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Articles

On Golden Parachutes—Ripcords or Ripoffs? Some Comments on Special Termination Agreements

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I. Introduction

The continuing development of new kinds of rewards for corporate executives has been an accepted part of the corporate scene. Basic salary, deferred compensation, and pension plans have over the years been supplemented by a variety of incentive programs, including profit-sharing and stock bonus plans, qualified and non-qualified stock options, restricted stock, performance shares, and phantom stock,[1] for the most part seeking to maximize executives' personal income by minimizing their income tax liability.[2] Prior to the latest manifestation of the crea-

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1. For descriptions and discussions of many of these programs, and their related tax aspects under the Internal Revenue Code as amended from time to time, *see, e.g.*, Note, *Phantom Stock Plans*, 76 HARV. L. REV. 619 (1963); Vernava, *Stock Options: Corporate, Regulatory and Related Tax Aspects*, 30 U. PITT. L. REV. 197 (1968); Sherman, *Deferred Compensation—Qualified and Nonqualified: A Legislative Perspective Through the Tax Reform Act of 1969*, 11 WM. & MARY L. REV. 870 (1970); Foote, *Performance Shares*, HARV. BUS. REV., Nov.-Dec. 1973, at 121; Herzel and Perlman, *Stock Option Rights*, 33 BUS. LAW. 749 (1978); Hubbard, *IRS Gives Some Answers on Incentive Stock Options*, Legal Times of Wash., Jan. 11, 1982, at 17.

2. *See, e.g.*, the comment of Peter F. Drucker in THE CHANGING WORLD OF THE EXECUTIVE 21-22 (1982):

> To shield executives from the rapacity of the tax collector, corporations have availed themselves of every tax shelter or tax loophole that the law and lawyers have created. Stock options are just one example. Most executives know that the explanations given for these gimmicks are pure hokum. I have yet to meet an executive who really believes that stock options act as an incentive or promote performance. Everyone knows that they are tax avoidance, pure and simple.

Id.

tive powers of management and their counsel—the so-called Special Termination Agreement or "Golden Parachute"—these programs without exception sought their corporate justification and legal validity in terms of their benefit to the employer corporation.[3] The Special Termination Agreement (STA), a questionable by-product of the current tender offer phenomenon, purports to be similarly motivated.

As its name indicates, the STA's focus is on the executive's potential exit rather than on his retention. In essence, it is the instrument for providing substantial money and other benefits, over and above those the executive would otherwise receive on termination, if the latter is the consequence of a change in control of the corporation that adversely affects his status or emoluments. The termination may then be at his option or it may be involuntary. In a number of instances these agreements have been hastily drawn in the thick of a contested takeover effort.[4] Other corporations have adopted them when no threat of takeover was imminent but there was some cause to fear they might be next.[5] Not surprisingly, the novelty of the STA as an executive "perk" and the amounts involved have attracted still others,[6] even though in biblical parlance, no man pur-

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3. For example, the Phillips Petroleum Company's Proxy Statement for its 1982 Annual Meeting stated: "The objective of the Company's total compensation program is to assist the Company in competing to attract, retain, develop, and motivate the full potential of its human resources." Proxy Statement of the Phillips Petroleum Company 10 (March 29, 1982). The faithful reader of corporate proxy statements has seen the substance of this recital endlessly repeated in connection with executive compensation descriptions and proposals.

4. *See, e.g., Garfinckel Officers Get Hefty Protection in a Hostile Takeover: Move Was Cleared by Board A Day Before Allied Stores Advanced $48-a-Share Bid,* Wall St. J., August 25, 1981, at 14, col. 3.

> The board of Garfinckel, Brooks Brothers, Miller & Rhoads Inc. has agreed to pay David R. Waters, its chairman, and 11 other officers lump sum payments equalling three times their annual compensation, if they quit after an unfriendly takeover . . . . Garfinckel said it was a concidence that the antitakeover package was approved just before the Allied offer.

Id. Garfinckel's STA is described more fully *infra* notes 41-45 and accompanying text.

5. *See, e.g.,* Proxy Statement of the Phillips Petroleum Company at 20: "The development of these contracts [STAs] was not undertaken in the belief that a takeover of the Company was imminent." *Id.* It was done "[i]n recognition of widespread merger activity in 1981 . . . ." *Id.*

The most publicized example that year involved another oil company, Conoco Inc., discussed *infra* notes 10-12 and accompanying text.

6. *See, e.g., Olin Corp. Discloses Contracts for Officers In Event of Takeover,* Wall

sueth.[7] Whatever the immediate motivation, the STA is already reaching for a place in the executive compensation catalogue.[8]

The ultimate question raised by the STA is why, in the special circumstances of a takeover, merger, or other shift in the control of the corporation, the order of the executive's going should be accompanied by special benefits in large amounts that he would not otherwise receive on termination. Cast in contract law terms, the question is whether the corporation receives valid and adequate consideration for these special, and substantial, additional payments, or whether they are, in fact and in law, no more than gifts on parting, constituting corporate waste. Some representative examples adopted in 1981, a year in which STAs proliferated,[9] provide the background against which this article will consider the validity of these agreements.

II. Representative STAs

A. *Conoco*

Conoco Inc., having successfully resisted other suitors, reported in July of that year that it had agreed to merge into a wholly-owned subsidiary of Du Pont following consummation of

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St. J., Apr. 22, 1982, at 3, col. 5: "An Olin spokesman said that the contracts weren't prompted by any takeover approach or merger offer and that none have been made. 'It's being done by quite a lot of companies in an atmosphere where there are and have been takeovers and mergers . . . . It's almost a fad.' " *Id.*

7. The reference is to *Proverbs* 28:1 (King James Version): "The wicked flee though no man pursueth."

8. As might be expected, the corporate bar is more than an incidental beneficiary of, and contributor to, the mounting trend to adopt STAs. *See* Stern, *Pulling the Golden Cord*, FORBES 31 (May 24, 1982), quoting a leading practitioner in this area: " 'I would say that this year perhaps half of the biggest 500 companies have either this kind of severance program or options or other benefit programs that would be accelerated in the event of change of control'. . . . In fact, the law firm has been advising clients with a fill-in-the-blanks 'senior executive severance plan.' " *Id.*

9. *See "Golden Parachutes" for Ousted*, N.Y. Times, Apr. 4, 1982, at 31, col. 5. Examples in 1982 are not lacking; *see, e.g., Marietta is Seeking "3d Parties,"* N.Y. Times, Sept. 1, 1982, at D1, col. 8: "The Martin Marietta Corporation, continuing to resist an unfriendly takeover offer from the Bendix Corporation, disclosed yesterday that it expects to hold merger talks with unidentified 'third parties' . . . . Martin Marietta also disclosed that it had given so-called golden parachutes, or employment contracts, to 29 key executives on Monday—five days after it received the takeover bid from Bendix." *Id.* As Bendix in turn became the takeover target, it followed suit with parachutes for its own executives. *See infra* note 62.

