Takeover Regulation after the 'Convergence' of Corporate Law

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1. *Introduction*

Recent scholarship on corporate governance, cutting across law, finance, government and economics; has centred around whether or not corporate law is converging toward one dominant model within a competitive global capital market. There seems little doubt about the growing globalization of mergers and acquisitions. In 1985, for example, the great majority of takeovers included at least one American party, a percentage that by 1999 had fallen by more than half to 40 per cent and was below the number of takeovers involving at least one European party.[1] Other factors support the growth of globalization: IPOs have become common across Europe, including civil law systems;[2] and stock markets have grown dramatically outside the United States and the United Kingdom.

The seminal work of La Porta, Lopez-de Silanes, Shliefer, & Vishny[3] ('LLS&V') presents a world divided between dispersed and concentrated ownership structures within business entities. Beyond this descriptive structure, LLS&V suggest that the primacy of either system turns on the legal system's protection of minority shareholders, that the strength of capital markets correlates with legal systems and that common law systems consistently outperform civil law systems.[4] Much of current academic scholarship suggests a convergence in this competition toward the dispersed ownership model with its reliance on strong securities markets, extensive disclosure and the use of the market for corporate control to discipline management. Often this is linked to the recognition of shareholder primacy in corporate governance. Hansmann & Kraakman, for example, assert, '[t]here is no longer any serious competitor to the view that corporate law should principally strive to increase long-term shareholder value'[5] and they conclude 'the pressure for moving toward the standard model is likely to grow irresistibly strong in the relatively near future.'[6]

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1 Bruce Stokes, 'The M&A Game's Global Field' (2000) 32 *Nat'l J* 2290.

2 See John C Coffee, Jr, 'The Rise of Dispersed Ownership: The Roles of Law and the State in the Separation of Ownership and Control' (2001) 111 *Yale LJ* 1 at 18.

3 Rafael La Porta et al, 'Corporate Ownership Around the World' (1999) 54 *J Fin* 471.

4 Rafael La Porta et al, 'Law and Finance' (1998) 106 *J Pol Econ* 1113; Rafael La Porta et al, 'Legal Determinants of External Finance' (1997) 52 *J Fin* 1131.

5 Henry Hansmann & Reinier Kraakman, 'The End of History in Corporate Law' (2001) 89 *Geo LJ* 439 (hereinafter 'End of Law').

6 Id at 462.

Not surprisingly, there is not a consensus on convergence. Lucian Bebchuk has made the case for continuation of concentrated ownership; his 'rent protection' model suggests concentrated ownership can still dominate dispersed ownership.[7] Margaret Blair and Lynn Stout have argued against shareholder primacy.[8] Mark Roe has presented a political story for the growth of strong securities markets somewhat different than LLS&V; he suggests that social democracies pressure managers to forgo profit maximization in order to promote high employment.[9] More to the point of this article, John Coffee has chronicled that even within the common law market-centred shareholder primacy culture there are divergent methods of responding to takeovers.[10]

Against the backdrop of such global discussions, this article has a more limited goal: to focus on the role for takeover regulation in a dispersed ownership system, a reach designed to be broad enough to encompass the American and Australian legal systems as well as the United Kingdom. Takeover regulation necessarily weaves two relationships — first, the interaction between the bidder company and the shareholders of the target and second, a separate but necessarily overlapping relationship between the shareholders of the target and their own management. Poison pills, for example, impact both relationships — they prevent a bidder from coercing target shareholders at the same time that they empower managers to prefer their view of the corporation over that of the shareholders. My focus is on the second relationship and the different methods visible in national legal systems to address this problem. The American system, illustrated by Delaware's law, relies on courts and judicial enforcement of fiduciary duty to decide when managers have overstepped their bounds in imposing defensive tactics. Other dispersed ownership jurisdictions rely on self-regulatory organizations or governmental bodies to limit director defensive tactics in a way that necessarily empowers collective shareholder action. My preference is for a greater reliance on shareholder self-help in resolving disputes about the extent of takeover regulation.

2. *The Challenge of Takeover Regulation*

Takeover regulation occupies a central place in the dispersed ownership/ shareholder primacy view of convergent corporate law. Shliefer and Vishny have said, for example, that 'takeovers are widely interpreted as the critical corporate governance mechanism in the United States, without which managerial discretion cannot be effectively controlled.'[11] This management monitoring view is the most visible purpose ascribed to takeovers and indeed is the most dominant today, but

7 Lucian Bebchuk, 'A Rent-Protection Theory of Corporate Ownership and Control' 1999 (Nat'l Bureau of Econ. Research, Working Paper #7203): <http://www.nber.org/papers/7203>.

