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Nancy A. Lester-Lawson

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Notes and Comments

Greenmail: Is It Just Passing The Buck?

I. Introduction

The practice of a corporation repurchasing its own stock from a shareholder at an above market premium in order to thwart a hostile takeover attempt is not new.¹ Its occurrence, however, has increased dramatically in recent years.² The practice, known colloquially as "greenmail," has been referred to as "corporate blackmail" by the *New York Times*³ and the *Wall Street Journal*.⁴ The House Committee on Energy and Commerce, in its report accompanying H.R. 5693,⁵ one of three House bills proposed in 1984 to regulate the practice of greenmail,⁶ defined greenmail as "a maneuver in which a 'raider' who

1. See generally *Bankers Sec. Corp. v. Kresge Dep't Stores, Inc.*, 54 F. Supp. 378 (D. Del. 1944); *Cheff v. Mathes*, 41 Del. Ch. 494, 506, 199 A.2d 548, 555 (1964); *Alcott v. Hyman*, 40 Del. Ch. 449, 456, 184 A.2d 90, 94 (1962), *aff'd*, 42 Del. Ch. 233, 208 A.2d 501 (1965); *Kors v. Carey*, 39 Del. Ch. 47, 54, 158 A.2d 136, 140 (1960). See also E. FOLK III, *THE DELAWARE GENERAL CORPORATE LAW* 154 (1972).

2. See THE OFFICE OF THE CHIEF ECONOMIST, SECURITIES AND EXCHANGE COMMISSION, *THE IMPACT OF TARGETED SHARE REPURCHASES (GREENMAIL) ON STOCK PRICES*, (Sept. 11, 1984) [hereinafter cited as SEC STUDY ON THE IMPACT OF GREENMAIL].

3. Lipton, *The Minority Takeover Threat 'Greenmail' is a Corporate Disgrace*, N.Y. Times, Apr. 15, 1984, at F2, col. 3.

4. Leefeldt, *'Greenmail' Far From Disappearing Is Doing Quite Well in Disguised Forms*, Wall St. J., Dec. 4, 1984, at 14, col. 1 [hereinafter cited as *Disguised Forms*]; Leefeldt, *Rise in 'Greenmail' Payoffs Spurs Challenges in Courts and Congress*, Wall St. J., May 2, 1984, § 2, at 29, col. 4.

5. H.R. 5693, 98th Cong., 2d Sess., 130 CONG. REC. H4357-60 (daily ed. May 22, 1984). This bill, known as the "Tender Offer Reform Act of 1984," was first introduced into the House of Representatives by Rep. Timothy Wirth (D-Colo.) on May 22, 1984. See also *infra* note 226 and accompanying text.

6. This comment will refer only to the bills introduced in the House, H.R. 5693, H.R. 5694 and H.R. 5695, 98th Cong., 2d Sess., 130 CONG. REC. H4357-60 (daily ed. May 22, 1984), introduced by Rep. Wirth, and not to similar companion bills introduced in the Senate, S. 2777, 98th Cong., 2d Sess. (1984) by Sen. H. John Heinz (R-Pa.), S. 2782, 98th Cong., 2d Sess. (1984) by Sen. Alfonse D'Amato (R-N.Y.) and S. 2784, 98th Cong., 2d Sess. (1984) by Sen. Alfonse D'Amato (R-N.Y.).

has accumulated a large block of stock in a company threatens to make a hostile bid for the company or to sell his block to someone else to facilitate a hostile takeover, unless the target buys him out at a high price”⁷

The payment of greenmail, as one of a number of corporate defensive maneuvers, has increased with the growing number of hostile takeovers and hostile takeover attempts.⁸ In the first three months of 1984, the number of takeovers increased by thirty-one percent over 1983, and the aggregate dollar value of the transactions more than doubled to \$48.3 billion.⁹ The 1984 statistics become significant when viewed in light of the fact that the 2,500 mergers and acquisitions in 1983 was the greatest number since 1974.¹⁰

Many factors have contributed to this surge in takeover activity.¹¹ Higher interest rates made the purchase of existing facilities a more attractive, less expensive option than building new facilities.¹² In addition, a depressed stock market made securities investments an undervalued, inexpensive investment option.¹³ As a result, companies previously insulated from takeover attempts, either because of their size or overvalued stock, fell prey to hostile raiders¹⁴ who often sold asset-rich divisions to

7. HOUSE COMM. ON ENERGY AND COMMERCE, H.R. DOC. NO. 1028, 98th Cong., 2d Sess. 7, n.15 (1984) [hereinafter cited as HOUSE REPORT].

8. See SEC STUDY ON THE IMPACT OF GREENMAIL *supra* note 2, at 1.

9. Reiser, *Corporate Takeovers: A Glossary of Terms and Tactics*, 89 CASE & COM., Nov. - Dec. 1984, at 35. For a general discussion of merger activity in the past 10 years see Sonenclar, *How to Play the Merger Game for Profit*, FIN. WORLD, Sept. 5-18, 1984, at 16.

10. See Reiser, *supra* note 9, at 35.

11. Williams, *Frenzy and Style in the Merger Boom*, N.Y. Times, Jan. 15, 1984, at F1, col. 3. By the end of 1983, merger agreements were being signed at a rate of eight a day. Moreover, aggressive proxies have proliferated and takeover bidding wars have become virtually “common place.” *Id.*

12. See *infra* note 15.

13. See Sonenclar, *supra* note 9, at 17. “One of the key measurements of takeover eligibility, say experts, is market price in relation to book value, which is essentially the valuation at which total assets are carried on a company’s books, less depreciation, debt and the value of any preferred shares.” *Moran v. Household Int’l, Inc.*, 490 A.2d 1059, 1078 (Del. Ch. 1985). This tactic is often referred to as a company’s “break-up value” and is utilized by a “bust-up artist,” an acquiror who sells off corporate assets piecemeal after acquisition. *Id.*

14. In this comment, the terms “raider,” “greenmailer” and “acquisitor” will be used relatively interchangeably to mean a dissident shareholder who acquires a significant block of stock and who poses the threat of a hostile takeover or tender offer.

help finance the takeover.¹⁵

This heightened takeover activity has made the market more susceptible to greenmail threats by corporate investors who view greenmail as a lucrative alternative to actual takeover.¹⁶ A record number of companies (575) repurchased their own shares in buyback programs in 1984, compared with only 200 in 1983.¹⁷ Although the majority of these buybacks were responsive to concerns that corporate shares were undervalued in the market (thereby making the company a prime takeover target),¹⁸ a significant number were actually greenmail payments.¹⁹ The largest greenmail payment occurred in March, 1984, when Texaco, Inc. paid \$1.28 billion to purchase the 9.9% stake held by the Bass family of Texas.²⁰ This greenmail payment resulted in a \$400 million profit to the Bass family.²¹

The practice of greenmail has been criticized for a variety of reasons. First, as with certain other defensive corporate maneu-

15. Wayne, *A Look at New Corporate Tactics*, N.Y. Times, Feb. 26, 1984, § 3, at F6, col. 3. "It matters little that these companies are among America's mightiest; they still become easy marks for the ravenous advances of others. Their sin was simple - fend off the attack." *Id.* See also Rosenzweig, *The Legality of "Lock-Ups" and Other Responses of Directors to Hostile Takeover Bids or Stock Aggregations*, 10 SEC. REG. L.J. 291 (1983). "Characteristics of vulnerability have included a sale or liquidation value higher than market value, a significant unused debt capacity, a highly liquid financial condition, a low price-earnings ratio, and widely held stock ownership, possibly including large blocks of stock in institutional hands and limited ownership by management." *Id.* at 298.

16. See *supra* note 7, at 1. "Many of these large premium payments clearly were made by target management to reduce the threat of losing control of the firm through a tender offer or proxy fight." *Id.*

17. See *supra* note 9.

18. Many corporations now find themselves "in play" or "up for sale" in the increasingly growing market for corporate takeovers. Such companies, known as "target companies" often attempt to repurchase their own stock on the market as a protectionist measure to prevent future takeover attempts. See Fisher, *Oops! My Company is on the Block*, FORTUNE, July 23, 1984, at 16; Wayne, *A Look at New Corporate Tactics*, N.Y. Times, Feb. 26, 1984, § 3, at F6, col. 3.

19. See generally Williams, *Companies' Stock Buybacks Soared in 1984 but Might Slow This Year*, Wall St. J., Jan. 2, 1985, at B6, col. 1, for tables entitled "Biggest Stock Buybacks of 1984" and "Biggest Greenmail Deals of 1984." See also Work, "Greenmail" - *It's Legal, but is it Right?* 96 U.S. NEWS & WORLD REP., June 25, 1984, at 75, containing a table entitled "Profits from Buy-Backs in 1984"; *Leading Deals and Deal Makers in the First Half of This Year*, N.Y. Times, July 3, 1984, at D6, col. 1, containing tables entitled "Largest Mergers and Acquisitions" and "Merger Activity" and also brief biographies of some of the more well known greenmailers.

20. See Williams, *supra* note 19.

21. *The Greenmail Blues*, L.A. Daily J., May 31, 1984, at 4, col. 1.

vers like "Pac-Man,"²² "lock-up" options,²³ "poison pill,"²⁴ "scorched earth"²⁵ and sale of the "crown jewel,"²⁶ the payment of greenmail often constitutes a major, self-inflicted financial blow to the target company.²⁷ This, in turn, may cause stock val-

22. This practice, named after the popular video game, occurs when a target company threatens to "eat you before you eat me" in terms of a hostile takeover. In effect, the target company threatens the raider with a takeover. The Pac-Man defense was used by Martin Marietta to prevent a takeover by Bendix in a well-publicized battle. See *Martin Marietta Corp. v. Bendix Corp.*, 549 F. Supp. 623, 625 (D. Md. 1982).

23. Lock-up options are arrangements made by a target company with a preferred acquirer or "white knight" in which the target grants the "white knight" some sort of option which, if exercised would make a hostile takeover either impossible or far less attractive to the raider. These include "stock lock-ups," agreements to purchase treasury shares or unissued stock of the target, and "asset lock-ups" which are options to purchase some key assets of the target. Courts have differed as to the legality of these maneuvers. See *Mobil Corp. v. Marathon Oil Co.*, 669 F.2d 366 (6th Cir. 1981), *cert. denied*, 455 U.S. 982 (1982) ("lock-up" option granted to defendant corporation by target company during a tender offer constituted a violation of the Williams Act because there were no indications that the offer was so inadequate as to justify the actions), *cf.* *Data Probe Acquisition Corp. v. Data Lab, Inc.*, 568 F. Supp. 1538 (S.D.N.Y. 1983), *rev'd*, 722 F.2d 1 (2d Cir. 1983), *cert. denied*, 104 S. Ct. 1326 (1984).

24. A poison pill is any provision in a corporate charter or agreement that will mature upon a change in control and create problems for the acquirer, often by severely diluting the surviving entity's value, *see* Daniels, *'Poison Pill': A Court Test*, N.Y. Times, Jan. 22, 1985, § 2, at D2, col. 1, or diluting voting rights upon certain events. See *Moran v. Household Int'l, Inc.*, 490 A.2d 1059, 1066 (Del. Ch. 1985). A poison pill "rights plan" was upheld by the court under the business judgment rule as serving a rational purpose to fend off a hostile raid. Under this rights plan, each shareholder received one right for each share of outstanding common stock. The right entitled the shareholder, over a 10 year period, to purchase one hundredth of a share of a new series of participating preferred stock. The right would only materialize upon certain "triggering" or "flipover" events, i.e. any 20% acquisition by a shareholder or group of related shareholders, or a tender offer or exchange offer for 30% of the company's outstanding stock. The net result would be that a right holder would be able to purchase \$200 worth of the acquirer's common stock for \$100, resulting in a significant dilution of the acquirer's capital.

25. A scorched earth policy encompasses any number of desperate attempts by target management to discourage the raider in the final hours of a takeover battle. These include poison pill measures, *see supra* note 24, selling off the company's most financially attractive asset, the "crown jewel," *see infra* note 26, large last-minute dividend payments to shareholders, etc. As stated in *Minstar Acquiring Corp. v. AMF, Inc.*, No. 85 Civ. 3800 (MJL) (S.D.N.Y. June 7, 1985) (available Nov. 7, 1985, on LEXIS, Genfed library, Dist file), a scorched earth policy means "[t]he offeror would be left with nothing but smoldering ash."

26. The "crown jewel" is the target company's most lucrative asset and its sale creates a disincentive for the raider to acquire the corporation.

27. *Takeover Tactics and Public Policy, 1984: Hearings on H.R. 5693 Before the Committee on Energy and Commerce, Subcommittee on Telecommunications, Consumer Protection, and Finance*, 98th Cong., 2d Sess. 142 (1984) [hereinafter cited as *Hearings*] (statement of Rep. Timothy Wirth (D-Colo.): "[c]ompanies have engaged in

ues to drop.²⁸

Second, the payment of greenmail has been criticized as inequitable because the corporation only offers to buy back its stock at a premium from the raider, but does not make a similar offer or self-tender²⁹ for the remainder of its outstanding shares.³⁰ In this sense, the premium, operating akin to extortionate payoff money, eliminates the threat of a corporate takeover.³¹ However, the remaining non-threatening shareholders do not receive the benefit of this buyback offer by the corporation.

Third, the payment of greenmail has been criticized because target management, by making the payment, is able to head off a threatened takeover and effectively bypass the tender offer process.³² This prevents shareholders from benefitting from higher stock market prices during a tender offer and serves to

enormous bank borrowings to conduct counteroffers and tender offers for their own shares simply as defensive tactics." *Id.*).

28. There is some dispute as to whether the stock drop is caused by the end of the takeover speculation or by the market reaction to the greenmail payment itself. See Note, *Greenmail: Targeted Stock Repurchases and the Management-Entrenchment Hypothesis*, 98 HARV. L. REV. 1045 (1985). See *infra* notes 73-78 and accompanying text.

29. A "self-tender" is a tender offer conducted by the issuing company for its own stock usually at a premium. See *infra* notes 49, 233 and accompanying text.

It should be noted that neither Congress nor the SEC has defined "tender offer." SEC v. Carter Hawley Hale Stores, Inc., 587 F. Supp. 1248 (C.D. Cal. 1984), *aff'd*, 760 F.2d 945 (9th Cir. 1985). However, the SEC has adopted an eight-factor test to determine whether the stock purchaser has in fact made a tender offer. This test has met with general approval in the courts, and not all factors need be present in order to find the existence of a tender offer. These factors are: (1) active and widespread solicitation of public shareholders for the shares of an issuer; (2) solicitation made for a substantial percentage of the issuer's stock; (3) offer to purchase made at a premium over the prevailing market price; (4) terms of the offer are firm rather than negotiable; (5) offer contingent on the tender of a specific number of shares, often subject to a fixed maximum number to be purchased; (6) offer open only for a limited period of time; (7) offeree subjected to pressure to sell his stock; and (8) the public announcements of a purchasing program concerning the target company precede or accompany rapid accumulation of a large amount of target company's securities. SEC v. Carter Hawley Hale Stores, Inc., 587 F. Supp. 1248 (C.D. Cal. 1984), *aff'd*, 760 F.2d 945 (9th Cir. 1985); Zuckerman v. Franz, 573 F. Supp. 351, 358 (S.D. Fla. 1983); Wellman v. Dickinson, 475 F. Supp. 783, 823-24 (S.D.N.Y. 1979), *aff'd*, 682 F.2d 355 (2d Cir. 1982), *cert. denied*, 460 U.S. 1069 (1983).

30. See *infra* notes 35-44 and accompanying text for definitions of greenmail.

31. See *supra* notes 3, 4, 30 and accompanying text.

32. See Note, *Buying Out Insurgent Shareholders with Corporate Funds*, 70 YALE L.J. 308 (1960). "Moreover, the use of corporate funds to buy out insurgents is offensive to the underlying premise of the proxy-expenditure doctrine — that decisions about policy and management in contests for control should be made by the stockholders." *Id.* at 313.

entrench the incumbent management by eliminating any threat to a change in it.³³

This comment will explore the dimensions of the greenmail problem and examine the extent to which three draft Congressional bills, proposed in 1984 by Rep. Timothy Wirth (D-Colo.), might solve the problem. Part II reviews various definitions of greenmail and compares differing points of view regarding the nature of the perceived wrongdoing. Part III examines whether greenmail should be regulated by determining if it causes actual harm to shareholder interests and whether existing legal and commercial mechanisms are sufficient to handle the problem. Part IV analyzes the provisions of H.R. 5693, H.R. 5694 and H.R. 5695 as possible ways to amend the Securities and Exchange Act of 1934 to regulate greenmail. Part V concludes that there is a need to regulate greenmail, but that none of the three proposed bills in their present form offers a realistic solution. The author proposes, however, that certain provisions of H.R. 5693 may be useful as guidelines to establish earlier disclosure requirements. These earlier disclosure regulations could be implemented through changes in sections 13(d) and 13(e) of the Exchange Act. In addition, a substantive change could be made in section 14(e) of the Exchange Act, counteracting the Supreme Court's most recent interpretation, to include certain "manipulative" acts between issuer and shareholder. When combined, these changes in the federal securities laws would enable a complaining shareholder to seek injunctive relief in the federal courts against the payment of greenmail.

33. When management "pays off" the potential raider, the shareholders are deprived of the opportunity to tender their shares at an above-market price. The tender offer is either never made or withdrawn, and the raider never achieves the status of majority shareholder to challenge the existing management's status. Moreover, the "pay-off" to the raider ensures that he will not attempt a proxy contest, since his potential threat as a major shareholder is eliminated by the repurchase of his shares. The shareholders are denied an opportunity to profit from a tender offer and the possibility of a proxy battle for a change in corporate control. By eliminating its opposition, management entrenches itself in the corporation.