that company's tender offer for the common stock of Conoco.[10] The report related that "employment agreements" had been entered into by Conoco with the chairman and with the president of that company, and with seven other executives, to become operative if and when there was a "Change in Control" of the company.[11] By definition in the agreements this would occur if the company's common stock was no longer listed on the New York Stock Exchange,[12] or if as much as 20% of that stock would be acquired by another corporation or person or group of persons acting in concert.[13] The latter event being foreshadowed, if not in fact already completed by Du Pont, at the time the agreements were executed, these became operative shortly thereafter. The chief executive's contract provides he may now "terminate his employment at any time if he shall determine in good faith that due to the Change in Control he is not able effectively to

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10. *See* Solicitation/Recommendation Statement on Schedule 14D-9 filed with the Securities and Exchange Commission by Conoco Inc., July 15, 1981, at 3-4 [hereinafter referred to as Conoco's Schedule 14D-9]. The merger transaction was to be used here, as in other successful tender situations whether or not "hostile," to eliminate the shares that were not tendered. The tender offeror in such cases, having acquired sufficient shares via the tender route, is assured of the merger's approval. The terms of the merger will then force the non-tendering shareholders to accept cash or other securities for their shares. The procedure is well summarized in Freund and Greene, *Substance Over Form S-14: A Proposal to Reform SEC Regulation of Negotiated Acquisitions*, 36 Bus. Law. 1483, 1499-1505 (1981). Merger with a wholly-owned subsidiary of Du Pont rather than with Du Pont directly, a so-called "triangular merger," is utilized for various business reasons, e.g., to shield the parent company from liabilities of the acquired target company. See Freund, The Anatomy of a Merger 78-79 (1975).

11. The agreements are set forth in Exhibits 5 and 6, Amendment No. 1 to Conoco's Schedule 14D-9, filed July 20, 1981.

12. This could occur if the number of publicly-held shares or the number of shareholders fell below prescribed numbers, as the result of merger or tender offer, respectively. *See* N.Y. Stock Exchange Manual, Sec. A 16 (1981); S.E.C. Rule 12d2-2, 17 C.F.R. § 240.12d2-2 (1981).

13. The concern here is that holdings of this amount would threaten control. Forbes reports that the latest fad in corporate acquisitions is the purchase of a number of minority interests rather than an attempt at total takeover via tender offer: " 'This is absolutely going to be the game of the 1980's,' " according to one of the country's top takeover lawyers. *Lawyer's Lament, Arbitrager's Delight*, Forbes 31 (May 24, 1982). One reason is that 20%-size blocks of stock can be acquired in the market, at market prices, as distinguished from total takeover for which premiums of from 35% to 100% over market have been paid. At the same time the threat posed by a 20% block may lead the target company to repurchase it at a premium price. *See* Nathan and Sobel, *Corporate Stock Repurchases in the Context of Unsolicited Takeover Bids*, 35 Bus. Law. 1545, 1564-1566 (1980).

discharge his duties."[14] The other executives are not given quite the same freedom of action. They may now voluntarily terminate for "Good Reason;" defined, inter alia, to mean downgrading of position, reduction in salary, or failure by their new employer to increase salary annually in accordance with a Conoco merit increase budget, or failure to maintain participation in benefit plans, or relocation of the executive.[15] Meanwhile, the contracts having become operative, the executives are guaranteed the salary, incentive compensation, and other benefits provided in the agreements until the dates indicated in the following paragraph.[16]

The benefits are substantial. Upon voluntary termination (unless for other than a "Good Reason"), or if the executive's employment is "arbitrarily" terminated, (but not if terminated by reason of death, retirement, disability or by the employer for "Cause"), he will continue thereafter to receive each month one-twelfth of his then annual base salary, plus one-twelfth of his then highest previous annual award under Conoco's incentive compensation plan.[17] This would go on until April 1, 1989 in the case of the chief executive officer, until October 1, 1985 in the case of the president, and until July 1, 1984 in the case of the remaining executives.[18] All the executives would on termination

14. Amendment No. 1 to Conoco's Schedule 14D-9, Exhibit 5, section 4(d). *See supra* note 11.

15. *See id.* at Exhibit 6, para. 4(d).

16. The Du Pont acquisition may not be so positive for others. *See Merger's Aftermath: Du Pont, Once a Hero, Has Become a Villain, Many at Conoco Feel*, Wall St. J., June 16, 1982, at 1, col. 6. Nor have Du Pont's shareholders necessarily benefited from the acquisition at a cost to Du Pont approximating $7.54 billion. See Ruback, *The Conoco Takeover and Stockholder Returns*, SLOAN MGMT. REV. 13 (Winter 1982).

17. Amendment No. 1 to Conoco's Schedule 14D-9, Exhibit 6, para. 5. In passing, one is struck by the anomaly of an ex-employee continuing to receive "incentive" compensation. Perhaps no more incentive was required before termination than after. *See supra* note 2. *Cf.* Loomis, *The Madness of Executive Compensation*, FORTUNE 42, 43 (July 12, 1982): "In the compensation of chief executives, any similarity between rewards received and performance demonstrated often seems almost coincidental." *Id.*

18. *See* Conoco's Schedule 14D-9 at 5. It is specially provided that the chief executive's amounts could be received by him in a lump sum equal to the present value on termination of his remaining payments discounted at 9% per annum. Amendment No. 1 to Conoco's Schedule 14D-9, Exhibit 5, section 5(c)(i). His 1981 compensation was approximately $637,000. This amount per year over eight years discounted at 9% would approximate $3.5 million. Among his other Conoco benefits assumed by Du Pont were stock options, exercisable at an average price of $39.70 per share, of which he held op-

continue to be entitled, until the dates given above for each, to all benefits and service credits under all employee benefit plans as if still employed,[19] and the exercise period of any stock options they held would be extended to the same dates;[20] in addition, the employer would be obligated to pay all legal fees and expenses incurred by the executive should the company contest the validity or enforceability of the agreement.[21] None of the provisions of the agreement, as noted above, would become effective until a Change in Control. Until then the agreement did not require the employer to retain the executive or to pay him any specified level of compensation,[22] thus emphasizing the total preoccupation with preservation of the executive's benefits after a Change in Control.

B. *Sunbeam*

Sunbeam Corporation, while resisting a tender offer, reported in October of 1981 that it had some days earlier executed "termination agreements" with a number of key executives, including its chairman, president and 16 other top officers of the company.[23] The benefits provided by the agreements would not be payable until after a change in control of the company, defined somewhat differently than by Conoco, but with a similar import. In Sunbeam's case this would occur in the event of a change in control of a nature required to be reported to the Securities and Exchange Commission,[24] or if any person or corporation became the beneficial owner of 25% or more of the voting power of the company's securities,[25] or if during any period of two consecutive years the persons constituting a majority of the

tions to purchase some 79,000 shares. In anticipation of the Du Pont merger, Conoco stock closed on July 8, 1982 at $76 ⅜] per share. *See Conoco Protects Nine of Its Top Officers With Takeover Compensation Agreements*, Wall St. J., July 9, 1981, at 4, col. 2.

19. Amendment No. 1 to Conoco's Schedule 14D-9, Exhibit 5, para. 5(c)(ii) and Exhibit 6, para. 5(c)(ii).

20. *Id.*, Exhibit 5, para. 5(c)(iv) and Exhibit 6, para. 5(c)(iv).