8 Margaret M Blair & Lynn A Stout, 'A Team Production Theory of Corporate Law' (1999) 85 *Va LR* 247. Reprinted in (1999) 24 *J Corp Law* 751.

9 Mark J Roe, 'Political Preconditions to Separating Ownership from Control' (2000) 53 *Stan LR* 539.

10 Above n2.

11 Andrei Shliefer & Robert Vishny, 'A Survey of Corporate Governance' (1997) 52 *J Fin* 737 at 756.

any discussion of takeover regulation should include a second purpose, to protect existing shareholders and their companies against corporate raiders. For the most part, this second purpose has been achieved in the various legal systems where takeovers are common, so that controlling managerial discretion dominates our discussion. But we should not overlook this other purpose. A poison pill, for example, is a defensive tactic that, at its origin, appeared as a means to protect shareholders against raiders and has morphed to have a long life as a principal means for directors to prevent shareholders from accepting hostile tender offers that the directors do not like.

A. Protecting Against Corporate Raiders

The possibility that an acquiring shareholder would expropriate the wealth of the current shareholder base was a common concern that motivated United States takeover legislation found in the *Williams Act* and related legislation in other countries, but its history is much older. Carl Icahn and Boone Pickens of the late 20th Century follow in the steps of Jay Gould of the 19th Century. Gould, for example, sought to gain control of the Albany & Susquehana Railroad in 1869[12] and elsewhere sought to conduct a proxy fight after buying substantial shares of stocks.[13] John Coffee, in a recent article, has traced how investment bankers of the late 19th Century, such as J Pierpont Morgan, occupied a role as a 'protector of the public shareholder from attempts by speculators to steal a firm's control premium.'[14]

The 20th Century brought other means of protecting shareholders in such a situation. The *Williams Act*, passed by the US Congress in 1968, sought to regulate the conduct of hostile bidders so that shareholders could not be forced into hasty ill-advised decisions because of a lack of information.[15] The statute mandated substantial disclosure about the bidder and the terms of the offer; in addition, the statute required a minimum time for tendering shareholders to change their mind, a pro rata requirement for dividing the premium if more shares were tendered than the bidder was willing to buy, and a provision guaranteeing all shareholders any additional premium that the bidder may offer later. The goal was to counter 'first come, first served' tactics by bidders seeking to rush shareholders into a decision. In the wake of front-end loaded, two tiered coercive offers such as Boone Pickens' offer for Unocal in 1985 and the company's response,[16] additional SEC regulation required the best price be paid to all shareholders.[17]

12 Ron Chernow, *The House of Morgan: An American Banking Dynasty and the Rise of Modern Finance* (1990) at 31–32.

13 Maury Klein, *The Life and Legend of Jay Gould* (1986) at 197 et seq (describing Gould stock purchases, proxy fights and reselling to the corporation that today would be termed 'greenmail').

14 Above n2 at 31.

15 Pub L # 90–4393, 82 Stat 454 (1968) codified as amended at 15 USC §§78m(d)–(f) and 78n(d)–(f).

16 *Unocal Corp v Mesa Petroleum Corp* 493 A 2d 946 (Del 1985).

17 Securities & Exchange Commission Rule 14d–10, 17 CFR §§240.14d–10.

In Australia the Eggleston principles, that have informed Australian takeover law since the late 1960s, focus more on possible mistreatment of shareholders by bidders. Four of the specific needs cited by the Committee — identity of the bidder, reasonable time to consider the proposal, information necessary for shareholders to form a judgment, and equal opportunity to participate[18] — primarily address the bidder-shareholder relationship. Australia and the United Kingdom go beyond the United States in protecting shareholders from unequal or unfair bids by requiring mandatory bids; an acquirer who obtains more than 20 per cent in Australia[19] or 30 per cent in the United Kingdom is required to make an equal offer for every share of stock.[20] In the United States, it is possible for a bidder to purchase a control block from a private party without making an offer to other shareholders[21] and probably without any sharing of a control premium paid to the departing control group.[22]

In the United States, concern for regulating the bidder's relationship to the target shareholders has mostly been left to federal law and state law is the primary regulator of the relationship between the shareholders and their own directors. Yet there is a prominent part of Delaware state corporate law that can best be explained as an effort to protect shareholders from bidder overreaching. This is the *Revlon* duty, an enhanced fiduciary duty that requires the board of a target company to convert into an auctioneer and to get the best price for shareholders when the company is up for sale.[23] This is ostensibly a fiduciary duty owed by target directors to their shareholders, but its impact on the bidder/target shareholder relationship derives from the unusual way this duty has been interpreted by Delaware decisions following *Revlon*. First, much of the sting of the directors' obligation to affirmatively seek out the best price has been removed by the *Time Warner* decision in which the Delaware court declined to apply the *Revlon* duty to friendly stock for stock business combinations like the Time-Warner deal; in that transaction Time directors were permitted to take actions to combine with Warner without shareholder approval and leaving Time shareholders with shares trading at a price less than half of what Paramount was offering.[24] But the subsequent case involving Paramount as a target rather than a bidder, made clear that the enhanced

