ad hoc corporate tax integration. The corporations are using securities such as junk bonds, which only pay residual corporate profits corresponding to an equity position, and characterizing them as debt to increase the return to security holders and lower the cost of capital to the corporation. The problem is that while reducing tax rates, the required regular payments of debt financing and the defined events of default are increasing the risk of corporate default and failure.\textsuperscript{315}

Double taxation of equity also causes agency costs for the firm in addition to the economic effects. The double taxation of equity gives management an incentive to retain earnings instead of returning the gains to shareholders.\textsuperscript{316} The 1986 tax reform eliminated the lower capital gains

\textsuperscript{309} McLure, Integration of the Personal and Corporate Income Taxes: The Missing Element in Recent Tax Reform Proposals, 88 Harv. L. Rev. 532, 540-41 (1975); Leveraged Buyouts, supra note 304, at 35. This effect may have been aggravated by the 1986 tax reform. See Zolt, supra note 306, at 865-66.

\textsuperscript{310} Peel, supra note 307, at 4.

\textsuperscript{311} Bagwell, supra note 275, at 192; Peel, supra note 307, at 3.

\textsuperscript{312} Peel, supra note 307, at 5; Canellos, supra note 276, at 100. It has been confirmed by several studies that after an LBO, firms pay almost no taxes; these tax benefits are between 31% and 135% of the premiums paid to shareholders. But these tax savings may be offset by the taxes paid by stockholders, investors and bond holders on the income. Corporate Restructuring, supra note 287, at 61. See also McLure, Integration of the Personal and Corporate Income Taxes: The Missing Element in Recent Tax Reform Proposals, 88 Harv. L. Rev. 532; Warren, The Relation and Integration of Individual and Corporate Income Taxes, 94 Harv. L. Rev. 719 (1981).

\textsuperscript{313} See Canellos, supra note 276, at 109-11, 113.

\textsuperscript{314} Id. at 109 (citing B. Bittker & J. Eustice, Federal Income Taxation of Corporations and Shareholders 4-10 (4th ed. 1979)); Warren, supra note 312, at 737-38.

\textsuperscript{315} Zolt, supra note 306, at 875.

\textsuperscript{316} See id. at 844; Black, Bidder Overpayment in Takeovers, 41 Stan. L. Rev. 597, 651 (1989); Peel, supra note 307, at 2-3.
rate and lower corporate tax rationales for retaining earnings, but the double taxation justification remains. Double taxation of dividends discourages the distribution of dividends by corporate managers and offers a rationalization for large amounts of retained earnings. The increase of agency costs and encouragement of retained earnings caused by double taxation of dividends and the reduction of shareholder benefits and control that results is evidenced by the fact that management and management groups such as the Business Roundtable vehemently opposed efforts in both the Reagan and Carter administrations to equalize the taxation of debt and equity.

The double taxation of dividends is creating distortions in corporations' financial structure by favoring debt. This bias may be increasing the risk of corporate failure and/or economic dislocations. No evidence indicates change of control transactions create additional risks of economic dislocation, but considerable evidence exists to show that high debt/equity ratios can reduce corporate performance and research and development and increase the risk of corporate failure and economic dislocation.

VIII. The Need for Legislation

A. The Need for Federal Legislation

The problem with any comprehensive legislation is the continuing disagreement as to the role and functioning of the public corporation in American society. The wholesale preemption of state anti-takeover laws is probably not appropriate considering the discord in the academic arena and the significant policy choices that must be made. The lack of a clear academic consensus, in addition, complicates any policy choice because Congress is then even more easily swayed by special interests. In fact, one commentator believes that any move to enact federal leg-

317. Bryan, supra note 252, at 1070.
318. Id. at 1073.
320. Saunders, supra note 308, at 194. As explained by Senator Robert Packwood, management "feared that corporations would be under unholy pressure to declare dividends' so their stockholders could get the credits." Caution Urged as Tax Panel Eyes Corporate Debt, Cong. Q., Jan. 28, 1989, at 162. See also Sheppard, Subchapter C Reform: Live Aid for Elective Carryover Basis, 35 Tax Notes 225, 228 (1987); Sheppard, Through the Looking Glass, 35 Tax Notes 436, 436-37 (1987).
321. Corporate Takeovers, supra note 9, at 9.
322. See Pinto, The Constitution and the Market for Corporate Control: State Takeover Statutes After CTS Corp., 29 Wm. & Mary L. Rev. 699, 726 (1988); Corporate Takeovers, supra note 9, at 9; Roll, supra note 149, at 241.
323. See Davis, supra note 102, at 500.
islation to restrict state regulation of takeovers may backfire and ultimately result in increased federal restrictions of takeovers. On the other hand, a complete preemption would probably be better than today's heavily management-biased legislation.