21. *Id.*, Exhibit 5, para. 5(c)(vi) and Exhibit 6, para. 5(c)(vi).

22. Conoco's Schedule 14D-9 at 4.

23. Amendment No. 2 to Sunbeam's Schedule 14D-9, filed Oct. 13, 1981, Item 3.

24. *Id.*, Exhibit 6, at section 2. The reference is to Item 5(f) of Schedule 14A of Regulation 14A under the Securities Exchange Act of 1934, as amended, 17 C.F.R.] 240].14A-5(f) (1981).

25. Amendment No. 2 to Sunbeam's Schedule 14D-9, Exhibit 6, section 2.

board ceased to be such, unless the election, or nomination for election by the stockholders, of each new director was approved by a vote of at least two-thirds of the directors still in office who were directors at the beginning of the period.[26]

Assuming a change in control, the Sunbeam executive, as with Conoco, would receive the STA's special benefits on voluntary termination for Good Reason; here to occur if his status and duties or his base salary are reduced, or existing bonus plans in which he may now participate, or his present participation therein, are discontinued, or any benefit or compensation plan, stock ownership plan, stock purchase plan, stock option plan, life insurance plan, health or accident plan or disability plan in which he is participating is discontinued or amended adversely to him, or he is required to be based more than 50 miles from his present office, or the number of paid vacation days to which he is presently entitled is reduced.[27] As if these did not suffice, the STA benefits would also be payable if, following a change in control, the executive is terminated without "adequate identification" of a reason that would deny him these benefits, such as disability or cause,[28] or if the successor in control fails to agree to perform the agreement.[29]

Upon termination entitling him to the STA benefits, the Sunbeam executive would receive, in addition to his full base salary to the date of termination, plus credit for vacation earned but not taken, plus the amount of any bonus not yet awarded or paid under the company's bonus plan, an STA lump sum equal to the amount of his annual base salary at its highest rate in the preceding 12 months multiplied by one if his age is less than

26. Such a change could be the consequence of a successful tender offer or of a merger. In addition, it could be the result of a proxy contest, as to which "many Wall Street analysts expect a new wave of proxy fights, in which dissident investors, rather than trying to buy a company outright, will seek to wrest the reins from management by winning shareholder support for a new corporate strategy." Lewin, *Waging Corporate War by Proxy*, N.Y. Times, July 4, 1982, at F1, col. 5.

27. Amendment No. 2 to Sunbeam's Schedule 14D-9, Exhibit 6, section 3(iii). Analogous provisions are set forth in Conoco's STA, Amendment No. 1 to Schedule 14D-9, Exhibit 6, section 4(d). It is instructive to observe top corporate executives, with six-figure salaries, as much concerned with the number of their paid vacation days as a labor union negotiating a contract for blue-collar workers.

28. Amendment No. 2 to Sunbeam's Schedule 14D-9, Exhibit 6, section 3(iii)(G).

29. *Id.* section 3(iii)(F).

fifty, or multiplied by one and one-half if he is fifty or over but less than fifty-five, or multiplied by two if he is 55 or over, plus all legal fees and expenses as a result of the termination, including those incurred in enforcing his rights under the agreement.[30] In addition, for two years thereafter, or until new full time employment elsewhere, all life insurance, medical, health and accident, and disability plans in which he had been entitled to participate, or the equivalent, would be continued for his benefit.[31] Two months after these agreements were executed, Sunbeam agreed to merge with a wholly-owned subsidiary of Allegheny International Inc.[32]

C. *Brunswick*

The pattern is repeated with Brunswick Corporation which, late in 1981, entered into "employment agreements" with a number of its top executives.[33] Some slight substantive differences from Sunbeam's agreement appear but the latter is closely tracked. Thus, a change of control would follow a change of a nature required to be reported to the Securities and Exchange Commission, or the acquisition of 25% or more voting power of Brunswick's outstanding securities by another person or corporation.[34] For Brunswick, a change in the composition of the

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30. *Id.* section 4(i)-(iii).

31. *Id.* section 4(iv).

32. For subsequent post-honeymoon developments, comparable to Conoco's, *supra* note 16, *see Employees at Acquired Firms Find White Knights Often Unfriendly,* Wall St. J., July 7, 1982, at 23, col. 4, describing the extensive bloodletting, including the departure of some executives with STAs, that followed Allegheny's takeover.

For a definition of "white knight", see Ehrbar, *Corporate Takeovers Are Here To Stay,* FORTUNE 91, 93 May 8, 1978: "[I]nvestment bankers have become remarkably adept at drumming up second bidders—known in the argot of the game as 'knights.' A 'white knight' is one that the target finds particularly attractive." *Id.*

33. *See* Brunswick's Schedule 14D-9, filed Feb. 16, 1982, Exhibit 2, at 18-19. In addition, existing contracts with its chairman and president were revised to add to them the STA benefits contained in the agreements with the other executives. *Id.* at 18.

34. *Id.*, Exhibit 8, at 1-2. *See supra* text accompanying notes 24-25. Resisting a tender offer by Whittaker Corporation, Brunswick recommended acceptance by its shareholders of a competing tender offer by American Home Products Corporation (AHP). *Id.* Exhibit 2, at 1. The latter sought the shares, not to acquire Brunswick in toto as did Whittaker, but for the purpose of exchanging them, pursuant to an agreement with Brunswick, for the stock of the latter's subsidiaries constituting its medical business. *Id.* at 2. On the completion of its offer, which was successful, AHP owned more than 25% of the voting power of Brunswick's securities, but the Compensation Commit-

board of directors would also constitute a change in control, confined, however, to a change in the majority of the board as the consequence of a shareholders' meeting involving a contest for the election of directors.[35] Like Conoco, the Brunswick agreement would establish a five-year period beginning with the date of change in control, unless the executive sooner reached his 65th birthday, during which his authority and duties would be "commensurate" with those immediately prior to the change in control, his salary could not be less than before, his eligibility for bonus, stock option, restricted stock, and other incentive compensation plans would be continued, and he would be entitled to receive such other benefits as medical, insurance, and split-dollar life insurance.[36] If, after a change in control, the benefits and perquisites available to executives with comparable duties are greater than those to which he was entitled before the change in control, he would be entitled to the greater.[37] A significant change in the nature or scope of his authority or duties, or a reduction in his salary or other benefits, or his own "reasonable determination" that the change in control and resultant changes significantly affecting his position left him unable to perform his duties as before, would permit the executive to resign and receive his special severance benefits.[38] These, called "termination payments," would consist of his continuing receipt of his salary for the balance of the five years from the date of the change in control, plus the estimated amount of any bonuses to which he would have been entitled had he remained in employment for the balance of the period.[39] In addition, he would be deemed an

tee of the Brunswick Board of Directors determined with respect to its STAs, "that the AHP Offer and the exchange of Shares acquired pursuant to the AHP Offer for the Medical Stock will not constitute a 'change of control of Brunswick' for purposes of such agreements." *Id.* at 19.