18 See eg, Explanatory Memorandum to the Corporate Law Economic Reform Program Bill Regulation Impact Statement at 6–10. Justin Mannolini, *Convergence or Divergence: Is There a Role for the Eggleston Principles in a Global M&A Environment,* (2002) 24 SLR 336 concludes, 'This 'general principle' provides the definitive statement of what has subsequently come to be known in Australia as the Eggleston Principles.'

19 *Corporations Act* (2001) s611.

20 City Code on Takeovers and Mergers, Rule 9.

21 Section 14d, added by the *Williams Act,* is triggered only by a tender offer, which, as defined, does not include private purchases.

22 There are examples where courts have required a sharing of a control premium but this is not the general rule. See for example, *Perlman v Feldmann* 219 F 2d 173 (2d Cir 1955) and *Zetlin v Hanson* 397 NE 2d 387 at 388 (NY 1979) 'absent looting of corporate assets, conversion of a corporate opportunity, fraud or other acts of bad faith, a controlling shareholder is free to sell, and a purchaser free to buy, that controlling interest at a premium price'.

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

24 *Paramount Communications Inc v Time Inc* 571 A 2d 1140 (Del 1989).

Revlon duty to seek the best price did apply to a friendly stock for stock merger if the friendly partner has a controlling shareholder. In that case the control of the merged company would not be in the hands of the combined shareholder group dispersed through the market, but rather in the controlling shareholder of the merger partner, such that the shareholders of the other company will have surrendered their chance to obtain a control premium.[25] How can one best explain that difference? It is the fact that the bidder, procured by the board, will be able to obtain shares without paying a control premium, a concern that parallels the long-standing concern in the bidder/shareholder relationship described above.

All in all, this risk from a predatory bidder seems substantially less than thirty years ago and seems to be controlled across the different legal systems in which takeovers are common. Thus, we realistically can focus our attention on the other dimension, that of target managers and their shareholders.

B. Target Shareholders Concern about their Managers

Concern over target management has been the central issue in corporate law for most of the last century. This single-minded focus on managerial opportunism has characterized corporate law since the writing of Berle and Means.[26] Corporate law provides a business form that intentionally centralizes almost all corporate power in the board of directors.[27] Such centralization promotes efficiency and facilitates an enterprise that can easily adapt to changing circumstances.[28] Law then constrains directors' use of this centralized power and with it, their ability to control other people's money, sometimes combining with non-legal constraints available from contracts, market behaviour, and norms.

In contrast, the role for shareholders is limited. They really only do three things — vote, sell or sue — and each of those is done within a very limited range[29] Shareholders vote on directors, usually at an annual meeting; they also get to vote on merger or certain other fundamental corporate changes, but only after the board of directors has proposed them.[30] The practical result has been that voting traditionally provided weak practical limits on centralized director power. Selling shares as an alternative to voting has been an option, provided that there was a market for the company's shares, but this was typically done in individual

25 *Paramount Communications Inc v QVC Network Inc* 637 A 2d 34 (Del 1993).

26 Above n2, referring to A Berle & G Means, *The Corporation and Private Property* (1932).

27 Del GCL tit 8 § 141; *Mod Bus Corp Act* § 8.01.

28 See Charles R T O'Kelley & Robert B Thompson, *Corporations and Other Business Associations* (3rd ed, 1999) at 154.

29 Robert B Thompson, 'Preemption and Federalism in Corporate Governance: Protecting Shareholder Rights to Vote, Sell and Sue' (1999) 62 *Law & Contemp Prob* 213 at 216.