Even though uncertainty abounds regarding the effect of takeovers and anti-takeover statutes on the American economy, at some point policy makers must make a decision before a fully developed model is created. What is clear is that the American economy and shareholders of American corporations are being deprived of corporate earnings through either management waste or indifference. The market responded to this management behavior by creating a corporate control market in which this unrealized value was returned to shareholders in tender offers.

Corporate management, in response to this pressure, used the state legislative process to disrupt the market for corporate control. Management used the legislative process to side-step their own shareholders and avoid a vote. This initial management pressure has now created a "race to the bottom" to provide management with the maximum possible guarantees of job security at the expense of American jobs and the American economy.

No evidence supports that anti-takeover statutes provide any benefits, and much evidence shows they provide none. The irony is that the only group deriving benefits from anti-takeover transactions, i.e. management, is the group that did not need any protection in the first place. In addition to corporate takeover concerns, management compensation no longer possesses any rational basis and further demonstrates the alienation of management from the shareholders.

What has emerged is a corporate management accountable to no one except for the grossest acts of negligence or intentional misconduct. Management has now initiated a bidding war between the states to see who can entrench incumbent management the furthest. The states are caught in their own "prisoner's dilemma"; they cannot afford to refuse managers their demanded protections without risk of losing domestic jobs, even though the states may know that the protections hurt the nation as a whole.

Obviously, the entire state anti-takeover area is ripe for federal legislation. Neither the states nor the exchanges have provided any leadership in this area. This paper advocates a moderate proposal that will restore some power to the shareholders of corporations and equalize the value of debt and equity.

324. Future of Hostile Takeovers, supra note 101, at 472.
326. Hazen, supra note 35, at 108.
327. Corporate Takeovers, supra note 9, at 105-06.
B. Proposal

To bring evenhandedness to the state legislation of corporate control transactions while protecting the state interests expressed, this paper makes four proposals: three proposals to amend the Williams Act and one proposal to amend the Internal Revenue Code. To protect the shareholders, eliminate side payments, and allow control over management, the first proposal is an amendment to the Williams Act that would subject management to the same requirements as outside bidders for changes of control and other related transactions in state anti-takeover statutes. The second proposal is similar and would require that all corporations opt into protections of anti-takeover statutes by shareholder vote. Both of these provisions should expressly preempt state law.

In addition, to satisfy the states' concerns for the welfare of shareholders and deal with the problems of the possible coercive effect of tender offers, the third proposal would amend the Williams Act to require a vote on the pending tender offer to be tendered along with the shareholder's shares. This idea, advocated by Lucian Bebchuk, would allow shareholders to vote against an acquisition, but still take advantage of the control premium if the shareholders as a whole approved the transaction. This proposal is similar to state control share acquisition acts; however, this proposal would unify the voting and tendering requirements and would not allow management to delay the consummation of a tender offer.

Finally, to protect management, employees, and other stakeholders, the fourth proposal would seek to discourage leverage by improving the economic return on equity by reducing the double taxation of equity through a fifty percent credit given shareholders for corporate taxes already paid. The measure would have to increase overall corporate taxes to remain revenue neutral.

1. Restoring Power to the Shareholders

Besides change of control transactions, academic literature has recognized four methods of controlling management, including limited charter executive authority, incentive compensation, legislative amendment of corporate charters, and judicial review of management actions. All of these have failed.328 The market for corporate control is the only serious mechanism for limiting management opportunism,329 and management through state anti-takeover legislation has effectively stripped

328. Carney, supra note 218, at 387-88. For discussion see supra text accompanying notes 213-220.
329. Gilson, supra note 79, at 841.
it from the shareholders without their consent. Not only are shareholders hurt by these proposals, but our entire economy is affected.