Brunswick's sale of its medical business, in response to a hostile tender offer, is an example of the use of asset redeployment as a defensive tactic. The present legal posture of this and other current takeover defenses is discussed in Fleischer and Raymond, *Whittaker-Brunswick Bid: Study in Takeover Defense*, Legal Times of Wash., June 28, 1982, at 18; July 5, 1982, at 14 [hereinafter referred to as Fleischer and Raymond].

35. Brunswick Schedule 14D-9, Exhibit 8, section 2.

36. *Id.* at section 4.

37. *Id.*

38. *Id.* at section 5.

39. *Id.* at section 6(a). Complex alternative provisions permit the executive to elect a "lump sum severance allowance" in lieu of his "termination payments." *Id.* at section

employee for the balance of the period for the purpose of inclusion in all other benefit plans, including all stock option or other incentive compensation plans, and medical, insurance, and like plans.[40]

D. *Garfinckel*

One further example, a bit off the beaten track, will suffice for the purpose of displaying representative STA examples. Garfinckel, Brooks Brothers, Miller & Rhoads, Inc. (Garfinckel), in August of 1981, agreed to merge into a wholly-owned subsidiary of Allied Stores Corporation (Allied), following a tender offer by Allied for the common stock of Garfinckel.[41] Earlier in the same year Garfinckel's Form 10-K for the year ending January 31, 1981 disclosed that there were then in effect employment contracts with its two top executives, who were also directors, running until 1987, and with other important executives none of whose contracts expired before 1983. A standard clause in all of the contracts provided that in the event of a merger with or into any other corporation, or if substantially all of the assets of Garfinckel were transferred to another corporation, or a change of control of Garfinckel was effected by any person, firm or corporation without approval or assent of its board, the option to terminate the contract could be exercised by the executive. No special monetary or other benefits attached to the exercise of this right.[42]

In a report filed with the Securities and Exchange Commission by Garfinckel on August 17, 1981, while Allied's initial $48 a share offer was pending and contested, it was disclosed that four days earlier the existing employment contracts had been amended with board approval to provide STA benefits.[43] These included, among other things, a lump-sum cash payment equal

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40. *Id.* at section 6(b).

41. *See* Garfinckel, Brooks Bros., Miller & Rhoads, Inc. Amendment No. 2 to Schedule 14D-9, filed Sept. 3, 1981, at 3.

42. The Form 10-K was filed May 1, 1981. The information regarding the employment contracts is contained in the Company's Proxy Statement dated April 24, 1981, at 14-16, filed as Exhibit 1 to the 10-K. The clause regarding the executive's termination right is found in Exhibit 10 to the 10-K, at 6-7.

43. *See* Garfinckel's Schedule 14D-9, filed August 17, 1981, at 4-5.

to three times the highest annual compensation (including incentive compensation as well as base salary) paid or payable to the executive for any of the three years ending with the date of his voluntary termination of employment, if such termination occurred within two years of a change in control not approved by the incumbent board of directors prior to such change.[44] There was no requirement of a "Good Reason" as a condition to the exercise of the right. It could be for any reason, other than death, disability, or retirement under the company's pension plan, following a "change in control", defined as acquisition of a majority of Garfinckel's common stock by Allied, or the change in a majority of the former's board.[45] By August 31 Allied had raised its offer to $53 per share, and on that date the merger agreement was executed. Because the incumbent board, in executing that agreement, had approved the change in control, the STA provisions presumably remained inoperative.

III. Contract or Gift

"Rewards to executives and employees should be based on services performed for the company rather than on other considerations. Elementary as this proposition may seem, it is sometimes

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44. *Id.*, Exhibit 2(b), at 1. The focus here on an unfriendly takeover, in apparent response to the immediate crisis, limits the STA in a way not present in STAs like Conoco's which, concerned also with the preservation of position, *see infra* note 45, look beyond a friendly takeover to guard against falling out of favor with the "white knight", an eventuality not unknown in executive circles. *See supra* notes 16 and 32.

45. *Id.* at 2. The Garfinckel STA should be distinguished from the type of STA represented by Conoco, Sunbeam and Brunswick. Those required both a change in control and a subsequent adverse impact on status or benefits to trigger access to their payout, thus reflecting dual motives: an effort at entrenching the executive's position despite a change in control, and the receipt of special benefits if the effort did not succeed.

An example of the unqualified "ripcord" in operation can been seen in the STA given to nine principal executives of Mohasco Corporation. *See* Form 10-K for the fiscal year ended December 31, 1980, filed with the Securities and Exchange Commission March 31, 1981, at Exhibit 6. Here the STA benefits were available upon the executive's election to leave at any time within six months following a change in control, with no requirement of "Good Reason," "inability effectively to discharge his duties" or other similar limiting condition. *Id.* at section 1. Within six months after another corporation had increased its purchases of the company's stock to an amount in excess of 19% of the shares outstanding (constituting a "change in control" as defined in its STA), four of the executives left "for greener hills." See *No Mohasco Takeover, But 4 Bail Out Anyway*, N.Y. Times, May 4, 1982, at D2.

overlooked."[46]

Any method of corporate compensation is subject to common law requirements of legal consideration, fairness, and fiduciary responsibility on the part of the board that votes it. The elements constituting corporate waste—a breach of director's duty of loyalty, and lack of legal consideration, a common law requirement—overlap in this situation.[47] The Supreme Court almost fifty years ago, in a case concerned with a corporate bonus plan, sanctioned the general principle applicable to corporate compensation: "If a bonus payment has no relation to the value of the services for which it is given, it is in reality a gift in part . . . ."[48] In that case the bonus plan was part of the executives' agreed and anticipated compensation. The bonus amounts were nonetheless required to relate to the value of the executives' services.[49]

Absent prior agreement or reasonable expectation by the executive that a bonus may be granted, a bonus given for past services lacks legal consideration.[50] None of the STAs examined in this article seek to sustain their validity on the basis of the reasonable expectations of the executives who are parties to them. In any event this argument is negated by the obvious fact, and

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46. WASHINGTON & ROTHSCHILD, COMPENSATING THE CORPORATE EXECUTIVE 232 (2d ed. 1962) [hereinafter cited as ROTHSCHILD].

47. *Cf.* FOLK, THE DELAWARE GENERAL CORPORATION LAW 130 (1972), regarding stock options as executive compensation:

> [T]he term 'consideration' indicates judicial concern . . . with the questions whether the options will likely guarantee the continued employment of the optionees or whether the corporation has 'wasted' its assets by giving out stock options with inadequate considerations. In this usage, the term may carry connotations of directors' fulfilling or breaching their fiduciary duty.

Id. See Michelson v. Duncan, 407 A.2d 211, 217 (Del. 1979):

> [A]verments that the options were granted for 'no consideration' is tantamount to an allegation of gift or waste of assets. The essence of a claim of gift is lack of consideration. The essence of a claim of waste of corporate assets is the diversion of corporate assets for improper or unnecessary purposes.

Id.

48. Rogers v. Hill, 289 U.S. 582, 591 (1933) (quoting Rogers v. Hill, 60 F.2d 109, 113 (S.D.N.Y. 1932) (Swan, J., dissenting)).