II. Definitions of Greenmail

The term "greenmail" does not appear in Webster's Dictionary or the Oxford Shorter.³⁴ Commentators have suggested that the word may have evolved from "greenback," which is United States paper currency printed with green ink.³⁵ Synonyms for greenmail include "targeted share repurchase" and "targeted buyout."³⁶ Furthermore, no formal definition of greenmail exists elsewhere. The variety of existing informal definitions appears to reflect a deeper conflict and disagreement as to exactly what type of transaction constitutes greenmail and which party to the transaction has committed the wrongdoing.³⁷

The following sample definitions are illustrative of this conflict: 1) the House Committee on Energy and Commerce report accompanying H.R. 5693 defined greenmail as a "threat to make a hostile bid"³⁸ (this definition views the raider as the wrongdoer); 2) "a ploy in which a financial sharpshooter creates a takeover threat by purchasing a chunk of a company's stock"³⁹ (this definition emphasizes the relationship of the purchase of stock by the raider with the perception of a threat by the target and views the raider as the wrongdoer); 3) "the repurchase of stock from an unwanted suitor at a higher-than-market price,"⁴⁰ (this definition appears to regard the target as the wrongdoer by defining the practice in terms of the repurchase of stock); 4) "[t]he term 'greenmail' refers to the practice of buying out a takeover bidder's stock at a premium that is not available to

34. Owles, *Corporations*, NEW L.J., July 13, 1984.

35. *Id.*

36. See SEC STUDY ON THE IMPACT OF GREENMAIL, *supra* note 2.

37. Raiders often deny that they have threatened greenmail and targets often deny that the repurchase of stock was in fact a greenmail payment. See Donovan, *The Cash was Green but Chesebrough Says It Wasn't 'Greenmail'*, 6 New Eng. Bus., Oct. 1, 1984, at 42 (target denies greenmail); Mahon, *Dealing with T. Boone Pickens*, Barrons, June 18, 1984, at 13. (raider denies practicing greenmail); *Disguised Forms*, *supra* note 4 (target admits greenmail but as part of a repurchase agreement cannot give the names of the sellers). Thus, the threat of greenmail can be actual or perceived. See *The Greenmail Blues*, 97 L.A. Daily J., May 31, 1984, at 4, col. 1; Potts, *'Greenmail' Takeover Tactic Under Scrutiny*, 107 The Wash. Post, June 17, 1984, at G8, col. 1.

38. See *supra* note 7.

39. Thomas, *Indecent Recklessness: 'Greenmail' A New Form of Old Cynicism*, L.A. Daily J., June 28, 1984, at 4, col. 3. See also Greenwald, *Corporate Fear and Trembling*, TIME, Jan. 14, 1985, at 51.

40. See *Disguised Forms*, *supra* note 4, at 14.

other shareholders in order to prevent the takeover"⁴¹ (this definition also places the onus on target management); 5) "the accumulation of a powerful block of stock by a buyer seeking only to resell his shares back to the company at a premium over the market price"⁴² (this definition focuses on the raider's motive in purchasing the shares, and views the raider as the wrongdoer with an "improper" motive); 6) "legal corporate blackmail by raiders who accumulate 10 to 25 percent of a company's stock and then threaten a takeover or proxy fight if not bought out at a premium"⁴³ (this definition focuses on the percentage of stock accumulated by the raider and clearly views the raider as the wrongdoer); and 7) "[a] greenmailer is a relatively recent buyer of a large block of a company's stock who says to management, 'Buy my shares at a premium or else' "⁴⁴ (this definition places the wrongdoing on the shoulders of the raider and emphasizes the explicit nature of the threat).

A. *What Constitutes A Greenmail Transaction?*

There are a number of sound business reasons for a corporation to repurchase its own shares. Thus, it is often difficult to distinguish greenmail from other beneficial corporate stock repurchases. Corporations often use stock repurchases to restructure the debt-equity ratio of the corporation,⁴⁵ increase the company's return-on-equity by investing in its own undervalued stock,⁴⁶ and diminish the need to issue new stock to employees

41. See *Unocal Corp. v. Mesa Petroleum Co.*, No. 152, 1985 (Del. Sup. Ct. May 17, 1985).

42. Wheat, *There's a Fair Way to Protect Takeover Targets*, L.A. Times, Jan. 13, 1985, at V, col. 1.

43. See *supra* note 3. See also *Hearings*, *supra* note 27, at 155 (statement of Martin Lipton, a member of the SEC Advisory Committee on Tender Offers).

44. Siegel, *How to Foil Greenmail*, FORTUNE, Jan. 21, 1985, at 157.

45. One rationale for buybacks is that the corporation is acquiring cheap assets (i.e. its own) since they are undervalued on the market. Another rationale is to make the balance sheet more attractive and enhance earnings per share by reducing the number of shares outstanding. See generally *Why Geico is Acquiring More of Itself*, BUS. WK., Sept. 12, 1983, at 45; Marcial, *What Could Keep a Lid on Teledyne*, BUS. WK., Oct. 29, 1984, at 92; Marcial, *Buybacks in the Oil Patch Don't Persuade the Pros*, BUS. WK., June 4, 1984, at 118.

46. Bianco, *Look Who's Buying the Battered Brokerage Stocks*, BUS. WK., Mar. 12, 1984, at 116.

exercising stock options.⁴⁷ Stock repurchases, either in the form of open-market purchases or self-tenders,⁴⁸ are often made in response to a hostile takeover as a means to reduce the number of outstanding voting securities and consolidate voting power.⁴⁹ All of these corporate stock repurchases are beneficial to the corporation. Greenmail is distinguishable from other stock repurchases only in that it is paid to a raider, as opposed to other shareholders, at an above-market premium. Greenmail is arguably beneficial to the target corporation because it protects the company from a threatened takeover.⁵⁰ However, this protection is achieved only at great expense to the target company.⁵¹

Greenmail is also difficult to isolate as a transaction because it need not be accomplished in cash, as the name suggests. Greenmail may occur in a variety of disguised forms such as the sale of a key asset to a raider at a bargain price,⁵² purchase of an unprofitable corporate division by a target at an exorbitant price,⁵³ corporate repurchase programs which include privately

47. *Id.*

48. *See supra* note 29.

49. The SEC Advisory Committee on Tender Offers has sharply distinguished the beneficial value of self-tenders from that of greenmail payments. The Committee report said "[i]n view of the legitimate business purposes that can be served by a self-tender, the Committee believes that regulation of the mechanism generally should be governed by the business judgment rule and, if abused, principles of fiduciary duty under state law." SEC ADVISORY COMMITTEE ON TENDER OFFERS REPORT OF RECOMMENDATIONS, FED. SEC. L. REP. (CCH) ¶ 1028, July 15, 1983, at 41. However, in the same report, the Committee said of greenmail, "[n]ot only does such a transaction generally serve little business purpose outside the takeover context but also it constitutes a practice whereby a control premium may be distributed selectively but not shared equally by all shareholders." *Id.* at 46.

50. Greenmail payments made by target management to "reduce the threat of losing control of the firm through a tender offer or proxy fight," SEC STUDY ON THE IMPACT OF GREENMAIL, *supra* note 2, at 1, are arguably beneficial when the raider has a dubious reputation for poor managerial ability or is known as a "bust up artist" who would sell off corporate assets to finance the takeover. *See supra* note 13 and accompanying text.

51. *See* SEC STUDY ON THE IMPACT OF GREENMAIL, *supra* note 2.

52. *See Disguised Forms*, *supra* note 4. The management of Morton Thiokol, Inc. agreed to sell its most profitable division, Textize, to Dow Chemical Co. within a short time after Dow's announcement of its plan to increase its holdings in Morton from 8.2 to 15 percent, albeit for "investment purposes only." In return, Morton received \$131 million in cash, a standstill agreement, whereby Dow agreed not to purchase any of Morton's stock for 10 years, and 1.4 million shares of Morton's stock. *Id.*

53. Carl Icahn, known for his hostile takeover attempts and greenmail tactics, "a renowned master of the takeover game" according to the court in *Trans World Airlines, Inc. v. Icahn*, No. 85 Civ. 3677 (JMC) (S.D.N.Y. May 28, 1985), acquired ACF Industries

negotiated buybacks,⁵⁴ and stock repurchases by major shareholders in the target corporation.⁵⁵

Aside from the difficulties in isolating the greenmail transaction from other beneficial stock repurchases, greenmail is often confused with blackmail. The term greenmail evokes an image of blackmail accomplished with green cash.⁵⁶ This is misleading because greenmail is not technically a form of blackmail. Blackmail exists where there is an unlawful demand of money or property coupled with a threat to damage property, cause bodily injury, falsely accuse of a crime or expose to public shame and humiliation.⁵⁷ Under current federal, state and common law, a raider is permitted to "threaten" a target corporation with a hostile takeover, tender offer or proxy fight.⁵⁸ By the same token, the target is permitted to pay the raider an above-market premium for the repurchase of its shares in response to such a "threat."⁵⁹ Thus, greenmail does not constitute the requisite "unlawful demand,"⁶⁰ and at present is considered a legal

in a takeover and was interested in selling off its unprofitable plastics division, Polymer Corp. Icahn soon acquired a five percent stake in Chesebrough-Ponds, Inc. In a buyback agreement with Icahn, Chesebrough agreed to purchase his stake at market price and acquire Polymer for \$95 million. Prior to these negotiations, Chesebrough had indicated to newspaper reporters that it had no intention of making any corporate acquisitions. See *Disguised Forms*, *supra* note 4.

54. Pioneer Corp. repurchased 4.6 million of its shares in 1984. However, 2.6 million shares were repurchased in "privately negotiated transactions" at \$32 per share, which constituted a \$7 premium over the prevailing market price. See *Disguised Forms*, *supra* note 4.

55. Irwin Jacobs, who was labeled a "raider" by the court in *Minstar Acquiring Corp. v. AMF Inc.*, No. 85 Civ. 3800 (M.J.L.) (S.D.N.Y. June 7, 1985), launched a takeover attempt of Walt Disney Productions, Inc. Unable to convince Disney's stockholders to sell their shares, Jacobs accepted a buyout of his 7.7% stake in the company at a premium of \$1.75 per share by the Bass brothers (also known for their greenmail tactics, See *Leading Deals and Deal Makers in the First Half of This Year*, *supra* note 19). The Bass brothers gained 24.3% of Disney, qualifying them as "insiders" under section 16(b) of the Securities and Exchange Act of 1934. Even though they were not representatives of the company, the effect was the same as if Disney had been greenmailed, with the stock falling \$4.12 per share on the day of the buyback. See *Disguised Forms*, *supra* note 4. See also Scheibla, *A Mickey for Greenmail? The Disney Affair Spurs Congress to Action*, *Barron's*, June 18, 1984, at 8; *A Price too High?*, *Fin. World*, Aug. 22 - Sept. 4, 1984, at 8.

56. See *supra* note 34 and accompanying text.

57. BLACK'S LAW DICTIONARY 89 (5th ed. 1983).

58. See *infra* notes 104-114 and accompanying text.

59. *Id.*

60. See Pauly, *A Row Over 'Greenmail'*, *NEWSWEEK*, Apr. 30, 1984, at 66. "Payment

transaction.⁶¹

B. *Who is the Wrongdoer: Greenmailer or Greenmailee?*

As the preceding definitions of greenmail indicate, significant controversy has centered upon the question of who commits the wrongdoing from a policy standpoint. Both raiders and targets have been accused of engaging in the practice of greenmail for purely selfish reasons. Raiders are accused of purchasing large blocks of corporate stock and threatening a takeover for the sole purpose of forcing the target to buy back its stock at highly inflated prices.⁶² On the other hand, target management is often accused of paying greenmail to preserve their jobs at all costs and without regard for the welfare of the shareholders or the corporation, for whom the directors are bound by law to act as fiduciaries.⁶³

The problem of identifying the wrongdoer is also found reflected in the divergent views regarding the nature of the greenmail threat. The definitions of greenmail, *supra*, indicate a difference of opinion as to whether the greenmail threat need be explicit or merely implicit by the purchase of a substantial block of stock. Similarly, when there is an actual threat of a takeover and a payment ultimatum, the raider appears more readily as the culprit. However, when the threat is implicit through the raider's purchase of stock, many critics and raiders have con-

of greenmail is perfectly legal, but a growing legion of brokers, analysts, investors and lawyers assert that it's simply unfair for one stockholder to be offered a big price for his shares when the same opportunity is denied the rest." *Id.* See also Potts, 'Greenmail' Takeover Tactic Under Scrutiny, *The Wash. Post*, June 17, 1984, at G8, col. 1.

61. In Britain, however, greenmail is prohibited since shareholder approval is required for nearly all defensive tactics. See Simon, *Needed: a "generic remedy,"* *FORBES*, Nov. 5, 1985, at 40.

62. See Rock, 'Greenmail: The Destabilizing of the American Corporation', 8 *DIRECTORS & BOARDS*, Summer 1984, at 3 (supporting target management and criticizing the "bullying power" of the raider).

63. See Easterbrook and Fischel, *Corporate Control Transactions*, 91 *YALE L.J.* 698 (1982).

Corporate directors and other managers are said to be fiduciaries, who must behave in certain upright ways toward the beneficiaries of fiduciary duties. Yet, as Justice Frankfurter put it, "to say that a man is a fiduciary only begins analysis; it gives direction to further inquiry. To whom is he a fiduciary? What obligations does he owe as a fiduciary?"

Id. at 700.

tended that management's decision to make a repurchase offer is merely a way to manipulate and stymie any corporate challenge.⁶⁴ Raiders often argue that they make large stock purchases for investment only or to effectuate changes in the corporate organizational structure.⁶⁵ Thus, due to the elusive nature of the greenmail threat, the line between a payment demand by the raider and a repurchase offer by the target becomes very blurred, making it difficult to determine who initiated the greenmail payment.

Ultimately, the issue of who has committed the wrongdoing may become one of economic policy. Generally, those who favor the free market system argue that the raider has only acted in the best interests of all the shareholders by bidding up the value of the undervalued stock and attempting to revitalize the corporate structure.⁶⁶ On the other hand, those favoring government regulation of greenmail argue that target management should not be thrust into the uncomfortable if not impossible situation of having to decide whether or not greenmail should be paid to protect the best interests of the corporation.⁶⁷ Indeed, it has

64. See Crittenden, *The Age of 'Me-First' Management*, N.Y. Times, Aug. 19, 1984, at B1, col. 2 (this interview with Carl Icahn provides a raider's perspective on greenmail); Dremen, *Robin Hood Steinberg*, FORBES, Jan. 14, 1985, at 298 (favoring raider tactics as an impetus for entrenched management to engage in beneficial restructuring of corporate policies); see also *Hearings*, *supra* note 27 (testimony of Carl Icahn arguing in favor of the raider not as a "bad guy" but as an activist for better management and corporate democracy, *Id.* at 183), (testimony of Irwin Jacobs arguing in favor of the "outside investor" who buys a large stake in a company he believes is undervalued on the market, who acts to stimulate management so the value can be increased by a variety of techniques such as streamlining the operation through sale of assets, merger, or shutting down facilities, and who ultimately increases the value of the stock by creating a tender offer premium or stronger company for the benefit of all shareholders, *Id.* at 467).

65. By accumulating large blocks of stock, the raider becomes sufficiently powerful as a stockholder to influence corporate policy, directly or indirectly, through the board of directors. As such, the raider is often able to cause streamlined corporate policies to be implemented, and non-productive divisions to be sold or made more efficient.

66. See *supra* note 64.

67. See *Hearings*, *supra* note 27 (opening statement during testimony by Rep. Timothy Wirth (D-Colo.) made on May 23, 1984):

[t]here is a balance of issues here that we have to come to understand. And I think our special concern has been the protection of the shareholders, making sure that in the process of takeovers, management does not act merely in its own self interest, but acts to safeguard the interests of millions of American shareholders. If shareholders believe that their interests are not being taken care of, clearly they are going to be less willing to invest in the market.

been said that greenmail *must* be paid if target management is to discharge its fiduciary duty to the corporation's shareholders.⁶⁸

Recent Congressional subcommittee hearings⁶⁹ on tender offer reform have indicated that legislators may prefer to regulate hostile takeover offensive and defensive tactics in a manner which will promote optimal industrial productivity and capital formation.⁷⁰ Thus, proposed legislation has been structured to promote economic efficiency, rather than to "punish" the perceived wrongdoer in the greenmail transaction.

III. Should Greenmail be Regulated?

The question of whether greenmail should be regulated turns on three major issues. First, the greenmail transaction must be shown to cause actual harm to corporate or shareholder interests. Second, as discussed in Part II, the greenmail transaction must be sufficiently isolated from other beneficial stock repurchases. Finally, greenmail legislation need only be considered if existing legal and commercial mechanisms are inadequate to resolve the perceived problems. This section examines these questions and concludes that there is a need for regulation of greenmail.

Id. at 201.

68. See Note, *supra* note 32.

Management's use of corporate funds to purchase stock held by potential insurgents may protect the corporation from being taken over by less competent or perhaps unscrupulous management, but the power to make such purchases is also an effective device which the incumbent management may use to insulate its position against shareholder action.

Id. at 308.

69. Two days of hearings on tender offer reform were held on March 28 and May 23, 1984. See *Hearings*, *supra* note 27.

70. In a written statement submitted to the House Subcommittee on Telecommunications, Consumer Protection and Finance, Rep. Timothy Wirth (D-Colo.) stated: "[w]hen we as a nation are worried about capital formation — and when we are concerned about productivity and international competitiveness — we must consider these consequences of takeovers." See *Hearings*, *supra* note 27, at 206.

Rep. Wirth has received support in his position from the Committee on Energy and Commerce in its report accompanying H.R. 5693 (see *HOUSE REPORT*, *supra* note 7, at 5-6). The report stated: "[h]owever, when a 'hostile' tender offer is the means employed to effect a business combination, the basic question of fairness - to shareholders, employees, pension fund recipients, management and the affected communities - also comes into play."

A. Actual Harm to Shareholder Interests

Although there has been little controversy as to the innate unfairness of greenmail, there has been disagreement as to the actual resulting harm to shareholder wealth.⁷¹ A recent study of the Office of the Chief Economist of the Securities and Exchange Commission (SEC) found that the value of greenmailed companies declined after the announcement of the buyback.⁷² The study of eighty-nine targeted share repurchases (i.e., greenmail payments) of New York Stock Exchange (NYSE) or American Stock Exchange (ASE) companies from 1979 to 1983, found that the announcement of the greenmail payment caused stock prices to decline and more than offset the initial appreciation of the stock from the announcement of the hostile takeover bid.⁷³ Subsequent to the greenmail transaction, the net overall stock price decline was "roughly equal to the magnitude of the cash premium paid to the block seller."⁷⁴ When the greenmail payment was preceded by a proxy contest or tender offer, there was an even greater decline in stock prices.⁷⁵

Other studies conclude that there may not be a long term decline in stock prices after a greenmail payment is made. Three recent unpublished studies by Mikkelson and Ruback⁷⁶ found that the initial appreciation of the stock more than offset the

71. See *infra* notes 75-79 and accompanying text.

72. See SEC STUDY ON THE IMPACT OF GREENMAIL, *supra* note 2.

73. *Id.* at 15-16.