It is clear, however, that anti-takeover amendments have a place in some areas of corporate law. What this paper proposes is to reinsert the shareholders' control by requiring shareholder approval before a corporation is protected under all state anti-takeover statutes. Furthermore, to ensure that there are no incentives for side payments to management to approve mergers and that managers do not take advantage of the shareholders, this paper proposes that all state anti-takeover statutes that impose voting, minimum offer, business combination or mandatory redemption provisions apply equally to both management and outside bidders.330

This proposal would be similar to Gilson's ideas to return control of corporate control decisions to shareholders.331 Shareholders cannot realistically control the actions of management.332 The market for corporate control exists as the only disciplinary mechanism available. To ensure that the shareholders' control over management continues to function, any state statute that provides impediments to the market for control would have to be approved by shareholders before being effective for a particular corporation. A similar proposal should also apply to other defensive measures taken by management outside a particular statute.333

330. Leading commentators recognize that shareholder approval is a way to mitigate against management conflicts of interest. See Ribstein, supra note 4, at 110-111; Takeover Controversy, supra note 160, at 345.
331. Gilson, supra note 79, at 879. This proposal is also similar to the approach taken in the ALI Corporate Governance project, Transactions in Control. Carney, supra note 218, at 408.
332. Gilson, supra note 79, at 834.
333. Management acts that significantly impeded a takeover would require shareholder approval. The impediments would be defined in two levels, similar to the ALI project on corporate governance. Corporate acts that would always result in increased costs for outside bidders would always have to be approved by shareholders. Examples include acts requiring shareholder approval, mandatory pricing formulas, special stock dividends such as poison pills, and other corporate acts in the nature of anti-takeover amendments. Corporate acts that could result in the defeat of a tender offer, but could also have a legitimate business purpose, would only be subject to shareholder approval if a tender offer or merger offer was pending before the corporation. Examples would include selective self-tenders, sales of substantial assets of the corporation, and acquisitions that might have negative anti-trust implications.

The author understands that these shareholder approval requirements could be burdensome in both time and expense, and that tender offers do not often give management sufficient time to get shareholder approval. Time concerns can be answered by opting into protections of the state takeover statutes at the corporation's earliest opportunity. Time concerns in the case of defensive tactics could be mitigated by the appropriate use of a TRO or preliminary injunction until shareholder approval can be obtained. Expense
A complete preemption of state anti-takeover laws may in fact be the best solution. Nevertheless, the raging debates, bitter disagreements, and strong preferences expressed by American corporations for this kind of protection through adoption of defensive maneuvers, mitigate against a complete preemption of state law. This proposal would simply restore shareholder control and prevent possible management side payments. It is a balanced approach in the spirit of the Williams Act, which does not favor management or shareholders, that should be politically supported. It simply restores the balance that previously existed in the market. Management can have all the protections that they deem necessary, but not without shareholder approval.

Concerns should be taken into consideration when a corporation's management is considering a possible anti-takeover maneuver. The language is also rather broad, but most obvious anti-takeover defenses would be covered during the pendency of a tender offer, and most defenses that are enacted outside the immediate threat of a tender offer are likewise apparent. Defenses that are better hidden, such as acquiring corporations to create anti-trust problems, could be resolved by the economic benefit test, but would only be able to be contested during the pendency of an offer, so as to not limit management's discretion in most cases.

334. See Easterbrook & Fischell, supra note 10, at 1194.
335. As of June 1989, approximately 43% of the United States' largest 1,440 public corporations (93% of total capitalization on the New York Stock Exchange, the American Stock Exchange, and the NASDAQ) had poison pill plans. Almost Half of Larger U.S. Companies Have Poison Pill Plans, Study Reports, Sec. Reg. & L. Rep. (BNA) No. 43, at 1630 (Nov. 3, 1989). In addition, 54% had staggered terms, and 32% had adopted fair price amendments which requires a bidder to pay all shareholders the same price. Almost 17% required a supermajority to approve a proposed merger and 7.4% had adopted dual class capitalization plans. In 1986 a survey of the Fortune 500 found that approximately 30% of the firms had adopted poison pill plans. Almost 30 Percent of Fortune 500 Firms Have Adopted Poison Pills, Study Finds, Sec. Reg. & L. Rep. (BNA) No. 7, at 223 (Feb. 13, 1987).
337. In the Senate report on the Williams Act, and also in the House of Representative's report, Congress was careful to indicate the neutrality of the act:

It was strongly urged during the hearings that takeover bids should not be discouraged because they serve a useful purpose in providing a check on entrenched but inefficient management. It was also recognized that these bids are made for many other reasons, and do not always reflect a desire to improve the management of the company... [This bill] avoids tipping the balance of regulation either in favor of management or in favor of the person making the takeover bid.

