Hostile Corporate Takeovers: Legal Problems of Defense

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I. Introduction

The problems concerning hostile corporate takeovers and defenses against them have been of great interest to legal scholars, attorneys, and other professionals in the whole world.

This interest can be seen in the enormous amount of literature on hostile takeovers and corresponding defenses.

All of the court opinions, statutes, books, articles, and other materials indicate that there are a lot of problems in this complex area of corporate law.

It is evidently impossible to cover all or even most of such problems within a single paper.

This paper, therefore, concentrates on the most important problem that forms the basis of many other problems in the takeover area.

The major problem is whom to defend and how.

Who to defend specifically refers to whether shareholders or directors are the main corporate

constituency.

How to defend refers to which mechanisms should ensure the interests of the primary corporate constituency.

This paper answers these questions in favor of shareholders. It particularly argues for a higher standard of responsibility of directors undertaking antitakeover actions.

The thesis of this paper is that, in order to protect the interests of shareholders better, the responsibility of directors in the antitakeover actions should be raised.

This objective can be accomplished by elevating the level of scrutiny of the directors' antitakeover activity from the enhanced scrutiny to a strict scrutiny.

Such an improvement is necessary to increase the directors' accountability to the corporation and its shareholders.

It will serve the best interests of the main corporate constituency, i.e., the shareholders.

Implementation of this proposal would generally

improve the corporate governance law and practice.

As a starting point for its thesis, this paper will cover the major legal issues flowing from the landmark antitakeover cases.

The paper will first analyze the fundamental problems already addressed by the courts.

It will then proceed to develop a more effective response to these problems.

The paper will ultimately suggest ways to improve the antitakeover defenses in the best interests of corporations and their shareholders.

This paper consists of four parts.

The Background part that follows will introduce you to the relevant takeover techniques and defenses in sections A and B respectively.

Analyzing various antitakeover defenses, section B will emphasize the ones that are most successful in protecting corporate interests.

This section will also point out certain problems in

defenses that may affect the interests of shareholders.

The Analysis part will analyze the major problem of the antitakeover law: Whom to protect and how.

Section A will first analyze the current judicial approach to the problem.

It will specifically review the application by courts of a higher standard of scrutiny instead of the traditional business judgment rule to the directors' antitakeover actions.

Section B will then argue for raising the directors' responsibility even further up to the entire fairness standard.

Section C will reveal that the thesis is based on the shareholder primacy doctrine.

Section D will justify the proposal not to apply the business judgment rule to the directors' antitakeover activity.

Sections E will suggest a couple of alternative defenses that would allow the directors to discharge their fiduciary

duties properly.

Section F will recommend the directors how to adopt and implement the antitakeover defenses more correctly.

Section G will finally concentrate on such a special type of hostile takeovers as the privatization of a state-owned corporation.

This section will demonstrate that, in the case of a privatization, the interests of the people of a relevant country should be subject to similar protection as those of shareholders in a privately-owned publicly-traded corporation.

The Conclusion part will summarize.

II. Background

Corporate takeovers can generally be either friendly or hostile.

This paper will focus only on the hostile takeovers, which raise more problems than friendly, negotiated ones.

A takeover is hostile when the target's management

opposes an acquirer's effort to gain control of the target.[1]

Since the hostile takeovers normally happen with regard to public corporations, this type of entity is analyzed in this paper.

Having decided to acquire a target, the acquirer usually deals with either of the two main corporate constituencies of the target: management or shareholders.

In a negotiated takeover, the acquirer deals with the management, while in a hostile takeover, the acquirer deals with the shareholders.[2]

A possibility or threat of a hostile takeover causes the target's board to adopt and implement antitakeover defenses.

The main problem with such antitakeover activity is who to protect first and how.

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[1] Barbara White, *Conflicts in the Regulation of Hostile Business Takeovers in the United States and the European Union*, 9 IUS Gentium 161, 166 (2003).

[2] *See* Meredith M. Brown, Paul S. Bird & William D. Regner, *Introduction to Hostile Takeovers*, 1584 PLI/Corp 309, 313-14 (2007).

"Courts have sought to strike a balance between the goals of protecting shareholders from threats that some hostile offers might present and preventing managers from entrenching themselves."[3]

As this paper demonstrates, the courts have failed so far to reach this balance. The courts have specifically been protecting managers at the expense of shareholders.