74. *Id.*

75. *Id.* at 11-12. Informal studies and compilations of stock prices before and after greenmail payment announcements also tend to confirm the SEC's findings of an overall net loss to shareholder wealth. See Sonenclar, *supra* note 9, at 17.

Rumors of a pending merger usually drive up the price of a target company's stock several points. Confirmation of these rumors - or, even better, an actual agreement - often lifts the price of the stock to within a few points of the dollar amount of the proposed takeover offer. But if the deal collapses, the stock price will often plummet, staying at or below the pre-offering price for several weeks or longer.

Id.

See also Samuelson, *A Misuse of Management Power*, NEWSWEEK, June 25, 1984, at 56 (contains a table of greenmail transactions with stock fluctuations one week before, during, and one week after the buyout, tending to confirm SEC findings).

76. Wayne H. Mikkelson of the College of Business Administration of the University of Oregon and Richard S. Ruback of the Sloan School of Management, Massachusetts Institute of Technology.

decline after the announcement of the greenmail payment.⁷⁷ Perhaps more importantly, the authors of the studies say that their results indicate that it is impossible to determine, simply by observing stock price effects, whether the drop in stock value subsequent to the greenmail announcement was precipitated by the greenmail payment or the unfavorable information that it brings with it, i.e. that there will be no takeover.⁷⁸

77. Mikkelsen and Ruback, *Targeted Repurchases and Common Stock Returns* (Oct. 1984) (unpublished manuscript); Mikkelsen and Ruback, *Corporate Investments in Common Stock* (Nov. 1984) (unpublished manuscript) (this study, which was based upon the valuation effects of corporate investments of five percent or more, compared the profitability of target and raider under several possible outcomes including a completed takeover, a targeted repurchase (i.e. greenmail), a takeover by a third party and a sale of the purchased shares. When the outcome was greenmail, the study found that the positive return at the initial announcement of the raider's investment position more than offset the negative return at the outcome announcement (that greenmail was paid)); Mikkelsen and Ruback, *Corporate Investments in Common Stock*, (Feb. 1985) (unpublished manuscript) (the results of this study concur with the previous two, and found that "[t]arget firms on average incur a significant loss of -2.29% in the two-day announcement period of a targeted repurchase." Acquiring firms, on the other hand, experience average abnormal returns of 2.13% at the announcement of the greenmail payment. *Id.* at 27). (Manuscript on File at Pace Law Review office).

78. In their study, *Targeted Repurchase and Common Stock Returns*, *supra* note 77, Mikkelsen and Ruback state that:

[o]verall, our evidence raises the burden of proof for those who argue that targeted repurchases harm the repurchasing firm's shareholders. The argument that a targeted repurchase harms shareholders requires evidence that the targeted repurchase was dominated by an alternative course of action. Evidence of only price effects cannot determine whether repurchases are in stockholders' interests. In other words, we cannot resolve whether targeted repurchases cause the observed decrease in shareholders' wealth or whether the targeted repurchases convey unfavorable information which motivated the decisions to repurchase shares.

Id. at 3.

An analysis of targeted repurchases conducted by Kidder, Peabody & Co. and presented to the House Subcommittee on Telecommunications, Consumer Protection and Finance, *Hearings*, *supra* note 27, at 446-66, also tends to confirm the findings of Mikkelsen and Ruback. This study, based on 220 buybacks from January, 1979 to December, 1983, found that "the stock price movement of companies who have repurchased a block of their securities since 1979 shows that in approximately 70% of the cases, the current market price is in excess of the premium purchase price paid to the accumulators." *Id.* at 447.

Honorable Arthur J. Goldberg, former Supreme Court Justice and a member of the SEC Advisory Committee on Tender Offers, has also expressed dissatisfaction with the stock price indicator and its mysterious influences. He stated:

[n]o evidence was presented to the Advisory Committee and no authoritative study seems to have been made as to whether, in the long run, tender offers have contributed to corporate viability or profitability or have benefitted shareholders of the offeror or target company or the public. Instead, attention has been focused

Aside from the arguable loss to shareholder wealth from stock market declines, the payment of greenmail inflicts other hardships on shareholders. Greenmail is often used as a means by which the target management can prevent a proxy contest or tender offer from materializing.⁷⁹ This circumvents the purpose of the tender offer mechanism, which permits the bidder to appeal directly to the shareholders, since under many state corporation laws shareholder approval of a merger can only be made subsequent to approval by the board of directors.⁸⁰ When target management is able to bypass the tender offer mechanism, shareholders are deprived of the tender offer for their stock (usually at prices above the market value) and the rising value of their stock based upon market speculation of a takeover.⁸¹ In

on stock prices which are based primarily on market perceptions at the time of the tender offer. Moreover, the market is influenced by many factors, some of which relate to stock values and others to the general economy, inflation, interest rates and the like.

Hon. Goldberg, *Regulation of Hostile Tender Offers: A Dissenting View and Recommended Reforms*, 43 MD. L. REV. 225, 228 (1984).

79. Gilson, *A Structural Approach to Corporations: The Case Against Defensive Tactics in Tender Offers*, 33 STAN. L. REV. 819 (1981). "Major forms of defensive tactics achieve success not because they convince target shareholders to retain their shares, but because they prevent the offer from being made, or if made, consummated, and thereby ensure that shareholders cannot make, from management's perspective, the 'wrong' decision." *Id.* at 819.

See also Prentice, *Target Board Abuse of Defensive Tactics: Can Federal Law be Mobilized to Overcome the Business Judgment Rule?* 8 J. CORP. LAW 337, 344 (1983).

80. For a discussion of the historical background and changes in shareholder approval of corporate mergers, see generally Scriggins and Clarke, *Takeovers and the 1983 Maryland Fair Price Legislation*, 43 MD. L. REV. 266, 267 (1984).

See also Lipton, *Takeover Bids in the Target's Boardroom* 35 BUS. LAW. 101 (1979).

[w]here the only issue in a tender offer is price, our present legal structure permits a raider, after compliance with the applicable federal and state laws, to short-circuit acceptance by the directors of the target and to make its offer directly to the shareholders of the target. The shareholders then have the power, independent of the directors, to determine whether or not to accept the offer.

Id. at 116.

81. The expectation that a tender offer will occur tends to drive up the price of the stock. This expectation is often triggered when a raider files a Schedule 13D with the SEC indicating an "initial foothold acquisition" in the target company. According to the SEC STUDY ON THE IMPACT OF GREENMAIL, *supra* note 2:

[t]he average net-of-market stock return for the 89 cases during the initial foothold acquisition is 9.7%. This is measured from twenty trading days before to five trading days after public announcement of the acquisition. This large, positive return reflects widespread expectations that the acquisition of these stock blocks will confer substantial future benefits to shareholders. The specific sources of

addition, the target management is able to retain control over the corporation, preserve their positions by eliminating the takeover threat, and thus deny shareholders the opportunity to vote a change in management.⁸²

Thus, there seems to be sufficient evidence that greenmail payments tend to stifle tender offers and proxy contests which are potentially beneficial to the shareholders. Moreover, despite some conflicting evidence, there are indications that the payment of greenmail actually causes stock values to decline.

B. *Existing Legal and Commercial Mechanisms*

Regulation of greenmail need only be considered if existing legal and commercial mechanisms are incapable of protecting shareholder and corporate interests. Currently, there are no adequate safeguards in the marketplace, common law, or federal or state law. Greenmail is neither prohibited nor discouraged, as evidenced by the increase in the size and number of greenmail payments in recent years.⁸³

1. *Market Self-Regulation*

The failure of the market to develop a way to protect target companies from the threat of greenmail is evidenced by the

these benefits have been the subject of much research. They include takeovers, proxy fights, and closer monitoring that can cause various improvements in the utilization of the target's assets.

Id. at 7.

The results of the Mikkelson and Ruback study, *Corporate Investments in Common Stock*, (Nov. 1984) (unpublished manuscript), tend to confirm this evidence of shareholder optimism.

A successful takeover is the least profitable outcome for acquiring firms and the most profitable outcome for the target firms. When the final outcome is a successful takeover attempt by a third party, the total return is positive for both the acquiring firm and the target firm. The most profitable outcome for the acquiring firm is either the sale of shares or a targeted repurchase. Target firms realize a small, but statistically significant, positive abnormal return for investments that conclude with targeted repurchases.

Id. at 3.

82. Some legal scholars, such as Professor Ronald Gilson of Stanford University School of Law, have suggested that the unhindered operation of the tender offer process may be one of the most effective ways to "police" target management and keep them accountable to their shareholders. See Gilson, *supra* note 79, at 848.

83. See *supra* note 19.

methods currently chosen by targets to insulate themselves from greenmail and takeover threats. First, many companies opt to pay greenmail with above-market premiums to the raider.⁸⁴ This practice has occurred with increasing frequency over the past ten years.⁸⁵ Second, many corporations have opted for "delisting," or dropping from the list of stocks traded on the national exchanges by "going private," in order to diminish the voting power of the public shareholders.⁸⁶ This often involves a "leveraged buyout," whereby corporate assets serve as collateral for loans used to finance the repurchase of a majority of the company's stock.⁸⁷ Third, corporations have implemented a wide variety of defensive tactics known as "shark repellent" or "porcupine" measures to fend off unwanted suitors.⁸⁸ These measures include: changes in the corporate articles of incorporation, charter or bylaws to prohibit corporate buybacks⁸⁹ or to provide for

84. According to the SEC STUDY ON THE IMPACT OF GREENMAIL, *supra* note 2, at 1, from January, 1979 to September, 1984 target companies paid individual shareholders (or certain groups of shareholders) more than \$5.5 billion to repurchase blocks of their stock.

85. See *supra* note 19 and accompanying text.

86. See Wheat, *supra* note 42.

87. See Reiser, *supra* note 9, at 44. "LBO's have become increasingly popular as a means of averting a hostile takeover bid. The procedure, which takes the company private, gets its name from the fact that it involves a high level of debt in relation to equity." *Id.*

See generally Longstreth, *New Controls for Leveraged Buyouts*, N.Y. Times, Nov. 6, 1983, at F3, col. 1; Metz, *How a Leveraged Buyout Works: A Look at Charterhouse's Success*, Wall St. J., Mar. 17, 1982, § 2 at 29, col. 4.

88. Rosenzweig, *The Legality of "Lock-Ups" and Other Responses of Directors to Hostile Takeover Bids or Stock Aggregations*, 10 SEC. REG. L.J. 291 (1983).

Another technique frequently employed by directors to deflect takeover bids has been the use of defensive charter and bylaw provisions, otherwise known as "shark repellent" or "porcupine" provisions. Although the increasing frequency with which companies have enacted such provisions has moved the SEC's Division of Corporate Finance to announce its position on the subject, their utility in accomplishing their intended purpose has been widely questioned.

Id. at 309.

Cf. BALDWIN, *CONFLICTING INTERESTS* at 167-79 (1984); Gilson, *The Case Against Shark Repellent Amendments: Structural Limitations on the Enabling Concept*, 34 STAN. L. REV. 775 (1982); Hudson, *The Use of Shark Repellent Charter Provisions to Forestall Hostile Takeover Bids*, 62 MICH. BAR J., July 1983, at 522.

89. For example, Mead Corp. has had a provision in its bylaws for 50 years forbidding stock repurchases at a premium unless it is part of a general tender offer.

Mobil Corp. recently called for an anti-greenmail amendment to its certificate of incorporation in an apparent move to counteract a possible takeover by raider T. Boone

staggered terms of office for directors; prohibiting so-called "frontend loaded offers" by raiders;⁹⁰ requiring a supermajority vote to approve takeover bids;⁹¹ reincorporation in states such as Delaware with laws favorable to corporate management; and limiting voting power to closely held classes of stock.⁹² These methods chosen by target corporations to protect themselves are illustrative of the defenseless position in which they find themselves.

It should be briefly noted here, that according to a study conducted by the Office of the Chief Economist of the SEC, entitled *Shark Repellants: The Role and Impact of Antitakeover Charter Amendments*, there was an aggregate loss of \$1.35 billion to the shareholders of the 127 NYSE, ASE and over the counter (OTC) corporations studied as a result of the adoption of the anti-takeover amendments.⁹³ The SEC report suggests that the aggregate stock price declines support the conclusion that these anti-takeover devices (primarily fair price and supermajority provisions) are perceived by the market as devices

Pickens. See *Mobil Proposes Protections* 134 N.Y. Times, Jan. 12, 1985, at 21, col. 6. For another example of a similar charter amendment, see *Annual Meeting Briefs - Ralston Purina Co.*, Wall St. J., Jan. 18, 1985, at 35, col. 2.

In its February 22, 1985 Notice of Annual Meeting of Stockholders, the NCR Corporation recommended shareholder approval of its anti-greenmail charter amendment that would prohibit the company from repurchasing stock from an "interested shareholder" at a premium over market price unless approved by a majority of the voting stockholders. Management justified the change for the following reasons:

[t]he Board feels that it is advisable to protect the Company's present stockholders from the possibility of unequal future treatment; by adopting the proposed amendment, the Company's stockholders would send a clear communication to corporate speculators that the Company is not vulnerable to the above-described tactic. This tactic, commonly known as "greenmail", has been the subject of recent litigation, legislative consideration and commentary by both business leaders and legislators. There is currently no Federal or state law that prohibits the use of this tactic. Therefore, the Board believes that action should be taken to minimize the possibility of the tactic being used against the Company and against the interests of the stockholders as a whole.

NCR CORP., NOTICE OF ANNUAL MEETING OF STOCKHOLDERS, 14-15 (Feb. 22, 1985).

90. See *Hearings*, *supra* note 27, at 155 (statement of Martin Lipton).

91. "Supermajority" votes require a high percentage of the vote, such as 75-80%. See Reiser, *supra* note 9, at 50.

92. *Id.*

93. See THE OFFICE OF THE CHIEF ECONOMIST, SECURITIES AND EXCHANGE COMMISSION, *SHARK REPELLENTS: THE ROLE AND IMPACT OF ANTITAKEOVER CHARTER AMENDMENTS* (Sept. 7, 1984).

to entrench management.⁹⁴ Thus, although the concept of a corporate charter or bylaw amendment may appear more palatable from the perspective of shareholder democracy and corporate control,⁹⁵ it may also result in a significant loss to shareholder wealth and serve to entrench management.⁹⁶

This author has been able to discover only two significant collective initiatives to control the practice of greenmail in the commercial sector. First, the Financial Accounting Standards Board (FASB), a major rule-making body for accountants, is considering a proposed accounting rule to categorize the greenmail premium paid by target companies as an expense and charge it against reported profits.⁹⁷ Currently, such premiums are deducted from the treasury stock account on the balance sheet and have not affected profits. The proposal is highly controversial, and many of its critics believe that it will only suppress stock values of the target by lowering the profit margin.⁹⁸ The measure would thus permit the payment of greenmail as a defensive maneuver, but would penalize the target once payment was made.⁹⁹

A second initiative has emerged from the nationally-based Council of Institutional Investors. This organization, comprised

94. *Id.* at 17.

95. Commentators have been wary of the degree of influence that target company directors may have in the passage of such anti-takeover amendments to corporate charters. See Rosenzweig, *supra* note 88. "It should be emphasized that, like most other target responses to takeover bids, charter and bylaw amendments have been protected by the presumption of validity that accompanies any exercise of directors' power." *Id.* at 310. See also *McKee & Co. v. First Nat'l Bank*, 265 F. Supp. 1, 4 (S.D. Cal. 1967), *aff'd*, 397 F.2d 248 (9th Cir. 1968).

The SEC ADVISORY COMMITTEE ON TENDER OFFERS REPORT OF RECOMMENDATIONS, *supra* note 49, at 35, recommended that Congress should adopt legislation to prohibit the use of charter and bylaw provisions that erect high barriers to change of control and thus operate against the shareholders and the national market place. In making its final recommendation to Congress, the SEC, while sharing the same concern as the Committee, disagreed with the Committee's recommendation on the grounds that it would constitute too great an intrusion into state corporation law. See *Hearings*, *supra* note 27, at 35 (statement of Committee Recommendations and the Commission's Positions and Contemplated Actions).

96. See *supra* note 93 and accompanying text.

97. See Berton, *FASB May Soon Weigh Rule Hampering Ability of Companies to Pay Greenmail*, Wall St. J., June 14, 1985, at 5, col. 1.

98. *Id.*

99. *Id.*

of several of the largest state and local pension funds, including those from California, Connecticut, New Jersey, New York and Wisconsin, has collective assets of more than \$100 billion and controls a substantial share of the securities market.¹⁰⁰ The Council plans to reevaluate the fiduciary role of pension fund trustees in the context of corporate takeovers involving stock held by the fund.¹⁰¹ Former U.S. Labor Department administrator of the Office of Pension and Welfare Benefit Programs, Robert Monks, had criticized institutional investors for supporting target management in all defensive tactics — including greenmail payments — rather than voting against the misuse of corporate assets.¹⁰² In the past, pension funds were badly injured when stock values in target companies plummeted after greenmail was paid, and fund portfolio values dropped as a result.¹⁰³

These two initiatives are still in developmental stages and have not yet been implemented. Thus, regardless of their merits in the long run, there are no existing prohibitions or disincentives to curb the practice of greenmail except shark repellent charter amendments which may result in a decline in shareholder wealth.

2. Existing Federal Law

Current federal securities laws do not regulate or prohibit the payment of greenmail. The Williams Act of 1968,¹⁰⁴ which amended the Securities Exchange Act of 1934,¹⁰⁵ was enacted to regulate cash tender offers through the use of disclosure require-

100. See Bleakley, *A Trustee Takes on Greenmailers*, N.Y. Times, Feb. 10, 1985, at F6, col. 1; *Pension Funds Agree to Organize to Fight 'Raiders' of Concerns*, Wall St. J., Jan. 4, 1985, at 6, col. 5; see generally DeBenedictis, *Pension Funds Plan for 'Greenmail' Council*, 97 L.A. Daily J., July 2, 1984, at 3, col. 1; Harris, *Unruh Urges Fight Against 'Greenmail'*, L.A. Times, July 27, 1984, IV, at 1, col. 6; Smith, *California Official Moves to Organize Pension Funds to Combat Greenmail*, Wall St. J., July 26, 1984, at 12, col. 2.