Johnson & Millon, supra note 87, at 1893 (citing Full Disclosure of Corporate Equity Ownership and in Corporate Takeover Bids: Hearings Before the Subcomm. on Securities of the Senate Comm. on Banking and Currency, 90th Cong., 1st Sess. 3 (1967)); Steinberg, supra note 3, at 203.
338. A 1988 survey found that 79% of the persons surveyed supported state legislation mandating shareholder approval of mergers. Future of Hostile Takeovers, supra note 101, at 499 n.112.
2. Shareholder Voting in Tender Offers

Most state anti-takeover statutes are justified as protection for shareholders from coercive tactics by outside bidders.339 No evidence shows shareholders are in fact coerced,340 but in theory the possibility exists.341 However, to ensure that shareholders are not pressured and to protect the states’ and the courts’342 avowed interest in protecting the shareholders’ undistorted choice in tendering decisions, this paper advocates a proposal, first drafted by Lucian Bebchuk, that would require shareholders to tender along with their shares a vote approving or disapproving any tender offer.343

Under this proposal, the bid’s success would depend on whether shareholders holding a majority of the shares approved the tender offer through a vote, not on the number of shares tendered. If a shareholder voted against the takeover, but nevertheless tendered his shares, the shareholder could still take advantage of the premium offered if shareholders holding a majority of shares approved the transaction.344 The shareholder could vote against the tender offer without fear of losing any premium or becoming a minority shareholder. In addition, if the tender offeror was interested in a partial tender, a second vote would be turned in, along with the first vote, indicating whether the shareholder would approve or disapprove of a partial offer.345 Shares that were not tendered would be counted as “no” votes.

This provision would not discourage tender offers, except for the theoretical lessened coercion on shareholders.346 This proposal would also not increase premiums paid in tender offers or create incentives for side payments to management. In effect, the statute would provide almost complete protection against possible shareholder coercion problems without creating an external regulatory body or management entrenchment

339. The shareholder coercion rationale is also offered to justify management defensive tactics. See, e.g., Lipton, Corporate Governance in the Age of Finance Corporatism, 136 U. Pa. L. Rev. 1, 17-20 (1987).
342. See, e.g, CTS Corp. v. Dynamics Corp. of America, 481 U.S. 69, 82-83, 107 S. Ct. 1637, 1646 (1987) (“The Indiana Act operates on the assumption, implicit in the Williams Act, that independent shareholders faced with tender offers often are at a disadvantage. By allowing such shareholders to vote as a group, the Act protects them from the coercive aspects of some tender offers.”).
343. The Pressure to Tender, supra note 341, at 931.
344. Id. at 932.
345. Id.
346. See Easterbrook & Fischell, supra note 10, at 710-11.
problems. Management would be free to solicit offers or offer advice on the virtues of the contemplated offer, but unlike state statutes, they would have no veto power over the transaction.\textsuperscript{347} Furthermore, the shareholder coercion rationale for defensive maneuvers and state anti-takeover legislation would be eliminated.\textsuperscript{348}

In addition, this proposal could be easily amended to the Williams Act and should not create additional administrative or regulatory burdens. This provision would provide balance to the proposed legislation and further the states' professed intent to protect shareholders.

3. Reducing Leverage in the Market Place

The Committee on Ways and Means of the House of Representatives in recent hearings came up with over twenty-one different proposals to reduce leverage in corporations.\textsuperscript{349} Most proposals fit into four categories. The first type of proposal seeks to limit the leverage of corporations by limiting the interest deduction for corporations.\textsuperscript{350} The second type would set required debt equity ratios and impose tax penalties on corporations that exceeded the ratio.\textsuperscript{351} The third type would provide tax penalties on certain types of financial instruments such as junk bonds.\textsuperscript{352} The fourth type of proposal equalizes the taxation of debt and equity.