30 For power of shareholders to vote on the election of directors, see Del GCL tit 8 § 211(b); *Mod Bus Corp Act* s8.03, 8.08. For certain 'fundamental' transactions, see Del GCL tit 8 § 242(b); *Mod Bus Corp Act* § 10.03 (amending the articles of incorporation); Del GCL tit. 8 § 251(c); *Mod Bus Corp Act* § 11.03 (approving mergers); Del GCL tit 8 § 271; *Mod Bus Corp Act* § 12.02 (approving sales of assets not in the ordinary course of business); and Del GCL tit 8 § 275(b); *Mod Bus Corp Act* § 14.02 (approving dissolution).

transactions.[31] The dominant pattern of passive, dispersed shareholders in most corporations made the collective use of this selling power difficult until the frantic takeover activity during the early 1980s — fueled by the use of 'junk bond' financing — transformed collective selling of shares into a real threat to director control.[32]

As a result, litigation, this third area of shareholder action, became the most visible check on centralized board power for most of the 20th Century. This necessarily means that courts are the key players, more than market constraints or contracts or other private ordering of the parties themselves, usually by means of courts defining fiduciary duties after the fact. 'Indeed, the key regulatory move of the 1980s in corporate takeovers was the rise of fiduciary duties as the primary means to sort out legal claims regarding the ability of directors to limit or thwart the collective use of shareholder selling. Fiduciary duty held centre stage, overpowering possible alternatives such as direct shareholder action to vote or sell shares, the regulatory provisions of the *Williams Act*, or the unfettered dictates of the market.'[33]

The practice in the United States, as illustrated by Delaware, has been to impose different levels of judicial review depending on the perceived possibility of management opportunism. The default rule when a challenge to corporate action is made is one of judicial deference to directors by use of the business judgment rule.[34] In such a setting, there is a presumption of the propriety of the decision which the court will observe unless the challenging party can present evidence of lack of sufficient investigation, lack of good faith, a conflict of interest, or perhaps, on rare occasions, a substantive decision that is so unusual as to be seen as not rational. The conflict of interest prong is practically the only criterion that results in any move of a judge away from this position of deference. When there is a conflict, the court is then willing to review the transaction requiring the defendant to show entire fairness, a much more onerous standard of review.[35]

The takeover contests of the 1980s strained this bifurcated level of judicial review of either deference under the business judgment rule or a seemingly intense judicial review for fairness if there was a conflict of interest. Director-instituted defensive tactics did not present express conflict of interests as in traditional cases

31 A shareholder's right to sell is not expressly covered by corporations statute but is rather part of common law property rights. This right is implicit in statutory provisions authorising the restriction on the transfer of shares. Del GCL tit 8 § 202; *Mod Bus Corp Act* § 6.27.

32 See John C Coates IV, 'Measuring the Domain of Mediating Hierarchy: How Contestable Are US Public Corporations?' (1999) 24 *J Corp L* 837 at 850 ('[F]rom the late 1950s, the tender offer mechanism has allowed bidders to package two relatively weak shareholder powers – the right to sell their shares and the right to vote for directors – into a powerful form of shareholder "voice"').

33 Robert B Thompson & D Gordon Smith, 'Toward a New Theory of the Shareholder Role: "Sacred Space" in Corporate Takeovers' (2001) 80 *Tex LR* 261 at 277 (footnotes omitted).

34 See eg, *Orman v Cullman* 794 A 2d 5 19–20 (Del 2001) (describing business judgment rule).

35 See eg, *Emerald Partners v Berlin* 787 A 2d 85 (Del 2001).

where the directors caused the corporation to enter into unfavourable transactions in which the interested director or a relative was on the other side. Prior to 1985 courts faced with such a claim would often find no conflict of interest and apply the deferential review of the traditional business judgment rule.[36] In *Unocal v Mesa Petroleum*, the Delaware Supreme Court's 1985 takeover decision that still defines the scope of American judicial review in a takeover situation, the court clearly expressed a desire to have judicial review beyond the deference of the business judgment rule based on the 'omnipresent specter' of conflict in a takeover defence, even though the conflict falls short of the express conflict in a self-dealing transaction.[37] At the same time, the court made clear that it was not buying into a then current view advanced by well known law and economics academics Frank Easterbrook and Dan Fischel that the law should leave the takeovers market free to monitor directors by requiring that directors be passive in the face of hostile takeovers.[38] The court expressly rejected the passivity principle and reaffirmed the ability of directors to take defensive action acting as representatives of the shareholders, even if the directors are not completely free of conflicts.[39]

Thus American law, in form, illustrates an intermediate standard of judicial review. There is now a 'threshold' test applied before the court gets to the deference of the business judgment rule. Instead of the plaintiff immediately having to show an absence of good faith, a lack of reasonable investigation, the presence of a conflict of interest, or a lack of substantive rationality, the plaintiff can now invoke the presence of a defensive tactic and thereby require the

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36 See eg, *Johnson v Trueblood* 629 F 2d 287 (3d Cir 1980); *Panter v Marshall Field & Co* 646 F 2d 271 (7th Cir) cert den 454 US 1092 (1981); *Treadway Co v Care Corp* 638 F 2d 357 (2d Cir 1980).