101. See *supra* note 100.

102. See *Red Light Flashed at Greenmail*, Pa. L.J. Rep., July 16, 1984, at 1, col. 3; see also *The Pension Watchdog is No Longer a Pussycat*, Bus. Wk., Oct. 8, 1984, at 152.

103. See *supra* notes 100, 102.

104. 15 U.S.C.A. §§ 781(i), 78m(d)-(e), 78n(d)-(f) (West 1981). The Williams Act is the popular name of Pub. L. 90-439, 82 Stat. 454 (1968) which added §§ 13(d), 13(e) and 14(d)-(f) to the Securities Exchange Act of 1934.

105. 15 U.S.C.A. §§ 77(b)-(e), 77(j), 77(k), 77(m), 77(o), 77(s), 78(a)-(d), 78(e)-(k-1), 78(l), 78(m)-(o), 78(o-3), 78(o-4), 78(p)-(q-1), 78(r)-(dd-2), 77(e)-78(hh), 78(ii)-(jj notes), 78(kk) (West 1981).

ments in response to the growing number of takeovers and tender offers in the country.¹⁰⁶ The principal disclosure provisions of the Act are contained in sections 13(d) and 14(d). Section 13(d)¹⁰⁷ requires a purchaser of a security to file a Schedule 13D¹⁰⁸ with the SEC within ten days of the purchase if the purchase exceeds five percent of the target's outstanding securities. Section 14(d)¹⁰⁹ requires a tender offeror to file similar information with the SEC to give shareholders in the target company a fair opportunity to make their investment decision.¹¹⁰ The Williams Act also contains a number of substantive provisions designed to protect shareholders who tender their shares in response to a tender offer.¹¹¹

The theme of the Williams Act is the protection of the investor by means of tender offer disclosure information. This method, which has been labeled a "market approach," advocates a non-interventionist means of supplying the investor with sufficient information upon which to reasonably base an investment decision.¹¹² The Act carefully preserves its regulatory impartiality by mandating disclosure, in an effort not to "tip the balance"

106. See H.R. REP. No. 1711, 90th Cong., 2d Sess., reprinted in, 1968 U.S. CODE CONG. & AD. NEWS 2811.

107. 15 U.S.C.A. § 78m(d) (West 1981). See generally Comment, *Section 13(d) and Disclosure of Corporate Equity Ownership*, 119 U. PA. L. REV. 853 (1971).

108. A Schedule 13D requires any person who becomes the beneficial owner of five percent or more of a company's outstanding securities to file certain information within 10 days of the purchase, including information about whether a "control purpose" is contemplated. See Annot., 57 A.L.R. FED. 806 (1982).

109. 15 U.S.C.A. § 78n(d) (West 1981).

110. *Id.* See generally *MITE Corp. v. Dixon*, 633 F.2d 486 (7th Cir. 1980), *aff'd sub nom*, *Edgar v. MITE Corp.*, 457 U.S. 624 (1982).

111. *MITE*, 633 F.2d at 492.

112. *Id.* See also *Rondeau v. Mosinee Paper Corp.*, 422 U.S. 49, 58 (1975) ("the purpose of the Williams Act is to insure that public shareholders who are confronted by a cash tender offer for their stock will not be required to respond without adequate information . . .") Sen. Williams (D-N.J.), the sponsor of the Williams Act, reiterated the disclosure purpose of the legislation in the Senate debate:

[t]oday, the public shareholder in deciding whether to accept or reject a tender offer possesses limited information. No matter what he does, he acts without adequate knowledge to enable him to decide rationally what is the best course of action. This is precisely the dilemma which our securities laws are designed to prevent.

113 CONG. REC. 24,664 (1967) (Remarks of Sen. Williams, *quoted in*, *Schreiber v. Burlington Northern, Inc.*, 105 S. Ct. 2458, 2463 (1985)).

in favor of the raider or target.¹¹³

The Williams Act does not address the issue of greenmail. However, the House Report accompanying the Act acknowledged the growing importance of corporate buybacks by the issuer as a means by which to consolidate voting power and frustrate tender offers.¹¹⁴ No specific legislative guidelines were established to regulate corporate buybacks, but the SEC was given a mandate to adopt regulations requiring appropriate disclosures when corporations repurchase their own securities, pursuant to section 13(e).¹¹⁵ Under this rule-making authority, the SEC has promulgated three regulations concerning stock buybacks by issuing companies. Rule 13e-1¹¹⁶ requires an informational filing by the issuer when a bidder has made a tender offer and the issuer thereafter intends to purchase its own securities. Information such as the names of persons from whom the securities are to be purchased, the purpose of the buyback, and the source of the funding, must be included in the filing.¹¹⁷

Rule 13e-3¹¹⁸ requires the disclosure of certain information by the issuer when a stock repurchase by the issuer would cause the corporation to "go private," i.e., the stock of a section 12(g) or section 15(d) issuer¹¹⁹ would be held by less than 300 persons or the corporation would be "delisted" on a national securities exchange.¹²⁰ Rule 13e-4¹²¹ requires informational disclosures by the issuer when the issuer makes a formal tender offer under section 13(e) for its own stock.¹²²

113. See 1968 U.S. CODE CONG. & AD. NEWS, *supra* note 106, at 2813.

114. *Id.* at 2814.

115. 15 U.S.C.A. § 78m(e)(1) (West 1981).

116. 17 C.F.R. § 240.13e-1 (1985).

117. *Id.*

118. 17 C.F.R. § 240.13e-3 (1985).

119. A section 12(g) issuer has total assets exceeding \$1,000,000 and a class of non-exempt equity security held of record under section 12(g)(1)(A) by 750 or more persons, or under section 12(g)(1)(B) by more than 500 but less than 750 persons. 15 U.S.C.A. § 781(g)(1) (West 1981). See 17 C.F.R. § 240.12g-1 (1985) for additional exemptions.

A 15(d) issuer includes all issuers who must file periodic or supplementary information pursuant to section 78m regarding securities registered under section 781, except securities issued by a foreign government or political subdivision. 15 U.S.C.A. § 78o (West 1981).

120. 17 C.F.R. § 240.13e-3 (1985).

121. 17 C.F.R. § 240.13e-4 (1985).

122. Such a situation is commonly referred to as a self-tender offer and is governed

The payment of greenmail tends to elude the three situations covered by the SEC rules. For example, in the first situation under Rule 13e-1, greenmail is often paid to *prevent* a tender offer, not subsequent to one.¹²³ In the second situation, under Rule 13e-3, greenmail payments do not generally cause a company to be delisted or go private.¹²⁴ Most greenmailers hold a stake which accounts for less than twenty-five percent of a company's outstanding securities, so the danger of causing a company to go private is minimal.¹²⁵ In the third situation, under Rule 13e-4, although greenmail may sometimes be disguised under the larger umbrella of a self-tender by the issuer,¹²⁶ it is more often than not accomplished through private negotiation with the raider thereby enabling the company to circumvent the requirement of a self-tender and Rule 13e-4.¹²⁷

In sum, the Williams Act does not prohibit the practice of greenmail, and the regulations promulgated by the SEC to monitor issuer buybacks are not sufficiently sensitive to result in the disclosure of greenmail transactions.

3. *Existing State Law*

Corporate stock repurchases or buybacks are regulated by two types of state laws: corporation law and takeover law.¹²⁸ However, the states, like the federal government, have declined

by the general tender offer rules and regulations of the act. *Id.*

123. *See supra* note 79.

124. *Cf.* notes 19, 42, 87 and accompanying text. The author knows of no formal study as to how often the payment of greenmail has caused companies to go private.

125. In support of this position is the fact that none of the largest leveraged buyouts in the first half of 1984 involved the same companies of the largest greenmail transactions. *See Leading Deals and Deal Makers in the First Half of This Year*, N.Y. Times, July 3, 1984, at D6, col. 1. Moreover, of the seven largest greenmail payments in the first half of 1984, the average stake held was 9.1%. *Id.* Under the Kidder, Peabody & Co. study, *see Hearings supra* note 27, at 446-66, if one averages out the amount of stock repurchased in each of the 220 cases, the average stake amounts to 12.7%.

126. *See supra* note 29 and accompanying text.

127. *See supra* note 54 and accompanying text.

128. In its recommendations to Congress regarding tender offer legislation, the SEC stated that state takeover law should be confined to local companies, so as not to conflict with federal takeover law. The SEC also suggested that federal takeover law should not interfere with state corporation law, except to the extent necessary to eliminate abuses or interference with the federal law. *See Hearings, supra* note 27, at 22 (Committee Recommendations and the Commission's Positions and Contemplated Actions).

to regulate the practice of greenmail.

State corporation laws have traditionally regulated the relationship between shareholders and corporate management.¹²⁹ No state prohibits a corporation from purchasing its own shares.¹³⁰ Most state statutes contain some minimal restrictions on the power of a corporation to repurchase its own shares.¹³¹ The majority of states authorize such a purchase by the issuer as long as the corporation is solvent and the buyback would not create insolvency.¹³² Many states mandate that there be no resultant "impairment of capital."¹³³ Several states permit a stock repurchase only if it is paid from the corporation's "earned surplus" or "paid-in surplus." The definition of these terms vary from state to state.¹³⁴ Other states have added further restrictions on

129. *Cort v. Ash*, 422 U.S. 66 (1975). "Corporations are creatures of state law, and investors commit their funds to corporate directors on the understanding that, except where federal law expressly requires certain responsibilities of directors with respect to stockholders, state law will govern the internal affairs of the corporation." *Id.* at 84.

130. See Note, *supra* note 32, at 320 app. A. See generally *Israels, Limitations on the Corporate Purchase of its Own Shares*, 22 Sw. L.J. 755 (1968).

131. See, e.g., CAL. CORP. CODE § 510 (West 1977); MINN. STAT. ANN. § 302A.553 (West 1985); see *infra* notes 132-135 and accompanying text.

132. See, e.g., ALASKA STAT. § 10.05.210 (1985); COLO. REV. STAT. § 7-3-102(4) (1973); FLA. STAT. ANN. § 607.017 (West 1977); HAWAII REV. STAT. § 416-28(3) (1976); IND. CODE § 23-1-2-3 (1984); KAN. STAT. ANN. § 17-6603(d) (1981); LA. REV. STAT. ANN. § 12:55(A) (West 1969); MICH. COMP. LAWS ANN. § 450.1365(2)(b) (1973); MISS. CODE ANN. § 79-3-131 (1973); MO. ANN. STAT. § 351-200(1) (Vernon Supp. 1985); N.J. STAT. ANN. § 14A:7-16(5)(b) (West 1969); N.C. GEN. STAT. § 55-52(e)(2) (1982); N.D. CENT. CODE § 10-19-05(1) (1976); OHIO REV. CODE ANN. § 1701.35(B) (Page Supp. 1984); S.C. CODE ANN. § 33-9-180(e) (Law. Co-op. Supp. 1981); VA. CODE § 13.1-40 (1978); W. VA. CODE § 31-1-112 (1982). In *re Brown's Estate*, 130 Ill. App. 2d 514, 264 N.E.2d 287 (1970); *Cate v. Pagel-Cliekman Co.*, 87 Ill. App. 2d 65, 230 N.E.2d 387 (1967); 13 ILL. LAW & PRAC. CORPORATIONS § 375, at 525 (1955). See also ILL. ANN. STAT. ch. 32, § 9.05 (Smith-Hurd 1984), while not explicitly mandating corporate solvency it has been interpreted by the courts as requiring such.

133. See, e.g., DEL. CODE ANN. tit. 8, § 160(1) (1983) (interpreted in *In re Reliable Mfg. Corp.*, 703 F.2d 996 (7th Cir. 1983) as prohibiting a corporation from purchasing its own stock when the purchase would impair its capital as of the date the price must be paid); KAN. STAT. ANN. § 17.6603(d) (1981); MO. ANN. STAT. § 351.200(1) (Vernon Supp. 1985); W. VA. CODE § 31-1-116 (1982) (in *Mountain State Steel Foundries, Inc. v. Commissioner*, 284 F.2d 737 (4th Cir. 1960), the court construed the term "impairment of capital" to mean the depletion of realizable value of assets to a point below total liabilities and capital); see also Note, *supra* note 32, at 320.

134. See, e.g., ALASKA STAT. § 10.05.012 (1985); CAL. CORP. CODE § 1707(c) (West 1985) (see *In re Belmetals Mfg. Co.*, 299 F. Supp. 1290 (N.D. Cal. 1969), *aff'd sub nom.*, *Eranosian v. England*, 437 F.2d 1355 (9th Cir. 1971) purchases by corporations must be from "earned surplus"); COLO. REV. STAT. § 7-3-102(1) (1974); FLA. STAT. ANN. §

the corporation's ability to repurchase its own shares.¹³⁵ In the states without legal capital statutes, common law generally authorizes stock repurchases by the issuing corporation.¹³⁶ However, the common law is silent on the subject in two states.¹³⁷

Thus, under the state corporation laws, target corporations are permitted to repurchase their own stock subject only to certain balance sheet considerations of the legal capital statutes.¹³⁸ Under these laws, the only time a greenmail payment might be considered illegal would be if it caused the corporation to become insolvent, was not paid from the requisite "surplus," or violated the statute in some other way.¹³⁹

State takeover legislation has also been ineffective in regulating the practice of greenmail. State takeover legislation generally governs the relationship between the bidder and the target corporation during tender offers.¹⁴⁰ Takeover legislation can be grouped into three major categories. The Maryland approach¹⁴¹ imposes fair price requirements on potential acquirers.¹⁴² The

607.017(2) (West 1977); HAWAII REV. STAT. § 416-28 (1976) (permits purchase from paid-in surplus and surplus created by a reduction in capital stock); IND. CODE § 23-1-2-3 (1984); MICH. COMP. LAWS ANN. § 450.1365 (1973) (see *Davis v. Brydges*, 122 Mich. App. 768, 333 N.W.2d 127 (1983) construing the meaning of "surplus"); N.H. REV. STAT. ANN. § 294:28 (1966); N.Y. BUS. CORP. LAW § 513 (McKinney 1963) (see *In re Dawson Bros. Constr. Co.*, 218 F. Supp. 411 (N.D.N.Y. 1963) prohibiting corporate purchase of its own stock except from "surplus"); N.C. GEN. STAT. § 55-52(c) (1982) (certain purchases must be made out of "surplus"); N.D. CENT. CODE § 10-19-05(2) (1976); S.C. CODE ANN. § 33-9-180(b) (Law. Co-op. Supp. 1981); VA. CODE § 13.1-4 (1978).

135. See, e.g., GA. CODE ANN. § 14-2-94 (1982); HAWAII REV. STAT. § 416-28 (1976); ILL. ANN. STAT. ch. 32, § 9.05 (Smith-Hurd 1984); KAN. STAT. ANN. § 17.6603 (1981); MD. CORPS. & ASS'NS CODE ANN. § 2-310 (1985).

136. In states without statutory restrictions on corporate buybacks, such purchases are permitted under common law if made in good faith and without prejudice to creditors. *Americanized Finance Corp. v. Yarbrough*, 223 Ala. 266, 135 So. 448 (1931); *Copper Belle Mining Co. v. Costello*, 11 Ariz. 334, 95 P. 94 (1908); *Bates Street Shirt Co. v. Waite*, 130 Me. 352, 156 A. 293 (1931); *Winchell v. Plywood Corp.*, 324 Mass. 171, 85 N.E.2d 313 (1949).

137. There is no relevant statutory or case law in Idaho and New Mexico.

138. See *supra* notes 132-137 and accompanying text.

139. *Id.*

140. See HOUSE REPORT, *supra* note 7, at 13.

141. This approach has also been adopted by Connecticut, Kentucky and Michigan. See Lewin, *infra* note 142.

142. See Lewin, *Business and the Law: State Controls On Takeovers*, N.Y. Times, Nov. 27, 1984, at D2, col. 1. For an excellent synopsis of the recent history of state takeover statutes see *Hearings, supra* note 27, at 289 (statement of Morgan Shipman for the Ohio Manufacturers' Association, and accompanying app. B).

Ohio model¹⁴³ requires that shareholders be allowed to vote on any transaction that would give an acquirer a controlling stake in a company.¹⁴⁴ The Pennsylvania approach, which is the least favorable to bidders, mandates that any holder of thirty percent or more of a public corporation, who does not have approval of the board of directors, *must* make a tender offer for the remaining outstanding stock at market value.¹⁴⁵

Although the takeover laws may make the threat of greenmail less likely by making it more difficult to acquire a substantial stake in a company, the practice is nowhere prohibited. Moreover, a recent United States Supreme Court decision placed the constitutionality of many of the state takeover statutes "under a cloud."¹⁴⁶ In *Edgar v. MITE Corp.*,¹⁴⁷ the Supreme Court held that the Illinois Business Take-Over Act¹⁴⁸ was unconstitutional because it created an unreasonable indirect burden on interstate commerce in violation of the Commerce Clause.¹⁴⁹ In addition, three Justices held that the statute was

143. This approach has also been followed by Minnesota and Wisconsin. See Lewin, *supra* note 142.

144. See Lewin, *supra* note 142.

145. See *Pennsylvania Bill on Dissident Stakes Clears Legislature*, Wall St. J., Dec. 15, 1983, at 42, col. 1; Inman, *Pennsylvania Senate is Seen Near Vote on Bill that May Deter Dissident Investors*, Wall St. J., Dec. 6, 1983, at 12, col. 1.

146. See HOUSE REPORT, *supra* note 7, at 13.

147. 457 U.S. 624 (1982).