49. Rogers v. Hill, 60 F.2d at 110.

50. *See* ROTHSCHILD, *supra* note 46, at 244 n.186: "As to bonuses and similar retroactive increases of salary except where there has been an expressed or implied understanding that they may be granted if conditions warrant, there is no consideration for them." *Id.*

indeed even by the admission,[51] that the STAs are occasioned by the tender offer phenomenon. Their validity, considered first in terms of legal consideration, must therefore be analyzed in the context of new contracts, or amendatory agreements where the STA supplements an existing contract.

A. *Delaware Case Law*

An excellent guide to analysis, with all-fours precedent lacking, is available in the Delaware courts' opinions regarding the grant of stock options to corporate executives.[52] Under the Delaware cases a corporation's stated desire to retain the services of valuable executives—an asserted justification of STAs—does not of itself suffice to validate the grant of stock options.[53] The courts require a quid pro quo from the recipient of the options. This need not be measurable quantitatively in a dollar sense.[54] But there must be "a reasonable relationship between the value of the benefits passing to the corporation and the value of the options granted."[55] Moreover, the courts will inquire into whether there is reasonable assurance that the contemplated consideration will in fact pass to the corporation.[56]

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51. *See, e.g.*, Proxy Statement of the Phillips Petroleum Company 20 (March 29, 1982) to the effect that its STAs were entered into "[i]n recognition of widespread merger activity in 1981 . . . ." *Id.*

52. For comment overlooking the Delaware stock option cases and decrying the lack of such precedent, *see* Masters, *Execs' "Golden Parachutes" Await First Court Challenges*, Legal Times of Wash., Nov. 2, 1981, at 1, col. 1 [hereinafter referred to as Masters]. The stock option cases have particular relevance because out of six derivative actions known to the author to have been filed attacking STAs as corporate waste, five were instituted in the Delaware Chancery Court, *viz.*, Lewis v. Anderson (Conoco Inc.), No. 6505 (Del. Ch. filed July 17, 1982), Sumers v. Bitzer (Sunbeam Corp.), No. 6589 (Del. Ch. filed Aug. 18, 1982), Kurs v. Abernathy (Brunswick Corp.), No. 6703 (Del. Ch. filed Feb. 10, 1982), Horvath v. Abernathy (Brunswick Corp.), No. 6729 (Del. Ch. filed March 9, 1982), and Hubner v. Brunswick, No. 6708 (Del. Ch. filed Feb. 16, 1982). A sixth action, Lowe v. Brunswick, is pending in the U.S. District Court for the Northern District of Illinois. In each case the company is a Delaware corporation.

53. Kerbs v. California Eastern Airways, Inc., 33 Del. Ch. 69, 90 A.2d 652 (Del. 1952); Frankel v. Donovan, Del. Ch. 69, 120 A.2d 311 (1956). *See generally* 57 ALR 3d 1241 (1974 & Supp. 1982).

54. Beard v. Elster, 39 Del. Ch. 153, 160 A.2d 731 (Del. 1960).

55. Olson Bros., Inc. v. Englehart, 245 A.2d 166, 168 (Del. 1968); Kerbs v. California Eastern Airways, Inc., 33 Del. Ch. at 78, 120 A.2d at 657-68.

56. *See, e.g.*, Kerbs v. California Eastern Airways, Inc., 33 Del. Ch. at 77, 120 A.2d at 656.

B. *Retention Thesis*

The value of the benefits granted to the executive by the STA is measurable without difficulty. The search for something of substance reasonably related to the value of the benefits and passing to the corporation, however, is the problem. Conoco's explanation, in its schedule 14D-9 filed with the Securities and Exchange Commission, was that the agreements "are designed to encourage the executives to remain in the employ of the Company by providing them with greater security."[57] Barely three weeks after the board meeting at which STAs were authorized for nine officers of Conoco, and at which time offers from two other corporations were not accepted, the Du Pont merger was announced. At no time was it suggested that the officers contemplated leaving;[58] to the contrary, in the nature of things it would be the principal executives of Conoco, recipients of STAs, who would be instrumental in the search for a "white knight" to fend off the undesired suitors. Nor was the "greater security" sought to be conferred by the STAs otherwise related to a benefit for Conoco. Indeed, it does not necessarily redound to Du Pont's benefit after the change in control. It is basic to the STA that its ultimate objective is keyed to the executive's termination, an act hardly consistent with his retention. As for the executive, his "greater security" lies now in Du Pont's obligation, if the STA is binding on it as the successor to Conoco's obligations,[59] to maintain his status and pay for the designated period, or pay him the additional STA benefits if it does not. The STA's validity is,

57. Conoco's Schedule 14D-9 at 4.

58. In Conoco and the other examples discussed, many of the recipients of STAs were directors and officers, with presumed fiduciary obligations to the corporation and its shareholders. There could not be a more unacceptable reason for an STA than such a recipient's threat to jump ship in the face of a takeover bid unless promised the "greater security" of an STA. See the recent criticism by courts in this connection cited in Fleischer and Raymond, *supra* note 34, at 29 n.56 (June 28, 1982).

59. If the STA lacked consideration from the executive, and hence was unenforceable, it would not be binding on Conoco's successor by virtue of the latter's obligation, as successor by statutory merger, to assume Conoco's liabilities. This defense may be unavailable to the successor if, as a condition of Conoco's agreement to the merger, the successor expressly assumed the STA, unless the courts should on other grounds, such as lack of corporate purpose, find the STA vulnerable. The Conoco STA contains a provision imposing on Conoco the obligation to require any successor by merger to assume it. Amendment No. 1 to Conoco's 14D-9, Exhibit 5, section 6 and Exhibit 6, section 6. Presumably the Du Pont subsidiary has done so.

however, to be judged in the first instance in relation to the parties that execute it, not their successors. As noted earlier, until a change in control the promise of greater security brought nothing from the executive in return.

Brunswick enlarges on the retention theme: "[T]he Company wishes to attract and retain well-qualified executive and key personnel and to assure both itself and the Executive of continuity of management in the event of any actual or threatened change in control of the Company."[60] The reference to "attract" in the first half of the sentence seems wholly irrelevant to STAs; no aspect of hiring plays any part in their origins. The "retain" reference was discussed in the preceding paragraphs dealing with Conoco's explanation for its STAs. One need only repeat, as emphasized by the Delaware opinions, that the desire to retain executives does not by itself constitute consideration.[61] The balance of the Brunswick sentence is no more persuasive. There is something strange about an effort by the company to assure continuity of management in the event of a change in control *of the company*. The sentence becomes more understandable if read as voicing the present management's desire to continue in office after a change of control. This, of course, may not accord with the wishes of those in control after the change. The STA, if valid, gives them an option of terminating the executives and paying them the special termination benefits. The objective is thus not the assurance of continuity of management; it is the assurance of special termination benefits. In any event, the company will accomplish neither, if the STA lacks consideration or is otherwise vulnerable *ab initio*. In the latter connection it is questionable that corporate norms permit a predecessor board, faced with a takeover, to contract with its executives to limit the discretion of a successor in control by requiring the successor to pay a special price to be rid of the executives.[62]

60. Brunswick Schedule 14D-9, Employment agreement, Exhibit 8.

61. *See supra* notes 52-56 and accompanying text.