37 493 A 2d 946, 954 (Del 1985) ('Because of the omnipresent specter that a board may be acting primarily in its own interest, rather than those of the corporation and its shareholders, there is an enhanced fiduciary duty which calls for judicial examination at the threshold before the protection of the business judgment rule may be conferred.') *Unocal* does mention the ability of the shareholders to vote out the directors but it does not develop that point.

38 Frank H Easterbrook & Daniel R Fischel, 'The Proper Role of Target's Management in Responding to a Tender Offer' (1981) 94 *Harv LR* 1161 at 1194–1195. See also Ronald J Gilson, 'A Structural Approach to Corporations: The Case Against Defensive Tactics in Tender Offers' (1981) 33 *Stan LR* 819 (hereinafter cited as 'Gilson, Structural Approach'); Lucian Bebchuk, 'The Case for Facilitating Competing Tender Offers' (1982) 95 *Harv LR* 1029; Frank H Easterbrook & Daniel R Fischel, 'Auctions and Sunk Costs in Tender Offers' (1982) 35 *Stan LR* 1; Lucian Bebchuk, 'The Case for Facilitating Competing Tender Offers: A Reply and Extension' (1982) 35 *Stan LR* 23. In reference to these articles Ronald Gilson noted that there was consensus around one important point: 'that there is no coherent justification for allowing target management to engage in defensive tactics that may deprive shareholders of the opportunity to tender their shares.' Ronald J Gilson, 'Seeking Competitive Bids Versus Pure Passivity in Tender Offer Defense' (1982) 35 *Stan LR* 51.

39 493 A 2d at 955 ('It has been suggested that a board's response to a takeover threat should be a passive one, Easterbrook & Fischel, 35 *Bus Law* at 1750. However, that clearly is not the law in Delaware').

defendant to now show both (1) that the directors reasonably perceived a threat to the corporation, and (2) that the directors' defensive responses were proportional to that threat.[40]

The decision in *Unocal* seemed to suggest a greater willingness of Delaware courts to insert themselves into hotly contested battles for corporate control.[41] Delaware Chancellor William Allen called *Unocal* 'the most innovative and promising case in our recent corporation law.'[42] But subsequent events belie the promise of those early statements. A recent survey that Gordon Smith and I did of all Delaware cases applying the *Unocal* framework shows that *Unocal* almost never results in judicial invalidation of takeover defences.[43] We also found a dramatic decrease in the number of *Unocal* claims decided in the Delaware courts. We concluded that *Unocal* as currently structured does not provoke judicial scrutiny of director defensive tactics that is at all 'enhanced' as compared with the review provided under the traditional business judgment standard.

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40 If the defendant carries this burden, the burden theoretically shifts to the plaintiff and the business judgment rule engages. As noted by Vice-Chancellor Strine in *In re Gaylord Container Corp Shareholders Litigation*, 753 A 2d 474 (Del Ch 2000), however: 'It is not at all apparent how a plaintiff could meet this burden in a circumstance where the board has met its burden under *Unocal*. To the extent that the plaintiff has persuasive evidence of disloyalty (for example, that the board acted in a self-interested or bad-faith fashion), this would fatally undercut the board's *Unocal* showing. Similarly, it is hard to see how a plaintiff could rebut the presumption of the business judgment rule by demonstrating that the board acted in a grossly careless manner in a circumstance where the board had demonstrated that it had acted reasonably and proportionately. Least of all could a plaintiff show that the board's actions lacked a rational business purpose in a context where the board had already demonstrated that those actions were reasonable, ie, rational.' (753 A 2d 462 at 476, n46.) In the converse situation, where the board fails to carry its initial burdens, the board is still allowed to proceed with an attempt to show the entire fairness of the transaction. *Unitrin*, 651 A 2d at 1377 n18. This, too, seems fairly implausible. *See Gaylord*, 753 A 2d at 476. All of this awkwardness surrounding *Unocal* has prompted Vice-Chancellor Strine to call for a reformulation of the *Unocal* standard: '[O]ne wonders whether it might be clearer to reformulate the *Unocal* test so that it incorporates the concept of due deference to board judgment articulated in *Unocal* and *Unitrin* without the confusing burden-shifting required to tie everything to the business judgment and entire fairness standards of review.... That is, if *Unocal* is the standard of review in a case, perhaps it ought to be the exclusive standard of review. One tentative approach to such a formulation might be to simply place the burden on the plaintiffs to prove that the directors' defensive actions were a disproportionate and unreasonable or an improperly motivated response to the threats faced by the corporation, based on all of the circumstances (which would include the interests of and care used by the directors who made the decision). Such a test could incorporate the requirement that directors' actions be sustained if they are not draconian and are within the range of reasonable defensive responses. This test would give plaintiffs an opportunity to attack the board's decision directly (a chance plaintiffs do not get in the normal case) and yet preserve for boards a realm of reasonable discretion protected from judicial intrusion.' (753 A 2d at 476 at n46).