148. ILL. ANN. STAT. ch. 121-½, §§ 137.51-70 (Smith-Hurd 1985).

149. See *MITE*, 457 U.S. at 646. Before the *MITE* decision was issued, state takeover laws had already encountered a great deal of opposition in the lower courts. See, e.g., *Kennecott Corp. v. Smith*, 637 F.2d 181 (3d Cir. 1980) (reasonable likelihood that the New Jersey Tender Offer Act which delayed takeover for five days was preempted by the Williams Act, according to the Third Circuit); *Hi-Shear Industries, Inc. v. Neiditz*, FED. SEC. L. REP. (CCH) ¶ 97,805 (D. Conn. Dec. 3, 1980) (district court in Connecticut held that the target company's option to hold a hearing on the adequacy of the bidder's disclosure under the Connecticut Tender Offer Act would violate the Supremacy and Commerce Clauses of the U.S. Constitution if the Commissioner found that the Act was preempted by the Williams Act); *Hi-Shear Industries, Inc. v. Campbell*, FED. SEC. L. REP. (CCH) ¶ 97,804 (D.S.C. Dec. 4, 1980) (district court in South Carolina held that the South Carolina Tender Offer Disclosure Act was preempted by the Williams Act because it caused tender offer delays). See also *State Takeover Statutes and the Williams Act (A Report of the Subcommittee on Proxy Solicitations and Tender Offers of the Federal Regulation of Securities Committee)*, 32 BUS. LAW. 187 (1976):

[a]nother fundamental objection to the state takeover statutes which has been raised is their extraterritorial application. Historically, state blue sky laws have regulated transactions in which the buyer is physically located within the state. The takeover statutes purport to govern transactions between the purchaser and

preempted by the federal Williams Act legislation under the Supremacy Clause of the United States Constitution.¹⁵⁰

The Illinois statute provided, *inter alia*, that the Secretary of State could pass upon the fairness of a takeover offer made by a bidder based upon information disclosed pursuant to the statute.¹⁵¹ In addition, the Secretary had the power to call a hearing for the protection of the offerees upon the written request of the non-employee directors of the target company.¹⁵² The Court found that these procedures conflicted with and were preempted by the Williams Act which requires that neither target nor bidder gain an unfair advantage under tender offer statutes.¹⁵³ The Court found that the Illinois statutory provisions favored target management by delaying the tender offer process at the expense of the bidder.¹⁵⁴

At the time of the *MITE* decision, approximately thirty-five states had takeover legislation.¹⁵⁵ As a result of the decision, the constitutionality of many of these statutes was placed in question and many state legislatures enacted new takeover statutes to conform with the *MITE* decision.¹⁵⁶ However, most of these statutes are still untested.¹⁵⁷ The *MITE* decision suggests that

the seller neither of which is physically within the state.

Id. at 189.

150. *MITE*, 457 U.S. at 639.

151. *Id.* at 627.

152. *Id.*

153. *Id.* at 639.

154. *Id.* at 635.

155. See *Hearings*, *supra* note 27, at 286.

156. See *supra* notes 141-143 and accompanying text.

157. The Minnesota Take-Over Act, which was revised in 1984 to reduce its burden on interstate commerce and tighten its relation to in-state investors, was upheld by the Eighth Circuit as "not facially unconstitutional." The court held that the Act could be narrowly construed to be consistent with the Williams Act. The court noted that the Act was "not unduly burdensome on interstate commerce" and served a legitimate state interest in protecting local investors. *Cardiff Acquisitions v. Hatch*, 751 F.2d 906 (8th Cir. 1984).

Recent proposed legislation to make the New York anti-takeover act conform to the *MITE* decision was sponsored by Assemblyman G. Oliver Koppell (D-Bronx) (A 6971-A) and Senator Jay P. Rolison, Jr. (R-Poughkeepsie) (S 5846-A). See *Governor to Meet With CBS and Turner on Takeover Bill*, N.Y.L.J., July 10, 1985, at 1, col. 3. In *Minstar v. Abrams*, 85 Civ. 3173 (MJL), *Minstar Acquiring Corp.*, headed by raider Irwin Jacobs, (see *supra* note 50), attempted to have the current New York anti-takeover statute declared unconstitutional, but the Attorney General Robert Abrams and the other defendants stipulated to effective non-enforcement of the statute and mooted the issue. This

even if the states were to develop takeover legislation that regulated the greenmail transaction, either by barring the raider from threatening greenmail or the target from paying it, it might well suffer the same fate as the Illinois statute by "tipping the balance" so carefully preserved by the Williams Act.

In sum, state corporation law does not prevent the target from paying greenmail and state takeover legislation has not attempted to regulate the practice, nor is it entirely clear that such an attempt would be constitutional.

4. Existing Common Law

Although the term "greenmail" is a relative newcomer to the judicial system,¹⁵⁸ the practice itself is not new.¹⁵⁹ State laws permitting a corporation to repurchase its own shares,¹⁶⁰ as discussed in Section III(B)(3) *supra*, are subject to an additional common law requirement that the corporate directors fulfill their fiduciary duties of care and loyalty in making the purchases.¹⁶¹ However, these fiduciary duties have not been effectively utilized by the courts as a means to prohibit the practice of greenmail.¹⁶² The primary obstacle to their effectiveness

unreported decision was discussed in *Minstar Acquiring Corp. v. AMF Inc.*, No. 85 Civ. 3800 (MJL) (S.D.N.Y. June 7, 1985) (available Nov. 7, 1985, on LEXIS, Genfed library, Dist file).

158. The term "greenmail" is only briefly mentioned in three federal cases: *Trans World Airlines, Inc. v. Icahn*, No. 85 Civ. 3677 (MJC) (S.D.N.Y. May 28, 1985); *Scientific Computers, Inc. v. Edudata Corp.*, 599 F. Supp. 1092 (D.C. Minn. 1984); *Asarco Inc. v. M.R.H. Holmes A COURT*, 611 F. Supp. 468 (D.N.J. 1985). The term is used in three state cases: *Heckmann v. Ahmanson*, 214 Cal. Rptr. 177 (Cal. Ct. App. 1985); *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946 (Del. 1985); *Moran v. Household Int'l, Inc.*, 490 A.2d 1059 (Del. Ch. 1985).

159. See *supra* note 1 and accompanying text.

160. In *Wolgin v. Simons*, 722 F.2d 389 (8th Cir. 1983), the plaintiff tried unsuccessfully to argue that the repurchase of its own shares by the target company was an *ultra vires* act. The court held that the corporation's agreement to repurchase its stock from a tender offeror at a substantial premium was lawful. The court stated that "[a] corporation acts '*ultra vires*,' or beyond its power, when it acts in an area outside the scope of the power allowed by its charter or statute." *Id.* at 393. The court ruled that since the state statute and corporate charter did not prohibit such a repurchase, the officers had not committed an *ultra vires* act.

161. See Gilson, *supra* note 79, at 821-31.

162. *Id.* Cf. *infra* notes 181, 182, 204, 210 and accompanying text. The courts have been reluctant to apply a strict fiduciary standard to corporate directors, since most corporate decisions involve some degree of self-interest. This reluctance has solidified in the

has been the courts' application of the business judgment rule.¹⁶³ The rule bars judicial inquiry into actions or decisions of corporate management when they are made in good faith and in the exercise of honest judgment.¹⁶⁴

*Cheff v. Mathes*¹⁶⁵ is regarded as the leading case dealing with the application of the business judgment rule to the repurchase of stock by an issuer.¹⁶⁶ The case involved a stockholders' derivative suit in which the plaintiffs alleged that the directors of the corporation had violated their fiduciary duties to the shareholders by improperly purchasing stock at a premium from a dissident shareholder in an effort to perpetuate their own control.¹⁶⁷ The directors defended their position on the basis that an informal investigation had revealed that the dissident shareholder was accumulating a significant stake in the company and had "been a participant, or attempted to be, in the liquidation of a number of companies."¹⁶⁸ The directors asserted that given this background, they refused to entertain his demand to

form of the business judgment rule. In *Johnson v. Trueblood*, 629 F.2d 287 (3d Cir. 1980), *cert. denied*, 450 U.S. 999 (1981), the court stated:

[i]t is frequently said that directors are fiduciaries. Although this statement is true in some senses, it is also obvious that if directors were to be held to the same standard as other fiduciaries the corporation could not conduct business. . . . Yet by the very nature of corporate life a director has a certain amount of self-interest in everything he does. . . . The business judgment rule seeks to alleviate this problem by validating certain situations that otherwise would involve a conflict of interest for the ordinary fiduciary.

Id. at 292.

163. In *Moran v. Household Int'l, Inc.*, 490 A.2d 1059 (Del. Ch. 1985), the court stated that:

[t]he business judgment rule has evolved as a corollary to the principle that a board of directors stands in a fiduciary relationship to the shareholders it represents. Because the role of a fiduciary ordinarily does not admit of any conflicting interests or conduct the business judgment rule seeks to accomodate that status to the realities of the business world.

Id. at 1074.

See also *Johnson v. Trueblood*, 629 F.2d 287, 292 (3d Cir. 1980), *cert. denied*, 450 U.S. 999 (1981).

164. The business judgment rule, in effect, creates a presumption of good faith on the part of corporate directors and places the burden of demonstrating bad faith on the complainant. See *Sinclair Oil Corp. v. Levien*, 280 A.2d 717, 720 (Del. 1971).

165. 41 Del. Ch. 494, 199 A.2d 548 (1964).

166. See Harrington, *If It Ain't Broke, Don't Fix It: The Legal Propriety of Defenses Against Hostile Takeover Bids*, 34 SYRACUSE L. REV. 977, 992 (1983).

167. *Cheff*, 41 Del. Ch. at 502, 199 A.2d at 553.

168. *Id.* at 499, 199 A.2d at 551.

be placed on the board of directors.¹⁶⁹ Moreover, when twenty-five key employees left amid threats of a takeover, the directors decided to buy back the shareholder's stake in the company.¹⁷⁰ The directors argued that their informal investigation and subsequent events indicated that it was in the best interests of the corporation to repurchase the stock.¹⁷¹

The Delaware Supreme Court held in favor of the directors and, applying the business judgment rule, refused to find that the directors had an "improper purpose" in making the stock repurchase.¹⁷² The court adopted a two-prong test to ascertain the scope of a director's fiduciary duty in the repurchase of corporate shares in response to a takeover threat.¹⁷³ The first prong of the test, derived from an earlier Delaware case, *Kors v. Carey*,¹⁷⁴ requires a showing by the directors that the decision to repurchase was made in a good faith belief that "buying out of the dissident stockholder was necessary to maintain what the board believed to be proper business practices" ¹⁷⁵ Furthermore, under this subjective test of motivation, "the board will not be held liable for such decision, even though hindsight indicates the decision was not the wisest course."¹⁷⁶

The second more objective prong of the *Cheff* test derives from another earlier Delaware case, *Bennett v. Propp*.¹⁷⁷ In the

169. *Id.* at 500, 199 A.2d at 551.

170. *Id.* at 500, 199 A.2d at 552.

171. *Id.* at 507, 199 A.2d at 556.

172. *Id.* at 508, 199 A.2d at 556-57.

173. *Id.* at 504, 199 A.2d at 554.

174. 158 A.2d 136 (Del. Ch. 1960). In *Kors*, the plaintiff alleged that the target board of directors had misused corporate funds in purchasing its stock from an aquirer at an excessive price for the sole purpose of maintaining control over the company. The court disagreed with the plaintiffs in deciding that the board had in "good faith" eliminated a clear threat to the future of the business. The court also stated that if the repurchase had been made for the "sole purpose" of retaining control, then it would have been improper. *Id.* at 141.

175. *Cheff*, 41 Del. Ch. at 504, 199 A.2d at 554.

176. *Id.* at 504, 199 A.2d at 554.

177. 187 A.2d 405 (Del. Ch. 1962). In *Bennett*, a director committed the corporation to repurchase its shares. When the other directors were informed of the commitment, they decided to ratify the agreement only because they feared embarrassment to the corporation if they did not agree. The court held the purchasing director liable, but the remaining directors were not held liable. The court made exception to the "improper purpose" doctrine and held that such a decision would be permitted if made upon "prior ignorance and immediate emergency." *Id.* at 411. See also *Potter v. Sanitary Co. of*

words of the *Cheff* court: "[o]n the other hand, if the board has acted solely or primarily because of the desire to perpetuate themselves in office, the use of corporate funds for such purpose is improper."¹⁷⁸ This has been called the "improper purpose" or "sole purpose" test.¹⁷⁹ To satisfy this half of the *Cheff* test, corporate directors must merely show that a reasonable investigation of the facts was conducted before the purchase and that the purchase was made in the best interests of the corporation.¹⁸⁰

The legal effect of the *Cheff* decision on similar cases has been to protect target management from challenge by corporate shareholders.¹⁸¹ Directors need only articulate a business purpose for making a stock repurchase, made in good faith, to satisfy the test under the *Cheff* formulation of the business judgment rule.¹⁸²

However, a recent case decided by a California Superior Court gives an indication that under some circumstances the payment or receipt of greenmail may constitute a violation of a fiduciary duty to corporate stockholders. In *Heckmann v. Ahmanson*,¹⁸³ the court affirmed the lower court's decision to issue a preliminary injunction which effectively created a constructive trust on profits obtained by a dissident shareholder group, amounting to \$60 million, from a greenmail transaction with Walt Disney Productions, Inc.¹⁸⁴ The plaintiff stockholders of Disney alleged that the "Steinberg Group"¹⁸⁵ had breached its

America, 22 Del. Ch. 110, 194 A. 87 (1937).

178. *Cheff*, 41 Del. Ch. at 504, 199 A.2d at 554.

179. See E. FOLK, III, *THE DELAWARE GENERAL CORPORATION LAW* (1972).

180. *Cheff*, 41 Del. Ch. at 508, 199 A.2d at 556.

181. See Gilson, *supra* note 79, at 827-29 (criticizing the *Cheff* decision); Harrington, *supra* note 166, at 993 ("it does not require great creativity to conjure up 'policy' differences with a potential bidder, the practical effect of the *Cheff* tests is to collapse duty of loyalty-conflict of interest cases into duty of care-business judgment cases.").

182. See *supra* note 181. In *Trans World Airlines, Inc. v. Icahn*, No. 85 Civ. 3677 (MJC) (S.D.N.Y. May 28, 1985), the court suggested that the recent decision in *Unocal v. Mesa Petroleum Co.*, 493 A.2d 946 (Del. 1985), which granted broad powers to target management under the business judgment rule, might actually condone a form of "reverse greenmail." The decision suggested that, at least under Delaware law, the target company might be able to exclude the raider's shares from a securities exchange offer to the remaining shareholders through a form of "reverse greenmail."

183. 214 Cal. Rptr. 177 (1985).

184. *Id.* at 188.

185. The "Steinberg Group" consisted of defendants, Saul P. Steinberg, Reliance Financial Services Corporation, Reliance Group, Inc., Reliance Group Holdings, Inc., Re-

duty to the other corporate stockholders by agreeing to accept the payment of greenmail in return for terminating a derivative stockholder suit against Disney.¹⁸⁶ In that derivative lawsuit, the "Steinberg Group" had sought to block Disney from acquiring Arvida, a company heavily laden with debt, in an attempt to discourage the "Steinberg Group" from increasing its holdings in Disney and attempting a takeover.¹⁸⁷ The greenmail payment resulted in a \$60 million profit to the "Steinberg Group," and placed Disney under an even heavier burden of debt.¹⁸⁸

The court stated that the plaintiffs had demonstrated a reasonable likelihood of success¹⁸⁹ on the merits under two theories: that the "Steinberg Group" was liable as an aider and abettor of the Disney directors' breach of fiduciary duty,¹⁹⁰ and that they were independently liable for breach of fiduciary duty as "con-

liance Insurance Co., Reliance Insurance Co. of New York, United Pacific Insurance Co., United Pacific Life Insurance Co., and United Pacific Insurance Co. of New York. *Id.* at 180 n.2.

186. *Id.* at 181.

187. *Id.* at 180.

188. *Id.* at 181.

189. The court did not decide the case on the merits. The sole issue was whether a preliminary injunction should be granted to entitle the plaintiffs to a constructive trust on the profits reaped in the stock sale of the "Steinberg Group." Accordingly, the court sought to determine if the plaintiffs were likely to suffer greater injury from a denial of the injunction than the defendants were likely to suffer from its grant; and if there was reasonable probability that the plaintiffs would prevail on the merits.

190. *Heckman*, 214 Cal. Rptr. at 182. The plaintiffs sued the defendants under several theories of breach of fiduciary duty. First, the plaintiffs argued, successfully, that there was a reasonable probability that the "Steinberg Group" breached its fiduciary duty as a plaintiff in a stockholders derivative action. The plaintiff relied on the decision in *Shelton v. Pargo, Inc.*, 582 F.2d 1298 (4th Cir. 1978). The court reasoned that as a plaintiff in a derivative action, the "Steinberg Group" assumed a fiduciary role as representatives of the other similarly situated plaintiff-shareholders. It appeared likely that the "Steinberg Group" had abandoned this role for "personal aggrandizement." *Heckman*, 214 Cal. Rptr. at 185 (quoting *Shelton v. Pargo, Inc.*, 582 F.2d 1298, 1305 (4th Cir. 1978)).

Second, the plaintiffs citing *Jones v. H.F. Ahmanson & Co.*, 1 Cal. 3d 93, 81 Cal. Rptr. 592, 460 P.2d 464 (1969), argued that the "Steinberg Group" breached its fiduciary duty as a controlling shareholder to other shareholders. Under this theory, a controlling shareholder assumes a fiduciary responsibility by virtue of his ability to influence corporate policy as a major shareholder. *Heckman*, 214 Cal. Rptr. at 182.

Finally, the plaintiffs successfully contended that the defendants acted as aiders and abettors of Disney's directors' breach of fiduciary duty. Under this theory of liability, the "Steinberg Group" acted to facilitate the Disney directors to use the power and position for personal gain and to the detriment of the corporation. The Disney directors failed to meet the threshold requirement of showing an absence of self dealing. *Id.* at 183.

trolling shareholders.”¹⁹¹ Under the first rationale, the court stated that “[t]he acts of the Disney directors — and particularly their timing — are difficult to understand except as defensive strategies against a hostile takeover.”¹⁹² The court saw this as ample preliminary evidence that the directors had “received a personal benefit from the transaction.”¹⁹³ This showing was sufficient to shift the burden of proof under the business judgment rule to the directors to show fair dealing.¹⁹⁴ Thus the court suggested that the greenmail payment may have constituted a breach of fiduciary duty by the directors, for which the “Steinberg Group” could also be liable as aiders and abettors.

The business judgment rule operates to shield corporate directors from liability for their decisions as long as they are made in good faith and without self-dealing.¹⁹⁵ A related issue to the protection offered by the business judgment rule, is the preliminary protection provided by the burden of proof.¹⁹⁶ Generally, the complaining shareholder has the initial burden of proof to show the existence of self-dealing on the part of the directors.¹⁹⁷ Once this is demonstrated, the burden then shifts to the direc-

191. *Heckman*, 214 Cal. Rptr. at 184.