62. It is one thing for a "white knight" to assume the STAs in the course of merger, as in Conoco. Paying billions in that case, the knight would deem the STAs a minor component of the takeover cost. It is quite another thing for a new group that acquired control by market purchases, or for a dissident stockholder group that won a proxy contest, to find its freedom of decision to install a new board and to make management changes, exercisable only at an exorbitant price, namely, the payment of special termina-

C. *Distraction Thesis*

Sunbeam's concern, according to the preamble to its STA, is that a threat of a change in control "may result in departure or distraction of management personnel" to the Company's detriment.[63] As for "distraction," the promise of STA benefits would, according to the preamble,[64] "reinforce and encourage the continued attention and dedication of members of the Company's management . . . to their assigned duties . . . ."[65] A variation of this explanation sees the STA as ensuring that corporate officers will be able to evaluate a possible takeover threat "cooly, with-

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tion benefits by the same corporation.

As a further, and perhaps conclusive, point, the "retention" argument in support of the STA loses plausibility in the light of current economic conditions. Companies are cutting jobs at the upper levels, not adding to them. *See* Main, *Hard Times Catch Up With Executives*, FORTUNE 50 (Sept. 20, 1982). The desire for "retention" in these cases is the executives,' out of concern for their income and position. *See Bendix Provides Salary Guarantee for 16 Officers*, Wall St. J., Sept. 10, 1982, at 2, col. 2:

> Bendix Corp., under pressure from takeover threats by United Technologies Corp. and Martin Marietta Corp., unfurled expensive "golden parachute" employment-contract guarantees for 16 officers to protect them in case control of the company changes . . . Bendix said the pacts would help assure that the officers would stay with the company during the current takeover threat and act "in the best interests of the corporation and its stockholders with respect to (the takeover offers) *without concern about income security.*"
>
> Bendix said the new pacts provide that the executives will be assured of their current base salary and incentive compensation payments for three years from the date of any change in control. In [the chairman's] case, the guarantee is for five years. The new pacts also provide for the company to purchase outright the executives' stock options after any change in control. Some 867,650 shares are under option.
>
> [The chairman's] most recent annual salary and bonus amounted to $805,000; [the president's], $435,000; [the executive vice president's], $435,000. . . . For all 16 executives, the annual total is $4.7 million, giving the package an indicated total cost of $15.7 million.

Id. (emphasis added).

As recently stated in the New York Times:

> In one sense, he [the chairman] cannot lose the current battle; if the Martin Marietta-United Technologies bid of $75 a share for Bendix succeeds, the sale of [the chairman's] 52,460 shares of stock plus the option he has to acquire 42,000 more shares at under $53 a share, will make him a millionaire many times over.

Holusha, *Bendix Chief Playing for High Stakes*, N.Y. Times, Sept. 10, 1982, at D1, col. 1. So much for "income security."

63. Amendment No. 2 to Sunbeam's Schedule 14D-9, Exhibit 6 at Preamble. *See supra* notes 53-62 and accompanying text for a discussion of the retention thesis.

64. *Id.*

65. *Id.*

out fear for their own safety."[66] It is novel doctrine that corporate executives need to be insulated in their decision-making from the fear that a takeover will redound to their detriment, by promising them more money if that happens. The argument in effect is that the law should recognize as valid consideration for the promise of more money, the doing of that for which executives are already being paid, i.e., their continued attention and dedication to their assigned duties.

D. *As Conditional Payments*

Some seek a basis for validity in the fact that STA payments are conditional; just how has not been explained.[67] The thought may be that a gift looks less like a gift if its delivery is delayed. Normally, if payments to executives are made conditional, the conditions will involve a discernible benefit to the corporation; for example, post-retirement payments may be conditioned on the executive providing consulting services, or on his not working for competitors. STAs predicate payments on the occurrence of a change in control—an event unrelated to the executive's duties of care and loyalty as an employee. Changes in the composition of the board, or the emergence of new controlling interests, are external to the job for which the executive was hired. Should these occasion his departure, no reason yet appears for his receiving benefits substantially in excess of what he would otherwise receive on termination if there had been no change of control.

E. *Established Expectations Thesis*

Another approach to the conditional aspect of the STA would seek to subsume it under the rubric "conditional cash bonus". The roadblock here is that the concept requires such bonus to be reasonably anticipated on the basis of an express or implied agreement that it may be granted.[68] The Garfinckel STA is as clear a case lacking this saving feature as may be found. As noted, none of the existing employment contracts had terms ex-

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66. Masters, *supra* note 52, at 10, col. 2.
67. *See id.*
68. *Supra* note 50.

piring before 1983.[69] The contracts expressly afforded the executives the right to terminate in the event of a change in control. By conveying no special benefits in this connection, the provisions themselves negate an expectation that they would be paid. The Garfinckel board resolution proceeded to graft substantial additional dollars to the provision on the eve of the Allied merger. These lump-sum amounts, equivalent to three years' pay, would be paid in the event of a change in control "to the Executive as compensation for services rendered to the Corporation."[70] Reliance on past services as consideration is, in this case, an admission of no consideration.

A sophisticated effort at utilizing a "reasonable expectations" argument, but not in its accepted context as described above, has been proposed by counsel apparently connected with STA preparation.[71] This argument posits the premise that a tender offer may result in "an important upset to established expectations of top executives."[72] The alleged established expectations are that they would have security of tenure if they are performing reasonably well, "[o]r, at the least, they might expect security from risks that are not anticipated and therefore have not been adjusted for in choice of job or in compensation";[73] on these premises "it is easy to see [sic] why an adjustment in compensation, *even at the last moment,* may be considered fair by a *sympathetic* board of directors."[74] The premises assumed in order to reach this conclusion carry their own refutation. No executive has a vested interest in his position, or a "reasonable" expectation of shelter from unanticipated risks. From the point of view of the corporation's and its shareholders' interests, execu-

69. *Supra* note 42.

70. *See supra* text accompanying note 42.

71. *See* Herzel, *Golden Parachute Contracts: Analysis,* Nat'l L.J., Feb. 15, 1982, at 20, col. 1 [hereinafter referred to as Herzel]. The author is a partner of a Chicago law firm, which is counsel to Brunswick Corporation; he appears to be personally involved with Brunswick matters. *See* Brunswick Schedule 14D-9, cover page. In Brunswick's Form 10-K Annual Report filed with the Securities and Exchange Commission on March 31, 1982, at 11, the firm states its opinion that the law suits, *supra* note 52, questioning the validity of Brunwick's STAs "are without merit." No disclosure is made in the Herzel article of the firm's interest in supporting the validity of STAs.

72. Herzel, *supra* note 71, at 22.

73. *Id.*

74. *Id.* at 22-23 (emphasis added).

tives are no more entitled to the expectation, or assurance, that their tenure is secure than is any other employee. If adversely affected by a change in control, the executive has experienced a normal risk of corporate life.

The "established expectations" thesis is also sought to be buttressed by an injection of market analysis. This argument poses that employment markets for executives do not adjust to the risk caused to executives by tender offers, and that the STA is therefore a remedy for this "economic inefficiency."[75] It being impossible to isolate quantitatively the discrete elements that make up an executive's compensation, rationalization of this sort, with its unproven assumptions, should have no more credence as an exercise in economics than it has in law.