Historic shareholder displeasure with the current corporate governance has forced such large companies as "Pfizer, Bristol-Myers Squibb, Aetna, Omnicom, Coca-Cola, CSX, Hewlett-Packard," and others to weaken their antitakeover defenses.[4]

As of 2004, nevertheless, "97% of all exchange-listed companies [had] at least one significant anti-takeover provision, with more than half of those having adopted

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3 Lucian Arye Bebchuk, John C. Coates IV & Guhan Subramanian, *The Powerful Antitakeover Force of Staggered Boards: Theory, Evidence, and Policy*, 54 Stan. L. Rev. 887, 892 (2002).

4 Frank Aquila, *Back to the Future! Recent Hostile Bids Make Takeover Defenses Relevant*, 7 No. 10 GLMALAW 6 (2004).

shareholder rights plans."[5]

A. Hostile Takeovers

The acquirers usually employ the following hostile takeover techniques:

- Toehold[6] acquisition – a purchase of the target's shares on an open market.[7]

  They allow the acquirer to become a shareholder

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5 *Id.*

6 Numerous takeover terms may seem to be informal. The courts nevertheless widely use these terms and, hence, make them appropriate in legal literature. For instance, "[i]n the modern takeover lexicon, [it is] consistently recognized that defensive measures which are either preclusive or coercive are included within the common definition of draconian." *Unitrin, Inc. v. American General Corp.*, 651 A.2d 1361, 1387 (Del. 1995). Also, the board of directors is "the defender of the metaphorical medieval corporate bastion," and can act "defensively before a bidder is at the corporate bastion's gate." *Id.* at 1388. The judicial use of these terms makes this area of law more interesting.

7 Robert W. Hamilton & Richard A. Booth, *Business Basics for Law Students: Essential Concepts and Applications* 404 (2006).

of the target and provide an opportunity to sue the target later on if the takeover attempt turns out unsuccessful.[8]

- Tender offer – an acquirer's offer to the target's shareholders to buy their shares at a premium over the market price.[9]

  A partial, two-tier, front-end loaded tender offer usually involves a back-end merger.[10]

  The takeover literature generally treats a tender offer as a hostile takeover technique.[11]

  It should not be treated as hostile, however, if it favors the interests of the majority of shareholders.

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[8] Dennis J. Block, Sanord F. Remz & Susanne M. Toes, *Stockholder Actions in Connection with Hostile Takeover Battles*, 300 PLI/Lit 219, 225-26 (1986).

[9] Hamilton & Booth, *supra* note 7, *at* 405.

[10] *See id.* at 412.

[11] *Id.* at 402, 405.

Such a majority should be adequate to approve the relevant merger or acquisition.

To claim that any tender offer is hostile would make virtually any merger or acquisition hostile.

- Proxy fight – a solicitation of the shareholders' proxies to vote for insurgent directors.[12]

  Proxy fights can run along with "board packing," where the number of board members increases and the acquirer intends to fill this increase with his slate of directors.[13]

B. Antitakeover Defenses

In response to these hostile takeover techniques, targets usually devise the following defenses:

- Stock repurchase – a/k/a self-tender offer – a purchase by the target of its own-issued shares

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[12] Hamilton & Booth, *supra* note 7, *at* 415-16.

[13] Elizabeth M. McGeever & Tanya E. Pino, *Legal Issues and Tactics in Hostile Takeovers*, SH083 ALI-ABA 567, 572 (2002).

from its shareholders.[14]

This is an effective defense that successfully passed both *Unocal* and *Unitrin*.

- Poison pill – a/k/a shareholder rights plan – a distribution to the target's shareholders of the rights to purchase shares of the target or the merging acquirer at a substantially reduced price.[15]

  What triggers an execution of these rights is an acquisition by an acquirer of a certain percentage of the target's shareholding.[16]

  If exercised, these rights can considerably dilute the acquirer's shareholding in the target and can, thus, deter a takeover.[17]

  The poison pill is "the most powerful defense

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[14] Brown, Bird & Regner, *supra* note 2, at 332.

[15] Julian Velasco, *The Enduring Illegitimacy of the Poison Pill*, 27 J. Corp. L. 381, 382 (2002).

[16] *Id.*

[17] *Id.* at 382-83.

against hostile takeovers."[18]

The pills can be flip-in, flip-over, dead hand, and slow/no hand.