41 The case was discussed at length in major news and financial publications. See eg, Stephen Koepp, 'A Shark Loses Some of His Teeth' *Time* (6 June 1985) at 58; James R Norman, 'At Unocal, A Victory "Without the Champagne"' *Business Week* (3 June 1985) at 41; Frederick Rose et al, 'Battle of the Titans: How T Boone Pickens Finally Met His Match: Unocal's Fred Hartley' *The Wall Street Journal* (24 May 1985).

42 *City Capital Assoc LP v Interco Inc* 551 A 2d 787 at 796 (Del Ch 1988).

43 Above n33.

The practical impact of *Unocal* was to provide plaintiffs three separate points at which to change the course of litigation and avoid the judicial deference that eventually will lead to a loss. But none of those three ended up making much of a difference. First, putting the burden of proof on the defendant, apart from the substance of the standard, could have made a difference in outcome, but seems to have had no perceptible effect.[44] Of the two substantive prongs of the *Unocal* standard, the first requires defendants to show that 'they had reasonable grounds for believing there was a danger to corporate policy and effectiveness.' How do they do this? The court in *Unocal* said this burden of proof was 'satisfied by a showing of good faith and reasonable investigation.'[45] In other words, the parties would be debating the same issues that would arise under the business judgment rule; the defendant does have the burden of proof but reasonable investigation is something for which defendants and their lawyers can easily provide a paper trail. The result has been that anything seems to satisfy the showing of a threat, including an assertion that shareholders misperceive the value of the company.

The second substantive prong of the *Unocal* standard has a different appearance. Proportionality seems to require a substantive judgment by the court, something completely missing from most cases decided under the business judgment rule.[46] By the time of the court's decision in *Unitrin* in 1995, the limits of proportionality were all too apparent.[47] The court based proportionality on whether the defensive tactics were coercive or preclusive. Those terms were defined to include only the most dramatic defensive tactics that completely shut out shareholders. Defensive tactics that effectively excluded shareholders from making a takeover decision but left a formal channel open perhaps to remove directors by a proxy vote over a two year period were to be evaluated under a 'range of reasonableness' standard, which the court defined in terms that echoed the traditional deference applied under the business judgment rule.

'The *ratio decidendi* of the 'range of reasonableness' standard is a need of the board of directors for latitude in discharging its fiduciary duties to the corporation and its shareholders when defending against perceived threats. The concomitant requirement is for judicial restraint. Consequently, if the board of directors'

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44 Gilson, *Structural Approach*, above n38.

45 506 A 2d at 180.

46 In his recent analysis of the relationship between *Unocal* and the business judgment rule, Vice-Chancellor Strine observed: 'In itself, the *Unocal* test is a straightforward analysis of whether what a board did was reasonable. But *Unocal*'s purpose and application have been cloaked in a larger, rather ill-fitting garment. Once the court applies the *Unocal* test, its job is, as a technical matter, not over. If, upon applying *Unocal*, the court finds that the defendants have met their burden of demonstrating the substantive reasonableness of their actions, the court must then go on to apply the normal review appropriate in cases that do not implicate *Unocal*. In essence, the court must reimpose on the plaintiffs the burden of showing 'by a preponderance of the evidence' that the business judgment rule is inapplicable. Of course, the business judgment rule exists in large measure to prevent the business decisions of the board of directors from being judicially examined for their substantive reasonableness – an eventuality that has, in the *Unocal* context, already taken place.' (753 A 2d at 474–475).

47 *Unitrin Inc v Am Gen Corp* 651 A.2d 1361 (Del 1995).

defensive response is not draconian (preclusive or coercive) and is within a 'range of reasonableness,' a court must not substitute its judgment for the board's.'[48]

The impotence of the *Unocal* approach can be seen in its use in response to poison pills defensive tactics.[49] Two new variations of poison pills have come before the court in recent years, the 'dead hand' poison pill and the 'slow hand' poison pill. Both reflect clever lawyer's efforts to further defend the corporate bastion against attack. While the poison pill is particularly effective so long as it remains in effect, it remains vulnerable because it can be redeemed by the board of directors. Thus, if insurgents are successful in a proxy fight to replace the current board, the protection of the pill disappears. To extend the pill's coverage to such a setting some companies instituted a dead hand pill that could only be redeemed by the board that instituted the pill or directors appointed by those directors. Directors elected by the votes of an insurgent would not be so empowered. A slow hand pill worked somewhat differently. No board of directors, whether elected by the insurgents or by the hold-over shareholders could redeem a pill in the six months following the takeover. Both of these pills were struck down by the Delaware courts, but neither occurred under the *Unocal* test and the fiduciary duty that it relies on.[50]