The analysis to this point, of necessity, has touched on both contract and corporate law aspects. The former implicates corporate issues; similarly, palpable corporate waste is the corollary of a lack of any meaningful benefit to the corporation, whatever the pretense of technical consideration.[76] The STA, seen clearly, is then no more than a self-serving effort by executives, with de facto control over position and pay, to preserve these in the face of a takeover, with special benefits for themselves at corporate expense if the effort fails. The effort deserves no legal sanction, and the benefits are properly characterized as gifts.

IV.

"You have to avoid making it look like a gift"[77]

A. *Conoco*

You do it by making the gift look like a normal employment contract. The Conoco STA, for example, is called, and has a format consistent with, an "Employment Agreement."[78] It purports

75. *Id.* at 23.

76. An overlay of purported consideration may be attempted by making the STA effective for a term of years upon its execution and providing that the executive is employed for that period. See the Phillips Petroleum Company's Severance Compensation Contract, Form 10-K for the fiscal year ended December 31, 1981, filed March 30, 1982, Exhibit 10(a). That agreement remains otherwise entirely confined to STA provisions.

77. The statement is attributed to Herzel (*supra* note 71). *See* Masters, *supra* note 47, at 10.

78. *See supra* notes 11-22 and accompanying text.

to employ the executive for a period beginning with the date of the agreement and expiring in 1984, 1985 or 1989 depending on the executive. The customary boilerplate as to non-assignability, notices and the like, and even a post-termination non-competition clause, are included.[79] The semblance of a standard employment contract then fades in the face of the provision that "[t]his Agreement shall be effective immediately upon its execution, but, anything in this Agreement to the contrary notwithstanding, neither this Agreement nor any of its provisions shall be operative unless and until there has been a Change in Control of the Company."[80] How distant, in fact, it is from the ordinary agreement is disclosed in Conoco's report to the Securities and Exchange Commission: "Absent one of such events [the two criteria making for a Change in Control], the agreements do not require the Company to retain the executive or to pay him any specified level of compensation."[81] Nor, if he were terminated, for any reason, prior to the change in control, would he receive the special benefits of the STA.[82] It is apparent the latter is not an employment contract in any true sense. It is rather an insurance policy, payable on a change of control if thereafter the executive suffers a reduction in status or benefits or is relocated. The trouble is that no premium was paid for the policy.[83]

B. *Sunbeam*

Sunbeam is slightly more candid in labeling its STAs as

79. *Cf.* Herzel, *supra* note 71, at 22: "Like ordinary executive employment agreements, which they resemble in many respects, these agreements require attention to details." *Id.*

80. Amendment No. 1 to Conoco's Schedule 14D-9, Exhibit 5, section 1, and Exhibit 6, section 1.

81. Conoco's Schedule 14D-9 at 4.

82. *See supra* text accompanying note 80.

83. To keep the insurance in force, so to speak, the agreement requires Conoco to obtain, from any successor to its business or assets, as by merger or purchase an assumption and agreement to perform its provisions. *See supra* note 59. Since this would not cover a change in control due solely to another corporation or group acquiring 20% or more of the company's voting power, the validity of the agreement might then be contested. Presumably to cover this contingency, among others, it is provided that in such event the company will pay the executive's legal fees and expenses. It is hard to see how he could collect if the agreement should be held invalid. The question may, in Conoco's case, be academic. *See supra* note 16 and accompanying text.

"termination agreement[s],"[84] and describes the payments as "severance benefits."[85] The agreement has a two-year term, operative, unlike Conoco's, from the date of its execution. But its benefits are inoperative unless there is a change in control during that period. And during that period the executive's employment could be terminated at any time. A full panoply of employment contract provisions is also included. The wording of both the agreement and Sunbeam's report to the Securities and Exchange Commission indicate it had the benefit of Conoco's filings, and despite minimal differences, the end product does not differ in substance. It merely holds out the prospects of STA benefits for a shorter period.

C. *Brunswick*

Brunswick reverts to the Conoco approach in stating a term of employment beginning on the effective date of the agreement, defined again as the date on which a change of control occurs.[86] Like Conoco, the Brunswick agreement does not deal with the period prior to that date. Executives could be terminated at the will of the Company prior to a change in control, except for the two principal executives who hold employment contracts. Thereafter the agreement sets up a five year term of employment with the salary and other emoluments, and the termination provisions, earlier described.[87] With careful attention to detail, the facade of an ordinary executive employment contract is preserved.

D. *Business Judgment Rule*

Counsel burdened with the need to sustain the STAs as contracts can be expected to retreat to the usual fall-back position in defending corporate action, namely the business judgment rule.[88] That the rule will be relied on in cases now pending

84. Amendment No. 2 to Sunbeam's Schedule 14D-9, Item 3.

85. Exhibit 6, Preamble.

86. Brunwick's Schedule 14D-9 at 1.

87. *See supra* notes 33-40 and accompanying text.

88. For a recent statement of the rule in a tender offer (but not "golden parachute") context, *see* Panter v. Marshall Field & Co., 646 F.2d 271, 293 (7th Cir.), *cert. denied*, 454 U.S. 1092 (1981). *See also* Arsht, *The Business Judgment Revisited,* 8 HOFSTRA L.

has been signalled by the author of the "established expectations" thesis as follows: "[I]t appears likely the courts would (and should) follow the usual business judgment rule with regard to golden parachute contracts."[89] For what reason? "[S]ince there are proper motives for these contracts, courts are unlikely to substitute their own judgments for those of directors except in situations involving particularly inept [sic] or outrageous conduct."[90] This last exception seems particularly applicable in the present context, in the process negating proper motives. In any case, the latter do not equate with legal consideration or proper corporate expenditure. The validity of these agreements as contracts is a question of law, as to which the courts must indeed substitute their own judgment for that of the board. Still another change is rung by its author on the "established expectations" theme: because in his view upsetting these could lead a sympathetic board to think it fair to make an upwards adjustment in compensation, even at the last moment,[91] "it appears improbable that a court would conclude that this decision is so unlikely to benefit the corporation as to put the decision outside the protection of the business judgment rule."[92] The notion thus advanced is that the courts must accept a sympathetic board's determination that there is benefit to the corporation, in calming upset executives with the promise of more money, without regard to the adequacy of legal consideration or corporate waste. This would push the business judgment rule to the point of re-

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REV. 93 (1979); Symposium, *Officers' and Directors' Responsibilities and Liabilities*, 27 BUS. LAW. 1 (Special Issue 1972). *See also* Fleisher and Raymond, *supra* note 34, at 18, 25-27 (June 28, 1982).

89. *See* Herzel, *supra* note 71, at 23.

90. *Id.* The exceptions to the business judgment rule are somewhat broader than indicated above. "Fraud, bad faith, gross overreaching and abuse of discretion" should be added. *See* Panter v. Marshall Field & Co., 646 F.2d at 293.