Limitations on interest deductions, including limits on high-yield, high-risk bonds, penalize American corporations. Limits on interest deductions could deny needed capital to start-up companies or other companies who invest heavily in research and depend heavily on debt.\textsuperscript{353} Limits on "junk bonds" and other high-risk, high-yield instruments

\begin{itemize}
\item \textsuperscript{347} See supra text accompanying notes 70-71.
\item \textsuperscript{348} See, e.g., Loewenstein, supra note 341, at 80.
\item \textsuperscript{349} Panel Issues Tax Options for LBOs, Cong. Q., Apr. 15, 1989, at 807.
\item \textsuperscript{350} Some of these proposals included: "deny the corporate interest deduction for debt incurred to finance purchases of 20% or more of a company's stock in a hostile takeover"; "deny the interest deduction for debt incurred to finance mergers that are not in the public interest, as determined by such factors as job loss and decline in the local tax base"; "deny the interest deduction for high-yield, high risk 'junk bonds'" above a certain limit; "repeal the corporate interest deduction and instead allow a credit to shareholders for the corporate taxes paid on earnings that are distributed as dividends." Id.
\item \textsuperscript{351} Some of the proposals included: "deny as much as 50% of a company's interest deductions for transactions that change its ratio of debt to equity to an undesirable level," "limit the interest deduction for transactions in which a corporation's net interest payments exceed a set percentage of its taxable income." Id.
\item \textsuperscript{352} For example, "deny the interest deduction for high-yield, high-risk 'junk bonds' above a limit, such as $50 million." Id.
\item \textsuperscript{353} See Tax Panels, supra note 303, at 118. Limits on interest deductions also hurt American corporations in relation to foreign competitors who would have a cheaper cost of capital. Id.; Hale, How to Lower the Leverage Boom, Wall St. J., Nov. 29, 1988, at A22, col. 3; Saunders, supra note 308, at 195.
\end{itemize}
likewise penalized younger or riskier companies that cannot get prime rates when borrowing.\(^{354}\) Furthermore, limitations on riskier debt instruments may not have any effect. While junk bonds have been influential in facilitating large transactions, overall they compose only a small amount of total debt in change of control transactions.\(^{355}\)

Set debt-equity ratios would likewise retard American industry and create expensive administrative burdens.\(^{356}\) There is no feasible method whereby the government could discern the "correct" debt-equity ratio for a particular industry, nor is there any method to account for variations in particular industries' markets and the credit markets themselves.\(^ {357}\) Any required debt-equity ratio would simply create distortions in credit flows and impede the efficient allocation of credit.\(^ {358}\)

The answer to reducing leverage in American corporations is easy: eliminate the double taxation of dividends.\(^ {359}\) The problem is the large loss of federal revenue if such a proposal is passed.\(^ {360}\) To be successful, such a proposal would have to be revenue neutral and make up the proposed losses by increasing the corporate tax rate.

There have been numerous proposals to integrate the taxation of corporate and personal income taxes.\(^ {361}\) Proposals have included elimination of the corporate tax altogether,\(^ {362}\) excluding dividends from taxable

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354. Hostile Takeovers, supra note 12, at 18 (Statement of Michael Bradley).
355. An SEC study of 272 successful cash tender offers that took place between 1981 and 1985 found that bank borrowing provided 78.6%, new debt issues 0.3%, internal funds 18.3%, and equity 2.8% of the average financing from 1981 to 1984. However, for 1985, the SEC found that on average, bank financing provided 77.6%, equity 2%, internal funds 6.8%, and new debt issues 13.6% of the tender offer financing. Junk bonds were used more in hostile takeovers (25%) and also in bigger deals (37%), but only furnished 6% of the financing for friendly takeovers. SEC Staff Says Junk Bonds Being Used More Frequently to Finance Takeovers, 18 Sec. Reg. & L. Rep. (BNA) No. 26, at 937 (June 27, 1986).
356. Corporate Takeovers, supra note 9, at 63-64. Proposals usually entail setting up an industry-by-industry schedule of acceptable ranges for debt-equity ratios and eliminating the interest deduction for corporations whose debt exceeds these ratios. See Leveraged Buyouts, supra note 304, at 37.
357. Id.
358. Hostile Takeovers, supra note 12, at 63-64 (Statement of Preston Martin, Vice-Chairman of the Federal Reserve).
359. See, e.g., LBO's and Corporate Takeovers, supra note 301, at 132 (Statement of Alan Greenspan).
360. The price of even a small deduction for corporate dividend payments would be tremendous. In 1985, when the Reagan Administration proposed a 10% deduction, the estimated cost was $7 billion a year. Tax Panels, supra note 303, at 118. See also Bentsen Proposes Limit on Carryback Tax Refunds from LBOs, Sec. Reg. & L. Rep. (BNA) No. 32, at 1220 (Aug. 11, 1989).
361. See generally McLure, supra note 309, at 549-61.
362. This method may be the simplest, but it is impossible considering current federal revenue needs.
income, treating corporations like partnerships, a dividends-received exclusion, a dividends-received credit, and a dividends-paid deduction for corporations. The best proposal in terms of fairness, least distortion to the tax structure, ease of administration, cost, and the ability to capture income, is the dividends-received credit for individuals.