192. *Id.* at 183.

193. *Id.*

194. *Id.* “While there may be many valid reasons why corporate directors would purchase another company or repurchase the corporation’s shares, the naked desire to retain their positions of power and control over the corporation is not one of them.” *Id.* at 182.

See also *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946 (Del. 1985): “[w]e must bear in mind the inherent danger in the purchase of shares with corporate funds to remove a threat to corporate policy when a threat to control is involved. The directors are of necessity confronted with a conflict of interest, and an objective decision is difficult.” *Id.* at 955 (quoting *Bennet v. Propp*, 187 A.2d 405, 409 (Del. 1962)).

195. See *supra* note 164 and *infra* note 196 and accompanying text.

196. The duty of loyalty required a corporate director to act in good faith, and where he is shown to have a self-interest in the transaction, the burden shifts to him. *Horwitz v. Southwest Industries, Inc.*, 604 F. Supp. 1130 (D.C. Nev. 1985). When the director is charged with a breach of his fiduciary duty, he may utilize the business judgment rule to bar inquiry into actions taken in good faith and in the exercise of honest judgment. *Id.* The business judgment rule serves as a defense for directors when it is shown that they acted in a good faith belief that their actions were in the best interests of the corporation, that they exercised due care before acting, and that they did not act in self-interest. *Whittaker Corp. v. Edgar*, 535 F. Supp. 933, 950 (N.D. Ill. 1982). Additionally, directors have a right to rely on information even if it later turns out to be erroneous. *Panter v. Marshall Field Co.*, 646 F.2d 271 (7th Cir. 1981).

197. *Whittaker*, 535 F. Supp. at 950-51.

tors to demonstrate that the decision was honestly considered by the directors to be in the best interests of the corporation.¹⁹⁸ This has proven to be a nearly impossible initial burden of proof to meet, since it is difficult to prove self-dealing in takeover tactics where the interests of the corporation are always arguably at stake.¹⁹⁹ The courts have not been consistent in their requirements to shift the initial burden of proof from the complaining shareholder to the corporate directors under the business judgment rule.²⁰⁰ In *Treadway Companies, Inc. v. Care Corp.*,²⁰¹ the insurgent shareholder (Care Corp.) was sued by Treadway for conspiring to take control of the company.²⁰² Care Corp. counterclaimed on the theory that the directors of Treadway had improperly sold corporate property to a third party, Fair Lanes, Inc., as a white knight, in order to perpetuate their own control over the company.²⁰³ The court held that directors are presumed to act in good faith unless a conflict of interest can be demonstrated by the plaintiff.²⁰⁴ Thus, the plaintiff must sustain his initial burden of proof by demonstrating a conflict of interest to overcome the presumption that the directors acted in good faith.

However, in *Johnson v. Trueblood*,²⁰⁵ the court stated that merely showing "a" motive to retain control does not, *per se*, constitute a conflict of interest.²⁰⁶ The plaintiff was required to show that the "sole or primary motive" of the directors was to retain control.²⁰⁷ The court also noted that "control is always arguably 'a' motive in any action taken by a director."²⁰⁸ The

198. *Id.*

199. See *infra* note 205 and accompanying text.

200. See *supra* note 196.

201. 638 F.2d 357 (2d Cir. 1980).

202. *Id.* at 365.

203. *Id.*

204. *Id.* at 382-83.

205. 629 F.2d 287 (3d Cir. 1980), *cert. denied*, 450 U.S. 999 (1981).

206. *Id.* at 292. In *Johnson*, the plaintiffs, who owned 47% of a real estate development company, sued the defendant directors, who owned 53% of the company, for improperly rejecting a proposed purchase of stock which would have been financially beneficial to the ailing corporation. The plan involved a purchase, by the plaintiffs, of \$20,000 of stock and a purchase, by one of the defendant directors, of \$15,750 of stock. The plan would have created a change in control in favor of the plaintiffs. The court held that the defendants' position was protected by the business judgment rule.

207. *Id.* at 293.

208. *Id.* at 292.

effect of this holding was to create a protective shield for management since plaintiffs must allege something more than a desire to maintain control in order to shift the burden of proof to the directors.²⁰⁹ The courts have thus been willing to condone any defensive strategy as long as it could be attributed to a "rational business purpose."²¹⁰

Despite these decisions, there has been growing conviction among legal scholars that directors have an inherent conflict of interest within the context of a hostile takeover.²¹¹ According to Professor William D. Harrington:²¹²

[t]he business judgment rule was never meant to be applied in cases involving judgments by directors who are interested in the transaction, and the evidence is overwhelming that, to say the very least, directors must necessarily find it exceedingly difficult to act independently in a takeover contest where the incumbent managers to whom they are beholden for their status are to lose both control of the corporation and likely their jobs as well.²¹³

This perspective has found support in a recent Second Circuit decision, *Norlin Corp. v. Rooney, Pace, Inc.*,²¹⁴ in which the court rejected the notion that any action taken by target management during the course of a takeover attempt should be sanctioned by the presumption that the board of directors acted in

209. See Gruenbaum, *Acquisitions and Mergers*, 4 CORP. L. REV. 263, 265 (1981).

210. *Sinclair Oil Corp. v. Levien*, 280 A.2d 717, 720 (Del. 1971). See also *Terrydale Liquidating Trust v. Barness*, 611 F. Supp. 1006, 1019 (S.D.N.Y. 1984). The court stated that a "somewhat more deferential standard has been applied (to the business judgment rule) where retention of control is the alleged basis for self-interest," citing *Panter v. Marshall Field Co.*, 646 F.2d 271 (7th Cir. 1981); *Johnson v. Trueblood*, 629 F.2d 287 (3d Cir. 1980); *Northwest Indus. v. B.F. Goodrich Co.*, 301 F. Supp. 706, 712 (N.D. Ill. 1969). The "primary purpose" standard has also been held to be applicable to prospective anti-takeover tactics. See *Warner Communications v. Murdoch*, 581 F. Supp. 1482, 1491 (D. Del. 1984).

211. See Gruenbaum, *supra* note 176, at 267; Harrington, *supra* note 166, at 1021-22; Prentice, *supra* note 79, at 344; Steinberg, *Some Thoughts on the Regulation of Tender Offers*, 43 MD. L. REV. 240, 243 (1984); Note, *Tender Offer Defensive Tactics and the Business Judgment Rule*, 58 N.Y.U. L. REV. 621, 649-58 (1983) (proposing that if it appears likely that management would have been replaced after a takeover, and they engage in defensive maneuvers, there should be no presumption of good faith under the business judgment rule).

212. William D. Harrington is an associate professor of law at St. John's University School of Law.

213. See Harrington, *supra* note 166, at 1021-22.

214. 744 F.2d 255 (2d Cir. 1984).

good faith.²¹⁵ In this case, Norlin's directors feared a takeover attempt by Piezo Electric Products, Inc.²¹⁶ After failing to procure injunctive relief, Norlin transferred 800,000 shares of authorized but unissued preferred voting stock to a wholly-owned subsidiary in exchange for a \$20 million interest-bearing note.²¹⁷ In addition, Norlin created an employee stock option plan and transferred 185,000 shares of common stock to the plan in exchange for a promissory note.²¹⁸ Three Norlin directors were appointed as trustees to the plan. As a result of these actions, Norlin's directors controlled forty-nine percent of the company's outstanding stock.²¹⁹

The court held that the plaintiff had made an adequate showing of a lack of good faith on the part of the Norlin directors to shift the burden to them. The court found that the fact that Norlin had issued stock to parties controlled by the directors in return for debt indicated a lack of good faith.²²⁰ Moreover, the court rejected Norlin's assertion that the threatened takeover bid supplied the necessary justification for all subsequent actions by the board of directors.²²¹ The court found that Norlin had failed to demonstrate that its directors had fulfilled their duty of loyalty under the business judgment rule merely by asserting that their actions were taken to forestall a takeover threat.²²²

The *Norlin* case has demonstrated a possible willingness by the judiciary to give "new teeth" to its construction of the business judgment rule and its burden of proof requirements.²²³ By

215. *Id.* at 265-66.

216. *Id.* at 259.

217. *Id.*

218. *Id.*

219. *Id.*

220. *Id.* at 265.

221. *Id.* at 265-66.

222. *Id.* at 267.

223. See Junewicz, *Mergers and Acquisitions: Advanced Planning Is Necessary To Battle New Defense Strategies*, The Nat'l L. J., Oct. 8, 1984, at 18, col. 1 (suggesting that the *Norlin* decision indicates that management may be under greater scrutiny under the business judgment rule).

In its report accompanying H.R. 5693, the House Committee on Energy and Commerce also indicated its belief that the *Norlin* decision may reflect an increasing judicial sensitivity to the inherent conflict of interest of target management in takeover situations. (See HOUSE REPORT, *supra* note 7, at 15-16).

lowering the initial standard of the plaintiff's burden of proof, thereby making it easier to show that the directors lacked good faith, the *Norlin* court effectively reduced the scope of management's protection under the business judgment rule. Although this new test has not yet been applied to the greenmail situation, it suggests that greenmail may also be viewed in a harsher light.²²⁴

IV. Three Proposed Amendments to Federal Securities Laws to Regulate Greenmail

In the preceding section, this comment analyzed existing laws and commercial mechanisms available to regulate greenmail and concluded that all fail to adequately address the problem. This section looks at three proposed federal bills, H.R. 5693, H.R. 5694 and H.R. 5695,²²⁵ which are designed to address various problems posed by defensive maneuvers that companies employ in response to hostile takeover attempts. Although all three bills have advantages and disadvantages, this section concludes that none is completely effective in eliminating the problem of greenmail.

A. H.R. 5693

H.R. 5693,²²⁶ known as the Tender Offer Reform Act of 1984, was first introduced in the House of Representatives along with H.R. 5694²²⁷ and H.R. 5695²²⁸ by Rep. Timothy Wirth (D-

224. The *Norlin* case has been cited with approval by a number of courts, e.g., *Ministar Acquiring Corp. v. AMF, Inc.*, No. 85 Civ. 3800 (MJL) (S.D.N.Y. June 7, 1985) (applied the *Norlin* decision in granting a preliminary injunction to prevent target management from implementing "scorched earth" and "poison pill" defenses in response to plaintiff's tender offer); *Terrydale Liquidating Trust v. Barness*, 611 F. Supp. 1006 (S.D.N.Y. 1984) (applied *Norlin* in denying the defendant directors' motion for summary judgment under the business judgment rule). Cf. *Rieuman v. Burlington Northern R.R. Co.*, No. 85 Civ. 3694 (RLC) (S.D.N.Y. June 21, 1985); *Hecco Ventures v. Avalon Energy Corp.*, No. 85 Civ. 2438 (RWS) (S.D.N.Y. Apr. 12, 1985); *Horwitz v. Southwest Forest Indus.*, 604 F. Supp. 1130 (D. Nev. 1985); *Enterra Corp. v. S.G.S. Assoc.*, 600 F. Supp. 678 (E.D. Pa. 1985).

225. 98th Cong., 2d Sess., 130 CONG. REC. H4357-60 (daily ed. May 22, 1984).

226. H.R. 5693 was designed to amend § 13(d)(1) of the Securities Exchange Act of 1934, 15 U.S.C.A. § 78(m)(d)(1) (West 1981).

227. 98th Cong., 2d Sess., 130 CONG. REC. H4357-60 (daily ed. May 22, 1984).

228. *Id.*

Colo.) on May 22, 1984.²²⁹ H.R. 5693 was the only draft bill of the three to be approved by the House Committee on Energy and Commerce.²³⁰ The bill has not yet been voted on by the full House.²³¹ H.R. 5693, which would amend the Securities Exchange Act of 1934, was designed to eliminate a variety of abusive defensive tactics employed during hostile takeovers, including "golden parachutes,"²³² self-tenders after a bidder has made a tender offer,²³³ the issuance of new voting securities,²³⁴ the "13D ten-day window,"²³⁵ and greenmail.²³⁶

Under the provisions of H.R. 5693 applying to greenmail, the target company would be prohibited, absent stockholder ap-

229. *Id.*

230. H.R. 5693 was approved with amendments by the House Energy and Commerce Committee on September 17, 1984, and was reported as H.R. 98-1028. The House Subcommittee on Telecommunications, Consumer Protection and Finance held two days of hearings on the proposed bill on March 28, 1984 and May 23, 1984.

231. A companion bill was introduced in the Senate by Senator Donald W. Riegle (D-Mich.) on June 20, 1984. S. 2784 was referred to the Senate Committee on Banking, Housing and Urban Affairs. Neither the House nor the Senate voted on the two bills, however, Rep. Timothy Wirth (D-Colo.) and Sen. Alphonse D'Amato (R-N.Y.) indicated their intentions to hold new hearings in 1985. See Crock, *A Drive to Rein in Raiders*, *Bus. Wk.*, Jan. 21, 1985, at 129.

232. H.R. 5693 would prohibit directors of the target company from entering into "golden parachute" contracts during a tender offer. Golden parachutes are termination contracts for top-level management, providing for substantial sums of money and benefits, to be exercised if the director or manager is terminated from his employment as the result of a change in control of the company. See generally Riger, *On Golden Parachutes - Ripcords or Ripoffs: Some Comments on Special Termination Agreements*, 3 *PACE L. REV.* 15 (1982).

233. H.R. 5693 would prohibit the issuing company from making a tender for its own shares during the pendency of a tender offer by a third party except through ongoing programs undertaken in the ordinary course of the issuer's business. See *Hearings*, *supra* note 27, at 219 and text accompanying note 27.

234. H.R. 5693 would make it unlawful for the target company, during a tender offer, to issue five percent or more of its securities without shareholder approval. See *Hearings*, *supra* note 27, at 220 and text accompanying note 27. See generally *Asarco, Inc. v. M.R.H. Holmes A COURT*, 611 F. Supp. 468 (D.N.J. 1985) (the court granted preliminary injunction to prevent target company from issuing 3.1 million shares of preferred stock during a tender offer by the defendant. The stock had several rights which far exceeded that of the common stock, including lucrative liquidation rights, a right to purchase common stock at half of the market price upon a change in control of the company, and voting rights equivalent to five votes of common stock).

235. See *infra* notes 246-249 and accompanying text. See generally Sargent, *Antitakeover Maneuvers: Developments in Defense Tactics and Target Actions for Injunctive Relief*, 35 *Sw. L.J.* 617, 632-33 (1981).

236. See *Hearings*, *supra*, note 27, at 210 (statement by Rep. Matthew Rinaldo (D-N.J.)).

proval, from repurchasing its own securities from an acquiritor who held a three percent or greater stake for less than two years, unless the same above-market premium was offered to all shareholders by the target.²³⁷

In the author's opinion, the bill's two most attractive features are the three-percent stake and two-year holding requirements. The three-percent stake requirement is desirable because under section 13(d) of the Williams Act²³⁸ the acquiritor is not subject to disclosure requirements until he becomes the beneficial owner of five percent or more of the target's outstanding securities. Many greenmail transactions occur when the acquirer holds less than five percent of the target, thus escaping the disclosure requirements of the 13D Schedule.²³⁹ The 13D Schedule requires, *inter alia*, that the acquiritor reveal his purpose for making the acquisition and state whether a "control motive" is contemplated as a result of the increased stake.²⁴⁰ Often corporate raiders claim the acquisition is "for investment purposes only,"²⁴¹ and later file an amendment to the form when a "con-

237. 98th Cong., 2d Sess., 130 CONG. REC. H4357-60 (daily ed. May 22, 1984).

238. 15 U.S.C.A. § 78m(d)(1) (West 1981).

239. 17 C.F.R. § 240.13d-1 (1985). One commentator has noted that many raiders appear to be trying to avoid the Schedule 13D filing by accumulating stock just short of the five percent level. See *Disguised Forms*, *supra* note 4. "Now greenmailers sit tight at 4.9 percent and bear down a little harder on management, says one New York arbitrager. "There may be less blood in the water, but the sharks are still out there." *Id.* at 1028.

Many recent incidents of greenmail support this conclusion. For instance, Superior Oil paid \$167 million to Mesa Petroleum for its three-percent stake in the company. See Hill, Dahl and Finn, *Mesa's Pickens, Partner Plan Tender Offer For 15 Million Shares of Philips Petroleum*, N.Y. Times, Dec. 5, 1984, at 1, col. 4; *The Takeover Game Isn't Over at Superior Oil*, Bus. Wk., Sept. 19, 1983, at 103. Chesebrough-Ponds, Inc. paid \$68.6 million (and agreed to purchase the acquiritor's unprofitable corporate division for an additional \$95 million) for a less than five percent stake in the company. Donovan, *supra* note 37. Pioneer Corp. paid \$83 million to a shareholder (who remained anonymous by the terms of the agreement) for a less than five-percent stake. See *Disguised Forms*, *supra* note 4; Williams, *supra* note 19.

240. 15 U.S.C.A. § 78m(d)(1)(C) (West 1981) requires that the purchaser of five percent or more of the equity security must file a statement of intent of such purpose in acquiring the stock with the SEC. For a definition of "control" see 17 C.F.R. § 240.12b-2 (f) (1985). For a complete discussion of "control purpose" under § 13(d) see Annot., 57 A.L.R. FED. 806 (1982).

241. See Feinberg, *Little Guys Unite! A Modest Proposal on Greenmail*, BARRON'S, Oct. 29, 1984, at 62.

Later that night I had a dream. I imagined that I had bought 100 shares of General Motors and on a whim had filed a 13(d) statement with the SEC announcing the purchase. When reporters called and expressed surprise that I had

trol motive" materializes.²⁴² Although the 13D Schedule does not appear to minimize the perceived threat of a takeover since the form can be easily amended at any time, the information exists at an early stage to alert investors to the possibility of a takeover or threat of greenmail. By the same token, the three-percent trigger of H.R. 5693 is valuable because it improves upon the existing section 13(d) requirements and would alert investors at yet an earlier stage.

H.R. 5693 would only apply its corporate buyback restriction to accumulations of a three percent or greater stake held for less than two years.²⁴³ The two-year holding requirement is also valuable for the purpose of identifying those investors who have made large stock accumulations in a short period of time and who therefore pose a greater threat of greenmail.²⁴⁴ Although the author knows of no formal study of the time elapsed after the raider's initial acquisition of stock and the subsequent announcement of the greenmail payment, the two-year provision has a certain logical appeal. Legislators and the SEC have demonstrated their concern about fast, unmonitored stock accumulations and maneuvers by raiders which cause shareholders to

made such a filing when I did not own 5 percent of the company's stock, I replied, "Not yet, I don't." Then I was asked, "Are you buying General Motors solely for investment purposes?"