- Flip-in poison pill can be "chewable," which means that the shareholders may "force a redemption of the pill by a referendum within a specified period of time, if the tender offer is an all cash offer for all of [target]'s shares."[19]

  The poison pill can also provide for a "window of redemption," a period within which the management can redeem the pill.[20]

  This window, hence, determines the moment when the management's right to redeem terminates.

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[18] Julian Velasco, *Just Do It: An Antidote to the Poison Pill*, 52 Emory L.J. 849, 849 (2003); Guhan Subramanian, *Bargaining in the Shadow of Takeover Defenses*, 113 Yale L.J. 621, 625 (2003).

[19] Brown, Bird & Regner, *supra* note 2, at 319.

[20] *Id.*

- "Dead hand" pill creates "continuing directors."

  These are current target's directors who are the only ones that can redeem the pill once an acquirer "threatens to acquire" the target.[21]

  While the earlier court decisions restricted use of dead hand and no hand pills, the later decisions upheld such pills.[22]

- "No hand" – also known as "slow hand" – pill prohibits redemption of the pill within a certain period of time, for example six months.[23]

- Staggered board – a board in which only a certain number of directors, usually one third, is reelected annually.[24]

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21 *Id.*

22 *See id.* at 319-20.

23 *See id.* at 319.

24 Bebchuk, Coates IV & Subramanian, *supra* note 3, at 893.

This is a "powerful antitakeover defense, stronger than is commonly recognized."[25]

For the reason of being too strong and reducing returns to the target's shareholders, the latter have resisted this type of defense.[26]

- Shark repellents – certain provisions in the target's charter or bylaws deterring an acquirer's desirability of a hostile takeover.[27]

  This defense typically involves a supermajority vote requirement regarding a merger of the target with its majority shareholder.[28]

  A shark repellent also includes other takeover-deterrent provisions in the target's

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[25] *Id.* at 887, 890 (concluding that "effective staggered boards are the most powerful antitakeover device in the current arsenal of takeover defense weapons").

[26] *Id.* at 890-92.

[27] Hamilton & Booth, *supra* note 7, at 416-17.

[28] Brown, Bird & Regner, *supra* note 2, at 317.

certificate of incorporation or bylaws.

- Golden parachutes – additional compensations to the target's top management in the case of termination of its employment following a successful hostile acquisition.[29]

  Since these compensations decrease the target's assets, this defense reduces the amount the acquirer is willing to pay for the target's shares. It then obviously harms shareholders.

- Greenmail – a buyout by the target of its own shares from the hostile acquirer with a premium over the market price, which results in the acquirer's agreement not to pursue obtaining control of the target in the near future.[30]

  The taxation of greenmail presents a considerable

[29] Hamilton & Booth, *supra* note 7, at 417.

[30] *Id.* at 411-12.

obstacle for this defense.[31]

Plus, the statute may require a shareholder approval of repurchase of a certain amount of shares at a premium.[32]

- Standstill agreement – an undertaking by the acquirer not to acquire any more shares of the target within a certain period of time.[33]

  A standstill agreement is an additional defense that usually accompanies the greenmail described above.[34]

- Leveraged recapitalization – a/k/a corporate

[31] William A. Klein, J. Mark Ramseyer & Stephen M. Bainbridge, *Business Associations, Cases and Materials on Agency, Partnerships, and Corporations* 767 (6th ed. 2006).

[32] Brown, Bird & Regner, *supra* note 2, at 333.

[33] Marc J. Segalman & Marina Jaudenes, *Developments in Defense to Hostile Takeover Attempts: Lock-Ups, No-Shop Provisions, Standstill Agreements, Bust-up and Topping Fees and White Squire Defenses*, 680 PLI/Corp 277, 338 (1990).

[34] Brown, Bird & Regner, *supra* note 2, at 333.

restructuring – "[a] series of transactions designed to affect the equity and debt structure of a corporation."[35]

- Recapitalization usually involves three transactions: (1) sale of assets; (2) issuance of debt; and (3) distribution of dividends.[36]
- Leveraged buyout – a purchase of the target by the management with the use of debt financing, which burdens the target with the debt.[37]

  In such a case, the management becomes a bidder and competes with a hostile acquirer for control over the target.[38]

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35 Ross W. Wooten, *Restructurings During a Hostile Takeover: Directors' Discretion or Shareholders' Choice?*, 35 Hous. L. Rev. 505, 520 (1998).