A second area where the Delaware fiduciary duty test has proven problematical is in the use of deal protection devices such as a no shop, lock-up clauses and termination fees. Management of a target company is able to insert them into a friendly deal with a preferred bidder and raise the cost so substantially that any other bidder will be practically deterred. The result is to take the takeover decision out of the hands of the shareholders and place it in the hands of directors, raising again the question of managerial opportunism. Recall that Delaware ostensibly applies an intermediate test of some enhanced scrutiny to defensive tactics taken in a hostile takeover setting so that one might except that such intermediate scrutiny would apply to deal protection devices. Certainly when such lock-ups have been implemented in a setting where the *Revlon* duty has been held to apply, these devices have been struck down by the Delaware court. But recall that *Revlon* does not apply to mergers in which the board can claim to be following a long-term business plan as in Time and Warner, so long as the combined deal did not have a

48 Id at 1388.

49 The poison pill is a defensive tactic by which the board causes the corporation to issue to all existing shareholders new rights that upon triggering by the actions of an unwanted bidder to take control of the target, will entitle then current shareholders, but not the bidder, to purchase additional shares usually at half price. The dilution effect usually exacts a high enough price to deter the bid, or at least push the bidder into the arms of the target board, who pursuant to the provisions of the rights plan can redeem the rights for a nominal fee. The result is to return the board to a gatekeeper function as to corporate takeovers. In *Moran v Household International Finance, Inc*, 500 A.2d 1346 (Del 1985), the Delaware Supreme Court upheld the poison pill against a claim that it was not authorized by statute and a claim that it violated directors fiduciary duty. The court did say that a board's subsequent decision not to redeem the poison pill in the midst of a hostile bid could be reviewed under the *Unocal* standard.

50 See *Quickturn Design Systems Inc v Shapiro* 721 A 2d 1281 (Del 1998); *Carmody v Toll Brothers* 723 A.2d 1180 (Del Ch. 1998).

controlling shareholder that would preclude the shareholders from ever getting a control premium. Even though *Revlon* did not apply in such a setting, the Delaware structure suggests that *Unocal* would apply with its enhanced scrutiny. However some sophisticated Delaware practitioners have suggested that such deal protection devices inserted into friendly deals before anything has happened to trigger a defensive tactics should be governed by the very deferential standard of the business judgment rule.[51] Delaware Vice-Chancellor Leo Strine, one of the ten Delaware judges who make most of American corporate law, warns against such reasoning of aggressive practitioners: 'From experience can practitioners really look themselves in the mirror and tell themselves that the typical stock-for stock merger does not raise the sorts of concern that led to the creation of the Unocal standard?'[52]

But the Vice-Chancellor may put too much trust in *Unocal*, which, as discussed above, almost always today does not disturb director decisions about defensive tactics. The hope for American law is if *Unocal* is interpreted not the way it was in *Unitrin*, where defensive tactics were permitted to defeat shareholder choice, but as Vice-Chancellor Strine himself has observed in writing outside the court. There he recognizes the wide berth given to directors. 'Well-motivated directors ought to have the right to present a strategic merger to their stockholders and to give the merger partner substantial contractual protection to induce them to contract...if all the board is asking is to go first and to require other bidders to await the outcome of an unfettered stockholder vote, it seems likely to get the opportunity.' But that deference is then balanced by a competing concern less often seen in the jurisprudence of the Delaware Supreme Court, 'At the same time, this emphasis on stockholder choice recognizes that a stock-for-stock merger agreement is not an ordinary contract within the sole power of the directors to consummate. Shareholders have the right to vote yes or no without being in essence compelled or coerced. Stockholders can legitimately expect that their directors will bring a merger proposal to a reasonably prompt vote so that the mere passage of time does not leave the board's preferred deal as the only viable corporate strategy.'[53] Combating the possibility of managerial opportunism requires that shareholders be able to insert an antidote against director-instituted defensive tactics that block their acceptance of a transaction that management does not prefer. Delaware law, at least as applied by the Delaware Supreme Court, does not leave sufficient room for this shareholder choice.

Jurisdictions outside the United States have developed somewhat different substantive rules for takeovers and an alternative forum to resolve challenges that arise in a takeovers context. The United Kingdom has been relying on voluntary codes of conduct in the takeover area since the 1950s, through the City Takeovers Code and then the Takeovers Panel.[54] In addition to requirements relating to

51 Paul K Rowe, *The Future of the 'Friendly Deal' in Delaware* (unpublished manuscript, Wachtell Lipton, 10 July 2000).

52 Leo E Strine, Jr, 'Categorical Confusion: Deal Protection Measures in Stock-for Stock Merger Agremeents' (2001) 56 *Bus Law* 919 at 931.