91. *See supra* text accompanying note 74. "However, a last moment adjustment could present a difficult case for a court unless handled very carefully by the board." Herzel, *supra* note 71, at 23. The haste that has marked the "last moment" adoption of many STAs brings to mind Bennett v. Propp, 41 Del. Ch. 14, 187 A.2d 405 (Del. 1962), in which the court found corporate waste in a chief executive officer's frantic market purchases of his company's shares, utilizing its credit for the purpose, to thwart a fancied threat to his control. The resemblance to executives' hasty entrance into STAs, which utilize corporate assets, to entrench themselves against a change in control is indeed close.

92. Herzel, *supra* note 71, at 23.

quiring total judicial abdication in the matter of executive compensation.

The Delaware courts, on the basis of their own decisions, should not agree. The Delaware Supreme Court's recent opinion in *Michelson v. Duncan,*[93] is pertinent in several vital respects. There the plaintiff shareholder had alleged stock options had been granted for "no consideration." The Vice Chancellor below had concluded that the plaintiff had failed to allege a claim of gift or waste of corporate assets.[94] Said the court: "While the Complaint does not use the words 'gift or waste,' the averments that the options were granted for 'no consideration,' is tantamount to an allegation of gift or waste of assets. *The essence of a claim of gift is lack of consideration.*"[95]

Defendants in *Michelson* invoked the Delaware statute that provides: "In the absence of actual fraud in the transaction, the judgment of the directors as to the consideration for the issuance of such rights or options and the sufficiency thereof shall be conclusive."[96] Said the court: "We do not read § 157 as intended to erect a legal barrier to any claim for relief as to an alleged gift or waste of corporate assets in the issuance of stock options where the claim asserted is one of absolute failure of consideration."[97] Defendants also sought to rest on the fact that the options had been granted by disinterested directors and ratified by the stockholders of the company.[98] Said the court: "[N]on-unanimous shareholder approval cannot cure an act of waste of corporate assets."[99] This would be *a fortiori* as to disinterested directors and compensation committees. And finally: "Although directors are given wide latitude in making business judgments, they are bound to act out of fidelity and honesty in their roles as fiduciaries . . . . And they may not, simply because of their position, 'by way of excessive salaries and other devices, oust the minority of a fair return upon its investment' . . . . It is common sense that a transfer for no consideration amounts to a gift

93. 407 A.2d 211 (Del. 1979).
94. *Id.* at 217.
95. *Id.* (emphasis added).
96. DEL. CODE ANN. tit. 8 § 157 (1978). *See* Michelson v. Duncan, 407 A.2d at 223.
97. 407 A.2d at 224.
98. *Id.*
99. *Id.* (citation omitted).

or waste of corporate assets."[100]

Corporate counsel are prone to seize on the business judgment rule as if recitation of the phrase ought to be conclusive of an issue. The fact is that STAs do *not* present the courts with complex corporate decision-making of the kind that merits total deference to a board's business judgment.[101] Neither good faith nor even an honest, if misguided, desire to benefit the corporation, to which a court might defer in other circumstances, erect barriers to an inquiry into the validity of a purported contract.[102] *Zapata Corp. v. Maldonado*[103] adds a further dimension to the inquiry. The facts of corporate life—the undeniable collegial ambience of the boardroom, the constant contact, social and otherwise, of independent board and compensation committee members with employee members of the board and other top executives[104]—influenced the Delaware Supreme Court in that case to require a measure of judicial review of independent members' decision to seek dismissal of a derivative suit.[105] The recipients of STAs, for the most part top executives, are the very

100. *Id.* at 217 (citations omitted).

101. Federal courts frequently review the reasonableness of executive compensation under Internal Revenue Code provisions limiting deductions for salaries and other compensation to reasonable allowances. *See, e.g.*, Hatt v. Commissioner, 28 T.C.M. (CCH) 1194 (1969), *aff'd per curiam*, 457 F.2d 499 (7th Cir. 1972). For a Delaware case that, while acknowledging the authority of a board of directors to determine officers' compensation, nevertheless reviewed the reasonableness of an officers' compensation, *see* Wilderman v. Wilderman, 315 A.2d 610, 615-16 (Del. Ch. 1974).

102. *Cf.* Mobil Corp. v. Marathon Oil Co., Fed. Sec. L. Rep. (CCH) 98,399, at 92,406 (6th Cir. Dec. 23 1981), where a finding of good faith and loyalty on the part of the directors of a target company in granting so-called "lockup options" to a white knight did not keep the Sixth Circuit from holding the grant in violation of the securities laws.

103. 430 A.2d 779 (Del. 1981).

104. For a critique of the independent director's efficacy as a monitor of managerial integrity, including management's desire for added rewards, *see* Brudney, *The Independent Director-Heavenly City or Potemkin Village?* 95 HARV. L. REV. 597, 610-22 (1982). *Cf.* Loomis, *The Madness of Executive Compensation*, FORTUNE 42, 45 (July 12, 1982):

> It is widely believed that many compensation committees are rubber stamps, unwilling to be hard-nosed about the pay of top executives, particularly those chaps who are fellow members of the board. Any reader of this article can imagine what his own attitude would be if he were required to sit in semi-public judgment on the salaries of his peers, some of whom were good friends. He would likely avoid harsh judgments and, in the end, be generous to a fault, particularly if he had the privilege of using money not his own.

Id.

105. Zapata Corp. v. Maldonado, 430 A.2d at 781.

persons with whom "outside" board and committee members deal regularly in the latter's performance of their functions. It is not strange in the circumstances that they may be "sympathetic," but this is not an excuse for indulgence in corporate waste.[106]

V. Conclusion

By unbundling one element of alleged compensation, and permitting its analysis unencumbered by other factors the emergence of the STA, with its grasping for "greater security," may have performed a public service.[107] The current excesses in corporate compensation[108] are underlined by the total lack of merit of this latest example which, stripped of its advocates' rationalizations and draftsmen's window-dressing, can be seen for what it is—a parting gift of corporate moneys without support in contract or corporate law. Mindful of the substantial, and at times extravagent, amounts already routinely received by executives on their normal departure from the corporation, from pension, incentive, and stock option plans, performance shares, and like programs, one is compelled, to ask, recalling a comparable question:[109] How much security does a man need?

106. "At some point even the 'disinterested' grant of excessive compensation becomes a problem of gross imprudence or waste of assets, whether or not self-dealing is involved." JENNINGS & BUXBAUM, CORPORATIONS 466 (5th ed. 1979).

107. There are intimations that STA provisions may be merged into "ordinary" employment contracts in the future. *See* Herzel, *supra* note 71, at 23. It would only sharpen the contrast between "normal" and STA benefits on termination to include them in the same agreement. STA benefits, being hinged on a change in control, should remain easily severable as serving no valid corporate purpose.

108. *See* Loomis, *supra* note 105; Kraus, *Executive Pay: Ripe for Reform?*, HARV. BUS. REV., Sept.-Oct. 1980, at 36; Crystal, *When Management Takes Care of Itself*, N.Y. Times, June 13, 1982, at F2, col. 3.

109. "How Much Land Does A Man Need?" Tolstoy's profound parable with that title can be found in A TREASURY OF RUSSIAN LITERATURE (B.G. Guerney ed. 1943). The answer, for those who may not know it, is—six feet.