The dividends-received credit would distribute tax credits to shareholders based on a standard corporate credit that would approximate the amount of taxes a particular corporation paid on distributed dividends. Any variance between the corporate and individual rates could then be adjusted at the corporate level. The dividends-received credit system would transform the corporate income tax into a tax on retained earnings, encouraging corporate managers to distribute retained earnings that are not creating profits for the firm. Combined with the present preference toward elimination of the capital gains tax and higher corporate over individual tax rates, this proposal would resemble earlier model tax integration proposals and eliminate earlier criticisms of other piecemeal integration proposals.

The complete mechanics of any corporate tax integration cannot be adequately discussed in this paper, but there is abundant literature regarding the mechanics of the dividends-received credit in both the academic area and in the two separate proposals by the Reagan and Carter administrations.

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363. See Peel, supra note 307, at 13-14.
365. Id. at 552-53.
366. Id. at 553-54.
367. Id. at 554-55.
368. Birnbaum & Duke, Tax Writers Move on Plan to Curb LBO's, Wall St. J., Jan. 26, 1989 at 2, Col. 2. A dividend-received credit for corporations would create problems because dividend payments to tax-exempt entities and foreigners would require special treatment. There are arguments, however, that this is the fairest system, and provides the corporation with the greatest incentive to distribute profits. The dividend-received credit proposed by the author is a modified system, similar to the Canadian Carter Commission's proposal. Earlier criticisms of the dividend-received credit have been resolved by the 1986 Tax Reform. See McLure, supra note 309, at 558-61.
371. The Carter Commission was a comprehensive study of individual and corporate tax rates conducted in Canada. See McLure, supra note 309, at 569-74. See, e.g., Warren, supra note 312, at 771-72.
372. See, e.g., McLure, supra note 309, at 570-74; Peel, supra note 307, at 11-12; Zolt, supra note 306, at 850-52; Warren, supra note 312, at 773-74.
Overall, the proposal should provide two benefits. First, the equalization in tax rates should reduce the market demand for debt-financed companies, therefore lowering the debt/equity ratios and corresponding risk that the corporation could fail, protecting against economic dislocations of employees and other stakeholders. Second, the equalization of debt and equity would further reduce management agency problems by reducing possible rationales for retaining earnings and making it more expensive, because of increased corporate taxes, to not distribute corporate earnings.

IX. Conclusion

The offered rationale behind anti-takeover statutes is the protection of shareholders and stakeholders. No evidence supports that anti-takeover statutes help either group, and significant evidence shows that the statutes provide no assistance to either. Anti-takeover statutes have been implemented almost entirely by corporate management, and compounded by the unique American federal political structure of corporate law. Management is the one group that needs no protection, and these anti-takeover statutes have created further disincentives for corporate efficiency, fairness, and responsibility.

The drafters of the Constitution anticipated the economic warfare and political externalities created by a federal system and included the Commerce Clause in our Constitution.374 Anti-takeover statutes are exactly the kind of political and economic externality the Commerce Clause was drafted to prevent.375 No state has the power or the incentives to resist the anti-takeover movement, "with the result that interstate economic competition [has been] conducted more through political processes than through the marketplace."376 Only federal legislation can overcome the states' parochial interests and restore balance and fairness to anti-takeover statutes while protecting the United States' overall economic health.

Although there are still many uncertainties in the corporate takeover area, Congress can no longer afford to sit back and watch. The four proposals offered by this paper are not radical, but together they can help restore some balance to American corporate law. The shareholder control proposals simply recognize management's inherent conflicts with the shareholders' interest and mitigate these conflicts through shareholder approval. The shareholder tender vote proposal ensures the states' and management's interests in protecting shareholders from coercive offers,
and reduces any possible conflicts of interest created under current law by management "protection." The last proposal, reducing the double taxation on dividends, recognizes the increase in risk for stakeholders, employees, communities, and suppliers of corporations as a result of the increase in debt. This proposal mitigates against this debt not by penalizing the corporations, but by encouraging the use of equity. Together, these proposals work to improve economic efficiency and reduce shareholder-management conflicts of interest without creating additional regulatory burdens on the corporation or on the government.

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