53 Id at 942.

disclosure and terms of the bid that are covered by the Williams Act in the United States, the City Code goes a good bit farther in terms of restricting defensive tactics that target companies may take. The General Principles state that if an offer has been made or is imminent, the target board cannot take action 'which could effectively result in any bona fide offer being frustrated or in the shareholders being denied the opportunity to decide on its merits.'[55]

Australia's recent changes relating to the Takeovers Panel suggest a move that will mark a greater contrast with the United States in terms of the forum within which conflicts about takeovers and defensive tactics are resolved.[56] Reconstituted as part of the Federal Government's Corporate Law and Economic Reform (CLERP) legislation in March 2000, the Panel has received positive reviews in its first two years.[57] The new law broadened the parties who might refer matters to the panel and it seeks to resolve takeover disputes quickly, informally and effectively.[58] This quasi-private system parallels what has been achieved by government in the United States where the Delaware courts have also been able to combine speed and substantive knowledge now offered by the Takeovers Panel. The majority of America's largest corporations are incorporated under the laws of Delaware so takeover disputes under corporate law are usually taken to its courts. All matters are originally heard by one of five judges who sit on the Delaware Court of Chancery, for whom corporate matters make up the bulk of their workload. These judges necessarily have achieved and are recognized for their expertise in corporate law. Any appeals are taken to the five member Delaware Supreme Court, who also have extensive experience in corporate law issues. Both courts are able to make quick decisions in the heat of a takeovers battle. Other American states have attempted to create special courts that could rival and take business way from Delaware, but have not been able to create a critical mass of casework and expertise in their judiciary on corporate law matters. Australia's takeovers panel, made up of practitioners in business and law and some judges and academics, has achieved notable expertise.[59] Its informality and speed provides substantial appeal in a business context.[60]

The substance of takeover regulation also differs somewhat under the Australian regime as compared to the United States. The question of termination

54 See Alexander Johnson, *The City Take-Over Code* (1980).

55 City Code on Takeovers and Mergers, General Principles.

56 Corporations Law §658D.

57 See eg, Brett Clegg, 'Takeovers Panel Earns its *Stripes*' *The Australian Financial Review* (27 February 2002) at S–3.

58 See id quoting Salomon Smith Barney co-head of corporate finance, Brett Wilson, 'I think sometimes it's probably slightly rough justice, but it's absolutely better than the previous regime. It's efficient, it's fast, and it's effective.'

59 See id, quoting Chris Mackay, Chief Executive of UBS Warburg, '... it provides greater certainty and a higher level of expertise than the previous court-based system which relied on Supreme Court judges around the country to review complex corporate matters and who generally did not have the day to day expertise of dealing with the issues.'

60 See id quoting Brian Wilson: 'A takeover situation is by nature a time-bound arrangement. [Getting it] 95 percent right in a few days [is] far preferable to 100 percent right in three months.'

fees as they are frequently called in the US or break fees as they are termed in Australia are resolved by the United States in the context of specific cases within the umbrella of fiduciary duties;[61] in Australia they have been the recent subject of a Panel action.[62] The outcome shows the differences that remain in a convergent world. Break-fees are uncommon in Australia and under the guidelines of the Panel cannot be more than 1 per cent of the value of the target company.[63] In the United States, fees regularly show up in the two to four percent range and have sometimes been higher.[64]

Target shareholders ability to take defensive actions seems more constrained in Australia. Poison pills and other defensive tactics are limited by listing requirements of the Australia Stock Exchange.[65] The Takeovers Panel's ability to provide guidance notes on particular policy issues provides a process for evolution of these rules outside of a government based system.[66]

The alternative regimes being developed in Australia, the United Kingdom and other common law countries with developed securities markets do a better job of protecting shareholder space to make corporate decision in a takeovers context when the interests of directors may diverge from those of shareholders. We may yet have convergence on one corporate law system, but at the moment the divergence in the discretion permitted shareholders, and who makes takeover decisions, appears to be a welcome characteristic of our global corporate law system.

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61 See above n25.

62 Takeovers Panel Guidance on Lock-up Devices, 7 December 2001.

63 Ibid.

64 See, eg, Marcel Kahan & Michael Klausner, 'Lock-ups and the Market for Corporate Control' (1996) 48 *Stan LR* 1539.

65 See Guide to Listing on ASX: <http://www.asx.com.au> (visited 10 February 2002).

66 See *Corporation Act* § 658C.