"I wouldn't say that," I said. The slight knowing smile of the financier could be seen on my face.

Detroit trembled and my shares soared.

Upon awakening, I realized how unfair it is now thinking of outlawing greenmail before the little guy has had a chance to experiment with this investment strategy.

Id.

242. The requirement for a "control purpose" does not appear to have been enforced very strictly by the courts, and often an amendment is the relief granted. *See e.g.*, Treadway Companies, Inc. v. Care Corp., 638 F.2d 357 (2d Cir. 1980) (amended schedule which indicated real control purpose was acceptable); Purolator, Inc. v. Tiger Int'l, Inc., 510 F. Supp. 554 (D.D.C. 1981) (fair accuracy at time of filing, not perfection, is the appropriate standard of control purpose); Kirsch Co. v. Bliss & Laughlin Indus., 495 F. Supp. 488 (W.D. Mich. 1980) (court found that the corporation had intent to control and enjoined it from further acquisitions until an amended schedule was filed); Graphic Sciences, Inc. v. International Mogul Mines, Ltd., 397 F. Supp. 112 (D.D.C. 1974) (misleading statements on schedule required to be amended). Such amendment is permitted under 17 C.F.R. § 240.13d-2 (1985).

243. *See supra* notes 6, 237 and accompanying text.

244. *See generally, Disguised Forms, supra* note 4. *See infra* notes 246-249 and accompanying text.

be "stampeded" into investment decisions without adequate notice or information upon which to base their decisions.²⁴⁵

For example, another provision of H.R. 5693 seeks to close the "13D ten-day window."²⁴⁶ Under existing law, an investor has ten days in which to file Schedule 13D after becoming a five percent beneficial owner of stock in a company.²⁴⁷ Because of current abuses of this disclosure loophole, the SEC has indicated its intent to close the 13D window by requiring next day filing.²⁴⁸ H.R. 5693 would give the SEC the authority to accomplish this task.²⁴⁹

The legislature has also eliminated other types of surprise raids by raiders who acquire large blocks of stock in short periods of time. Section 14(d) of the Williams Act largely eliminated a tactic known as the "Saturday Night Special" named after the guns used during weekend robberies.²⁵⁰ This practice involved gathering firm commitments from major target company shareholders during the weekend in order to obtain a control block before the target company could rally its forces.²⁵¹ This tactic has been eliminated by the disclosure and minimum offering period requirements of section 14(d).²⁵²

H.R. 5694,²⁵³ to be discussed *infra*, was also drafted with

245. See *infra* notes 246, 250, 254 and accompanying text.

246. See 17 C.F.R. § 240.13d-1(a) (1985).

247. *Id.*

248. See *Hearings, supra*, note 27, at 26 (Committee Recommendations and the Commission's Positions and Contemplated Actions):

[t]he Commission endorses closing the 10-day window period in Section 13(d). The Commission opposes a pre-acquisition filing requirement, because of its effect on the transferability of blocks of stock. The Commission proposes instead a requirement of immediate public announcement, next day filing of the Schedule 13D and/or a standstill until filing. The Commission's proposal will require an amendment to the Exchange Act.

Id.

249. See *supra* note 226 and accompanying text.

250. See Reiser, *supra* note 9, at 48.

The "Saturday Night Special" is a hostile tender offer that gives target shareholders a very short period of time in which to decide whether to tender. The goal of such a device is to stampede the shareholders into tendering before target management has a chance to galvanize into action in opposition to the bid.

Id. See also Prentice, *supra* note 79, at 338 n.9.

251. See Reiser, *supra* note 9, at 48.

252. See 15 U.S.C.A. § 78n(e) (West 1981).

253. 98th Cong. 2d Sess., 130 CONG. REC. H4357-60 (daily ed. May 22, 1984); see also app. B, *infra*.

the intent to eliminate another tactic employed by raiders to gain fast control over a target. The draft bill was intended to eliminate the "front-end two step takeover" and the "bootstrap" (or "toehold") tactics.²⁵⁴

Since greenmail often results from an actual or perceived threat associated with large, fast accumulations of stock, it stands to reason that the two-year holding period requirement would identify most greenmailers. The provision would also enable companies to repurchase stock, without requiring a shareholder vote, from long term dissident shareholders (as opposed to greenmailers) who held their block of stock longer than two years.

Although the three-percent stake and two-year holding requirements of H.R. 5693 appear to adequately address the source of the greenmail threat, the bill fails in three respects. First, under the provisions of H.R. 5693, the shareholders of the target become the ultimate decision-makers as to whether or not greenmail should be paid.²⁵⁵ Many commentators have argued the pros and cons of permitting shareholders to ratify defensive maneuvers of target management.²⁵⁶ Shareholder interests may, at times, diverge from the interests of the corporation, making shareholder ratification a dubious requirement. For example, once a tender offer has been made by a raider, shareholders may have little incentive to ratify a greenmail payment since this would extinguish the offer or possibility of a takeover. Statistics indicate that stock values rise during tender offers, often due to speculation that a takeover will occur.²⁵⁷ In this situation, shareholders might be more inclined to ride the crest of the stock market rather than to vote for a greenmail payment which would preserve the status quo of the corporation.

H.R. 5693 suffers a second, more serious, defect. The Reagan Administration opposed H.R. 5693 on the grounds that the bill would cause an unnecessary and unlawful intrusion of federal securities laws into the area of corporate governance tradi-

254. See *Hearings*, *supra* note 27, at 155-56 (statement of Martin Lipton who submitted H.R. 5694 as a draft amendment to the Williams Act).

255. See *supra* note 226 and accompanying text.

256. See, e.g., Fischel, *The Corporate Governance Movement*, 35 VAND. L. REV. 1259 (1982); Harrington, *supra* note 166, at 1014.

257. See *supra* notes 2, 77, 81 and accompanying text.

tionally relegated to the states.²⁵⁸ By mandating shareholder ratification and preventing target management from making certain stock repurchases, the bill arguably interferes with state corporation law.²⁵⁹ The Administration's objection to the bill appears to be founded on a tenth amendment argument that such legislation would unnecessarily intrude on state sovereignty. Federal securities laws derive from Congress' authority to regulate under the Commerce Clause of the United States Constitution.²⁶⁰ An argument might be advanced that if greenmail could be shown to have an effect on stock prices, and thus on interstate commerce, Congress would be empowered to regulate. The problem with this approach is that there exists no solid empirical evidence that greenmail payments cause the decline in prices after the announcement of a greenmail payment.²⁶¹ Given this deficiency in this argument, there may be little basis on which to grant federal legislative authority beyond mere disclosure requirements.²⁶²

H.R. 5693 appears to suffer from a third defect. By requir-

258. See Letter from U.S. Treasury Secretary Donald Regan to Rep. John Dingell (D-Mich.), Chairman of the House Committee on Energy and Commerce (September 25, 1984):

[w]e are also concerned about proposals to regulate potentially abusive defensive tactics by target corporations, which raise a separate set of issues that reinforce the need to proceed with caution. Given the success that we as a nation have had with over 100 years of State corporate law and the large body of case law that have been developed during that time, we believe that Federal regulation of corporate management should be considered only where a serious market failure of national dimensions has occurred, or where some broader national purpose is to be served. With respect to the provisions in H.R. 5693 relating to defensive tactics, we believe that the case for such market failure of broad national purpose has not yet been made.

Id.

See generally, Low, *Reagan Said to Question Greenmail Curbs*, L.A. Daily J., July 23, 1984, at 3, col. 1; Scheibla, *Greenmail Debate Heats Up Behind the Scenes*, BARRON'S, Sept. 3, 1984, at 17; "Greenmail" Bill Opposed, N.Y. Times, Sept. 26, 1984, at D15, col. 6.

259. See *supra* note 132 and accompanying text.

260. The Securities Act of 1933 and Securities Exchange Act of 1934 predicate prohibitions on use of the mails or interstate commerce. See, e.g., §§ 5, 12 and 17 of the Securities Act of 1933; and § 2 of the Securities Exchange Act of 1934.

261. See *supra* notes 2, 75, 77, 78 and accompanying text for conflicting views on the net effect of the stock price drop subsequent to the announcement of the greenmail payment.

262. The Williams Act was enacted to close the gap in disclosure requirements of the federal securities laws. *Piper v. Chris-Craft Indus.*, 430 U.S. 1, 22 (1977).

ing shareholder ratification of the greenmail payment, it may easily be argued that the bill effectively deprives management of one of its defensive tactics. As a result, the raider may gain the advantage of time to accumulate an even greater block of stock while the target tries to mobilize a shareholder vote. This would appear to "tip the balance" of strategic advantage in favor of the raider, contrary to the express intent of the Williams Act.²⁶³

In conclusion, H.R. 5693 is problematic in its present form because it interferes unnecessarily in the relationship between target management and shareholders. However, the three-percent stake and two-year holding requirements are useful indicators of greenmail activity.²⁶⁴

B. H.R. 5694

H.R. 5694,²⁶⁵ based upon a proposal by New York attorney Martin Lipton,²⁶⁶ was introduced at the same time as H.R. 5693²⁶⁷ but was not approved as a draft bill by the House Committee on Energy and Commerce. This proposed bill would have prohibited the acquisition of more than ten percent of a company's shares unless a tender offer was made for all outstanding shares in the company.²⁶⁸ The bill was designed to alleviate several perceived evils including greenmail, creeping tender offers (whereby a raider gradually acquires stock on the open market), and two-tier offers (whereby the raider makes a generous front-ended offer in cash and a low offer for the remainder of the

263. See *supra* note 113 and accompanying text.

264. See *supra* notes 6, 237 and accompanying text.

265. 98th Cong., 2d Sess., 130 CONG. REC. H4357-60 (daily ed. May 22, 1984); see also *app. B, infra*.

266. Martin Lipton is a partner in the law firm of Wachtell, Lipton, Rosen & Katz in New York City and a member of the SEC Advisory Committee on Tender Offers.

267. See *supra* note 6 and accompanying text.

268. See *Hearings, supra* note 27, at 210 (statement by Rep. Matthew Rinaldo (D-N.J.)). A number of other proposals have been made which similarly call for a ceiling on stock accumulations and a mandatory tender offer to all shareholders by the acquirer. *Id.* at 26 (SEC Advisory Committee on Tender Offers proposed a 20% ceiling); Hon. Goldberg, *Regulation of Hostile Tender Offers: A Dissenting View and Recommended Reforms*, 43 MD. L. REV. 225, 234 (1984) (recommending a 15% ceiling); Williams, *Business Seek to End 'Greenmail', 'Golden Parachutes'*, WALL ST. J., Jan. 23, 1985, at 31 (Andrew Sigler, head of the Business Roundtable, recommending a five to ten percent ceiling).

stock tendered).²⁶⁹

According to Mr. Lipton, "The culprit is a regulatory system that permits accumulations in excess of 10 percent."²⁷⁰ He testified at the House Subcommittee on Telecommunications, Consumer Protection and Finance hearings that H.R. 5694 would create a substantial disincentive for raiders to threaten greenmail.²⁷¹ He stated:

[i]t [H.R. 5694] also effectively eliminates the greenmail problem. If a raider or a group of raiders cannot accumulate more than 10 percent of a target's shares, there is no real threat of a change of control transaction without all shareholders being treated equally, and therefore no reason for the target to buy back the shares. The target will not buy. The greenmailer has no incentive to accumulate.²⁷²

H.R. 5694 has several advantages. First, by creating a ceiling on stock acquisitions, the bill would appear to confront the greenmail threat at its most basic level. A raider cannot create the illusion of a takeover threat by continuing to accumulate stock²⁷³ because there is no further need to "call his bluff" by paying the greenmail. Once he has acquired ten percent of the outstanding stock, he has no choice but to make a tender for all the remaining stock.²⁷⁴ Second, H.R. 5694 would eliminate the need for fair price provisions in corporate charters²⁷⁵ and state legislation,²⁷⁶ since a uniform tender offer would have to be made to all stockholders by the raider.²⁷⁷

However, H.R. 5694 also suffers from several shortcomings. First, it is not entirely clear that a mandatory tender offer, once the raider acquired ten percent, would prevent the raider from

269. See *Hearings*, *supra* note 27, at 155-57 (statement by Martin Lipton).

270. *Id.* at 156.

271. *Id.* at 157.

272. *Id.*

273. See *supra* note 64.

274. See *supra* note 268 and accompanying text.

275. See *supra* note 89 and accompanying text. "A fair price provision in a corporate charter generally requires supermajority approval for certain business combinations and may set minimum price criteria for mergers." *Moran v. Household Int'l, Inc.*, 490 A.2d 1059, 1064 n.1 (Del. Ch. 1985).

276. See *Hearings*, *supra* note 27, at 285. See also *supra* note 145 and accompanying text.

277. See *supra* notes 238, 268 and accompanying text.

threatening a takeover unless greenmail were paid. For example, a raider could still acquire five percent of the stock and management, fearful that he would continue to acquire stock up to the ten percent margin, would probably be receptive to a suggestion that greenmail be paid to avoid the inevitable tender offer when the raider acquired ten percent. The three-percent trigger in H.R. 5693²⁷⁸ appears to confront the issue of the perceived threat²⁷⁹ at a more appropriate, earlier stage in the stock accumulation.

Second, H.R. 5694 would also have serious consequences for raiders and passive investors. The bill would impose a financial hardship on raiders who would be obliged to make a tender offer upon accumulating ten percent. Any raider without sufficient resources to make such a tender offer would be precluded from ever gaining control of the corporation. Undoubtedly, this would limit the number of raiders who would be able to instigate a change in control. This in turn might tend to entrench management. Moreover, the concept of a passive investor with a ten percent or greater stake in a company would become obsolete. Passive investors would be forced to make tender offers despite a lack of desire to do so. In effect, upon the accumulation of a ten-percent stake, H.R. 5694 institutionalizes a mandatory tender offer process in the securities investment marketplace.

Finally, H.R. 5694 appears to interfere with state corporation law.²⁸⁰ By limiting the voting power of the shareholders to ten percent of the outstanding voting securities, unless a tender offer is made to all shareholders, the bill interferes with the voting provisions of most corporate charters. Perhaps recognizing this inherent weakness in his draft proposal for federal legislation, Mr. Lipton has also advocated a non-legislative solution to the greenmail problem.²⁸¹ Mr. Lipton has suggested that corpo-

278. See *supra* note 238 and accompanying text.

279. See generally *supra* notes 37-44 and accompanying text.

280. See *supra* notes 129, 258 and accompanying text.

281. Mr. Lipton's three-prong charter amendment proposal was designed to eliminate greenmail, bust-ups and front-end loaded bootstrap takeovers. First, he proposes a charter amendment that limits any holder or related group with five percent or more, but less than ninety percent, of the common stock to only five percent of the voting power for a three-year period after the five percent acquisition. Second, this provision would be complimented with another which would assure that all shareholders would have submitted to them a high premium unconditional cash offer for all the stock of the

rations could adopt charter amendments to limit the voting power of major shareholders and impose fair price restrictions on tender offers to the corporation.²⁸² This proposal accomplishes the essential purposes of H.R. 5694 but avoids the regulatory interference with corporate charters.

In sum, H.R. 5694 appears to be an imperfect solution to the greenmail problem.²⁸³ Similar measures might be useful, however, if adopted in the form of charter amendments by the target companies on a voluntary basis.²⁸⁴ If the shareholders of a corporation voted to adopt such measures then raiders and pas-

corporation. Third, there would be a "sunset provision" to ensure that the two other provisions would expire at the end of five years subject to renewal. See Lipton, *Greenmail, Bust-Up Takeovers - A Discussion Memorandum*, N.Y.L.J., Sept. 7, 1984 at 1, col. 3.

Mr. Lipton's proposal was criticized in two published responses to his article. Edwin Mishkin, a partner in the law firm of Cleary, Gottlieb, Steen and Hamilton, in New York, articulated his concern that the proposal would operate as a deterrent to proxy contests and that such limitations on voting rights of shareholders would be subject to state law limitations. He also stated that the proposal would entrench management. See Mishkin, *Greenmail, Bust-Up Takeovers - Comment on the Lipton Proposal*, N.Y.L.J., Sept. 18, 1984, at 1, col. 3.

The proposal was also attacked by Stephen Hochman who argued that regulatory focus should be placed on management and not the acquirer. See Hochman, *Comment on Greenmail and Bust-up Takeovers* (letter to editor), N.Y.L.J., Sept. 14, 1984, at 2, col. 5.

282. See *supra* note 281 and accompanying text.

283. See *supra* note 280 and accompanying text. See generally, LeBaron & Strassman, *'Greenmail' Takeover Threats: Shareholders, Economy Benefit*, L.A. Daily J., Apr. 20, 1984, at 4, col. 3.

Proposals to limit single-party ownership of a block of a corporation's stock were considered and resoundingly rejected by the [SEC] advisory committee. In dismissing any arbitrary limitation, the committee recognized the common international practice of interlocking business relationships. A domestic example would be IBM's recent purchase of a twenty-percent interest in one of its suppliers, Intel.

More importantly, however, investors who believe that assets are undervalued should not be prevented arbitrarily from making their will as minority shareholders known.

Id.

284. Martin A. Siegel, vice president of Kidder, Peabody & Co., has also advocated the use of charter amendments to curb greenmail. He has urged corporations to adopt a charter amendment requiring a shareholder majority vote prior to any purchase by the company of shares held by a five percent or more stakeholder at a premium. This appears to resemble a modified H.R. 5693 in charter amendment form. See generally Meisler, *Mergers and Divestitures: The Pace Quickens*, FORBES, Dec. 3, 1984, at 91; Siegel, *How to Foil Greenmail*, FORTUNE, Jan. 21, 1985, at 157; *Hearings, supra* note 27, at 446 (letter from Martin Siegel to Rep. Timothy Wirth, May 16, 1984).

sive investors alike would not be unwittingly prejudiced by the voting restrictions.

C. *H.R. 5695*

H.R. 5695²⁸⁵ was introduced in the House of Representatives with H.R. 5693 and H.R. 5694 but like H.R. 5694, was not approved as a draft bill by the House Committee on Energy and Commerce.²⁸⁶ H.R. 5695 differs from the other two bills in that it would not restrain the raider or target, but rather it would permit shareholders and the SEC to seek injunctive relief from harmful defensive tactics by management in takeover situations.²⁸⁷ Furthermore, H.R. 5695 would place the burden of proof on target management to show by a preponderance of the evidence that the transaction complained of was both prudent and fair.²⁸⁸

H.R. 5695 would alter most current law under the business judgment rule, as discussed in Section III(B)(4), *supra*. The bill would, in effect, recognize an inherent conflict of interest in any management decision in a takeover situation and cause the burden of proof to shift immediately to management to prove the fairness of the transaction. Currently, most federal and state courts have required the complaining shareholder to bear the initial burden of proof and show that management has breached its duty of loyalty by engaging in an activity involving a conflict of interest.²⁸⁹ The result of this approach has been that many shareholders are unable to overcome the first hurdle in the lawsuit, and are unable to demonstrate a traditionally recognized conflict of interest beyond merely a motive to retain control.²⁹⁰ By shifting the burden to management in takeover situations, the bill would aid shareholders in overcoming the initial burden of proof.

One of the advantages of H.R. 5695 is that it does not attempt to define greenmail or prohibit the practice outright. Im-

285. 98th Cong., 2d Sess., 130 CONG. REC. H4357-60 (daily ed. May 22, 1984). See also app. C, *infra*.

286. See *supra* note 285.

287. *Id.*

288. *Id.*

289. See *supra* note 196 and accompanying text.

290. See *supra* notes 205-209 and accompanying text.

plicit in the bill is a recognition that some defensive maneuvers are justifiable and, in some cases, desirable. As has been discussed, *supra*,²⁹¹ greenmail often cannot be sufficiently isolated from other beneficial stock repurchases by the issuing company. Moreover, greenmail may sometimes be an attractive option to thwart a hostile takeover. Thus, the bill would preserve the practice of greenmail as long as it could be justified as being in the best interests of the corporation. This approach maintains freedom in the marketplace, and places no restrictions upon either target or raider. Moreover, the bill enhances the protection of the shareholder by making it easier to bring an action against management for the payment of greenmail.

However, while H.R. 5695 appears to be a partially workable solution to the problem of greenmail, the emergence of the *Norlin* case²⁹² has made the need for this legislation less apparent. In *Norlin*, as discussed *supra*, the Second Circuit Court of Appeals implemented an almost identical burden-shifting rule for the application of the business judgment rule in takeover situations.²⁹³ Since H.R. 5695 would only apply to federal district courts, there seems little reason to adopt legislation to accomplish essentially the same goal.²⁹⁴

291. See *supra* notes 45-50 and accompanying text.

292. *Norlin Corp. v. Rooney, Pace, Inc.*, 744 F.2d 255 (2d Cir. 1984).

293. See *supra* notes 220-223 and accompanying text.

294. Several other proposals to resolve the problem of abuses of defensive tactics by corporate management have also been proffered. Marc I. Steinberg, associate professor at the University of Maryland School of Law, has suggested that target management should be permitted to make defensive moves during the takeover process, but once these moves materially impede or preclude shareholders from tendering their shares to a particular bidder, then management should be required to prove, under the business judgment rule, that its actions were fair to the corporation and its shareholders. It appears that a plaintiff in this situation must at least meet the burden of proving that the defensive strategy, such as payment of greenmail, impeded or precluded him from tendering his shares. See Steinberg, *supra* note 211, at 248.

Frank H. Easterbrook, professor of law at the University of Chicago, and Daniel R. Fischel, professor of law at Northwestern University, have suggested that in lieu of applying the business judgment rule, target management should be strictly prohibited from engaging in defensive tactics during a tender offer. This "passivity proposal" is offered on the grounds that it produces economic benefits for the raider and the target company shareholders. The raider is able to acquire the target at its undervalued price and the shareholders get a premium over the market price for their tendered shares. See Easterbrook & Fischel, *The Proper Role of a Target's Management in Responding to a Tender Offer*, 94 HARV. L. REV. 1161, 1194 (1981). This view has been criticized by Martin Lipton. See Lipton, *Takeover Bids in the Target's Boardroom: A Response to Professors*

V. Conclusion

As this Comment has demonstrated, the need for some sort of regulation of greenmail exists. The commercial sector has proffered some new initiatives to regulate the practice, but none have been implemented to date. Federal securities laws and SEC regulations do not regulate greenmail. State corporation laws do not impose buyback restrictions on target companies beyond minimal legal capital requirements. State takeover laws, although they have potential to regulate greenmail or to indirectly affect it by imposing stock accumulation restrictions, are subject to constitutional uncertainty since the *MITE* decision was issued.²⁹⁵ Common law decisions have generally been lax in applying the business judgment rule to decisions made by management during hostile takeover attempts. The most notable exception to this, however, has been the Second Circuit's decision in the *Norlin* case.²⁹⁶

This Comment has analyzed three proposed federal bills, H.R. 5693,²⁹⁷ H.R. 5694²⁹⁸ and H.R. 5695,²⁹⁹ to amend the Securities and Exchange Act of 1934. All of the bills would have a potential impact upon greenmail. All of the bills contain flaws. A variety of other proposals to amend other sections of the federal securities, anti-trust and tax laws have also been raised by legal scholars as possible solutions to the greenmail problem.³⁰⁰ This

Easterbrook and Fischel, 55 N.Y.U. L. Rev. 1231, 1233 (1980).

295. *Edgar v. MITE Corp.*, 457 U.S. 624 (1982); see *supra* notes 147-150 and accompanying text.

296. *Norlin Corp. v. Rooney, Pace, Inc.*, 744 F.2d 255 (2d Cir. 1984); see *supra* notes 214-224 and accompanying text.

297. See app. A, *infra*.

298. See app. B, *infra*.

299. See app. C, *infra*.

300. The House Committee on Energy and Commerce suggested, in its report accompanying H.R. 5693 (see HOUSE REPORT, *supra* note 7, at 16), that section 14(e) of the Securities Exchange Act of 1934 may have more application than simply that of mandating disclosure. Section 14(e) prohibits "manipulative acts." The courts have given recent indications that such an interpretation may be given substantive effect. See *Mobil v. Marathon Oil Co.*, 669 F.2d 366 (6th Cir. 1981). But see *Schreiber v. Burlington Northern, Inc.*, 731 F.2d 163 (3d Cir. 1984); *Data Probe Acquisition Corp. v. Datalab, Inc.*, 722 F.2d 1 (2d Cir. 1983), *cert. denied*, 104 S. Ct. 1326 (1984); *Buffalo Forge Co. v. Ogden Corp.*, 717 F.2d 757 (2d Cir.), *cert. denied*, 464 U.S. 1018 (1983); *Chris Craft Indus., Inc. v. Piper Aircraft Corp.*, 480 F.2d 341 (2d Cir.), *cert. denied*, 441 U.S. 910 (1973); *Martin Marietta Corp. v. Bendix Corp.*, 549 F. Supp. 623 (D. Md. 1982).

Comment has not attempted to examine these solutions and has attempted to focus merely on the three draft legislative bills.

Federal legislators need not "pass the buck" to state legislators or to the courts to regulate greenmail. However, they must be mindful of the potential for intrusion into areas traditionally regulated by non-federal authority. As this Comment has indicated, the problem with much of the proposed federal legislation is that it attempts to regulate target management and shareholder relations, an area traditionally left to state law. Similarly, it is not necessary to legislate a burden-shifting mechanism such as that proposed in H.R. 5695, when the courts have already embarked upon a similar course.³⁰¹

While the complexity of the greenmail problem stems from the overlapping areas of federal, state and common law, it stands to reason that the solution may emerge piecemeal from all quarters. This author proposes the following solution to the greenmail problem.

First, the disclosure requirements of section 13(d) of the Exchange Act³⁰² should be changed to require earlier disclosure of stock accumulations. Currently, a beneficial owner of more than five percent of a class of securities is required to file a

Other commentators have suggested that section 16(b) of the Securities Exchange Act of 1934, governing insider trading, could be amended so as to curtail the practice of greenmail. See Block & Barton, *Section 16(b) of the Exchange Act: An Archaic Insider Trading Statute in Need of Reform*, 12 SEC. REG. L.J. 203 (1984); Klein, *Outsider Proposes Changes in Insider Trading Bill*, Legal Times of Wash., Dec. 12, 1983, at 8; Thomas, *Indecent Recklessness: 'Greenmail', A New Form of Old Cynicism*, 97 L.A. Daily J., June 28, 1984, at 4, col. 3.

Still other commentators have suggested that an alteration in the pre-merger notification and waiting period requirements of the Hart-Scott-Rodino Antitrust Improvements Act, which amended § 7 of the Clayton Act in 1976, could effectively be used to deter greenmail and other takeover tactics. See generally Goldberg, *supra* note 268, at 227 n.13; *Hearings*, *supra* note 43, at 46 (SEC Tender Offer Advisory Committee recommendation).

Recent tax reform proposals may also have a secondary impact on greenmail. There has been a great deal of debate as to whether raiders who acquire target companies ought to be permitted to use the carryover losses from the purchased company. Other tax developments may make corporate restructuring by the target company more difficult. See generally HOUSE REPORT, *supra*, note 7, at 13; *The Tax Muddle that Could Spur More Takeovers*, BUS. WK., May 14, 1984, at 166; *Spinoffs Can be Used to Avoid a Hostile Takeover*, J. TAX'N, Sept. 1984, at 186.

301. See *supra* notes 292-294 and accompanying text.

302. 15 U.S.C.A. § 78m(d) (West 1981).

Schedule 13D³⁰³ containing information including whether a "control purpose"³⁰⁴ is contemplated. An exception should be created requiring all beneficial owners of three percent or more of a class of securities held for less than two years to file a Schedule 13D. Thus utilizing the "trigger requirements" of H.R. 5693,³⁰⁵ shareholders would be put on notice that a purchaser is making rapid stock accumulations. This would alert shareholders to the potential threat posed by the purchaser. More importantly, if the purchaser indicates on the Schedule 13D that "no control purpose is contemplated," any greenmail payment by management may be more easily challenged as irrational or non-beneficial to corporate interests since it was not paid as a protective measure.

Secondly, the SEC should adopt regulations, pursuant to its authority under section 13(e) of the Williams Act,³⁰⁶ to mandate disclosure by the issuer of its intent to repurchase any of its securities at a premium over market price from any shareholder holding three percent or more of a class of securities for less than two years. Again, using the three-percent stake and two-year holding triggers proposed in H.R. 5693, the SEC could thus close the most significant loophole in its issuer repurchase regulations. This would tend to identify the bulk of the pre-tender offer greenmail payments not currently regulated by disclosure requirements. The advantages of this type of regulation are numerous. First, by limiting the regulation to pure disclosure, state corporation law which has traditionally regulated management behavior³⁰⁷ is not impinged upon. Second, since the regulations merely require an informational disclosure, there is no danger that the delicate balance between target and raider will be "tipped" in violation of the Williams Act.³⁰⁸ Third, such a regulation would not attempt to penalize the raider for indulging in purely acceptable activities such as accumulating stock or accepting an above-market premium for the sale of his stock. Nor is the raider punished or prevented from threatening a takeover,

303. See *supra* notes 247-249 and accompanying text.

304. See *supra* notes 240-242 and accompanying text.

305. See *supra* notes 243-245 and accompanying text.

306. 15 U.S.C.A. § 17m(e) (West 1982).

307. See *supra* note 129 and accompanying text.

308. See *supra* note 263 and accompanying text.

tender offer or proxy contest, for until such threats are deemed "unlawful demands"³⁰⁹ there is little reason to regulate the raider's behavior. As long as the Williams Act sanctions hostile takeovers and tender offers, there is minimal likelihood that the "threat" of such behavior will be considered "unlawful." Fourth, by mandating earlier disclosure of the issuer's intent to repurchase its stock *in advance* of the actual payment, shareholders would then have an opportunity to seek injunctive relief in the courts.

Third, Congress should clarify the meaning of "manipulative acts" under section 14(e) of the Exchange Act³¹⁰ to encompass greenmail payments. The section currently provides in relevant part:

[i]t shall be unlawful for any person to make any untrue statement of a material fact or omit to state any material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading, or to engage in any fraudulent, deceptive, or manipulative acts or practices, in connection with any tender offer or request or invitation for tenders³¹¹

The term "manipulative" is nowhere defined in the Exchange Act or Williams Act. However, in its recent decision in *Schreiber v. Burlington Northern, Inc.*,³¹² the United States Supreme Court resolved a conflict in the circuit courts by concluding that misrepresentation or nondisclosure is a necessary element of a section 14(e) violation.³¹³ The Court rejected the plaintiff's argument that the term "manipulative" assumes a different meaning under section 14(e) than under section 10(b).³¹⁴ The plaintiff contended that the use of the disjunctive "or" in section 14(e) led to the implication that manipulative acts need not be "deceptive" or "fraudulent."³¹⁵ Relying on its interpretation of "manipulative" under section 10(b) in *Santa Fe Industries v.*

309. See *supra* notes 59, 60 and accompanying text.

310. 15 U.S.C.A. § 17n(e) (West 1982).

311. *Id.*

312. 105 S. Ct. 2458 (1985).

313. *Id.* at 2465.

314. *Id.* at 2462.

315. *Id.*

Green,³¹⁶ the Court held that the term "manipulative" under section 14(e) likewise must include misrepresentation or nondisclosure.³¹⁷

Congress should carve out an exception to this interpretation of "manipulative" by stating that manipulative transactions between issuer and shareholders, who have held at least three percent of a class of securities for less than two years, need not involve misrepresentation or nondisclosure. This would serve to give complaining shareholders a cause of action to challenge greenmail payments under the federal securities laws. The exception would also preserve current interpretations of the section by excluding other defensive tactics engaged in by target management unless misrepresentation or nondisclosure were adequately shown.

Finally, armed with a section 13(e) disclosure by an issuer that it was about to repurchase its stock at a premium, evidence under section 13(d) that a payment might be paid to a shareholder for his shares absent any "control purpose" on his part, and a section 14(e) cause of action for "manipulative" acts, a complaining shareholder could go into federal court seeking to enjoin the payment of greenmail under federal securities laws.

In addition to these securities laws violations, the complaining shareholder could claim a breach of fiduciary duty on the part of the issuer's directors under the pendent jurisdiction of the federal courts. Given recent developments in the burden-shifting mechanism in business judgment cases, as spearheaded by the *Norlin* decision,³¹⁸ courts will more likely be willing to shift the burden of proof to management in the takeover contexts. The management must then show that the payment of greenmail is in the best interests of the corporation and thus would not amount to a breach of their fiduciary duty. In this way, each instance of greenmail will be judged on a case by case basis to determine whether or not it constitutes an abuse of power on the part of target management.

This type of individual court review makes infinitely more

316. 430 U.S. 462, 476-77 (1977).

317. *Schreiber*, 105 S. Ct. at 2462 n.6.

318. *Norlin Corp. v. Rooney, Pace, Inc.*, 744 F.2d 255 (2d Cir. 1984); see *supra* note 214 and accompanying text.

sense than declaring a flat prohibition on greenmail.³¹⁹ The elusive nature of the greenmail "threat" coupled with a basic difficulty in isolating it from other beneficial stock repurchases makes greenmail unsuitable for blanket prohibitions or rough rule-of-thumb triggers for mandatory tender offers, such as H.R. 5694,³²⁰ or shareholder approval, such as H.R. 5693.³²¹ The problem with greenmail has not been that it continues to exist as a practice, but rather that when it becomes abusive, shareholders have had no preemptive power or recourse once the payment is made.

The author believes that this approach, combining federal and common law, will permit other areas to develop at a more conservative, less reactionary pace, and will create a sufficiently sensitive legal mechanism to permit greenmail to flourish only where it is considered a beneficial defensive tactic.

Nancy A. Lester-Lawson

319. This author disagrees with the suggestion that a "categorical ban" on greenmail by federal legislation is the best solution to the problem. See Note, *Greenmail: Targeted Stock Repurchases and the Management-Entrenchment Hypothesis*, 98 HARV. L. REV. 1045 (1985). This approach ignores the fact that many stock repurchases by an issuer serve a variety of beneficial purposes, and may occasionally constitute a legitimate defensive tactic under limited circumstances.

320. See *supra* note 268 and accompanying text.

321. See *supra* note 237 and accompanying text.

APPENDIX A

H.R. 5693 provides in relevant part:

It shall be unlawful for an issuer to purchase, directly or indirectly, any of its securities at a price above the market from any person who holds more than 3 per centum of the class of the securities to be purchased and has held such securities for less than two years, unless such purchase has been approved by the affirmative vote of a majority of the aggregate voting securities of the issuer, or the issuer makes an offer to acquire, of at least equal value, to all holders of securities of such class and to all holders of any class into which such securities may be converted

APPENDIX B

H.R. 5694 provides in relevant part:

It shall be unlawful for any person, directly or indirectly, by use of the mails or by any means or instrumentality of interstate commerce or of any facility of a national securities exchange or otherwise, to acquire or agree to acquire any shares of any class of voting equity securities of a corporation registered pursuant to section 12 of this title, or any shares of any class of voting equity securities of an insurance company which would have been required to be so registered except for the exemption contained in section 12(g)(2)(G) of this title, or any shares of any class of voting equity securities issued by a closed-end investment company registered under the Investment Company Act of 1940 if, after consummation thereof, such person would, directly or indirectly, be the beneficial owner of voting equity securities which would entitle such person to cast 10 percent or more of the votes that all holders of outstanding voting equity securities would be entitled to cast in an election of directors of the issuer, unless such acquisition shall be by means of a tender or exchange offer for all the outstanding shares of common stock of the issuer

APPENDIX C

H.R. 5695 provides in relevent part:

No issuer whose securities are registered under this title, or any affiliate of any such issuer, shall engage in any transaction in contemplation of effecting, or of defending against, a change in control of such issuer that is not prudent for the issuer and fair to the issuer's shareholders. The Commission or any shareholder of that issuer may bring a suit in the proper district court of the United States or of the District of Columbia to enjoin any such transaction and for such other equitable relief as may be appropriate. In any such suit, the burden shall be upon such issuer or such affiliate to prove by a preponderance of the evidence that the transaction complained of is both prudent for the issuer and fair to the issuer's shareholders.