36 *Id.*

37 Hamilton & Booth, *supra* note 7, at 427.

38 Gerald Rosenfeld, *The Use of Management LBO's, Leveraged Transactions and White Knight Strategies in Response to Hostile Takeovers*, 592 PLI/Corp 9, 11, 15 (1988).

- Crown jewels – options under which the "favored suitor can buy a key part of [target] at a price that may be less than its market value."[39]
- Scorched earth – a self-tender offer by the target that burdens the target with debt.[40]
- Lockups – defensive mechanisms in friendly mergers and acquisitions designed to deter hostile bids.[41]

  Lockups include (i) no-shop covenant, (ii) termination/bust-up fee, (iii) option to buy a subsidiary, (iv) expense reimbursement etc.[42]
- Pac man – a target's tender offer for the acquirer's

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39 Brown, Bird & Regner, *supra* note 2, at 336.

40 Marc P. Cherno & Elizabeth A. Raymond, *Hostile Takeovers and the Ever-Narrowing (Expanding) Business Judgment Rule*, 499 PLI/Corp 41, 85 (1985).

41 Segalman & Jaudenes, *supra* note 33, at 282-83.

42 Brown, Bird & Regner, *supra* note 2, at 336.

shares.[43]

- White knight – a strategic merger that does not involve a change of control and relieves the target's management of the responsibility to seek the best price available.[44]

  An example of white knight is in the *Paramount-Time* case.[45]

- White squire – giving by the target to a friendly party of a certain ownership in the target.[46]

  This defense is effective against acquisition by the hostile party of complete control over the target by "freezing out" minority shareholders.[47]

- Change of control provisions – target's contractual arrangements with third parties that

43 *Id.* at 333.

44 *Id.*

45 *Id.*

46 Segalman & Jaudenes, *supra* note 33, at 349.

47 *Id.*

burden target in the case of change in its control.[48]

- "Just say no" – board's development and implementation of a long-term corporate strategy that enables the board simply to reject a proposal of any potential acquirer who would fail to prove that his acquisition strategy matches that of the target.[49]

This non-exhaustive variety of defenses shows that the possibilities and, consequently, the power of directors in responding to hostile takeovers are virtually unlimited.

Some defenses are more effective than others.

Not all of the defenses are necessarily "show-stoppers"[50], nonetheless. One example, a golden parachute may decrease the price that the acquirer would be willing to pay for the target, but it may not necessarily stop the hostile

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48 Brown, Bird & Regner, *supra* note 2, at 334.

49 Dennis J. Block, Jonathan M. Hoff & H. Esther Cochran, *Defensive Measures in Anticipation of and in Response to Hostile Takeover Attempts*, 972 PLI/Corp 93, 101, 143 (1997).

50 Brown, Bird & Regner, *supra* note 2, at 331.

acquisition.[51]

Another example, a poison pill can easily lose its effect if the acquirer wins a proxy fight for the target and then redeems the pill.[52]

The above takeover techniques and defenses show the unlimited scope of power that the board enjoys in its antitakeover activity. The more power requires the higher degree of responsibility.

III. Analysis

A. Major Cases Raising Board's Antitakeover Responsibility

The major antitakeover cases demonstrate that the directors' antitakeover power is virtually unlimited.

All of these cases, thus, raise the directors' responsibility to a certain — yet limited — extent.

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[51] *See, e.g., id.*

[52] Sharon Hannes, *A Demand-Side Theory of Antitakeover Defenses*, 35 J. Legal Stud. 475, 480 (2006).

The following cases are also a benchmark of this paper's claim to increase the directors' responsibility even further.

1. *Cheff v. Mathes*

In *Cheff*, the defendant directors authorized a greenmail to a hostile acquirer.[53]

This defense allegedly aimed to remove a threat by the hostile shareholder to the corporation's business.[54]

The Court put the burden of proof on the directors in view of "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."[55]

The Court, thus, realized that the directors are highly likely to defend their corporate control before defending

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[53] *Cheff v. Mathes* , 41 Del. Ch. 494, 199 A.2d 548 (Del. 1964).

[54] *Id.*, 41 Del. Ch. at 500, 199 A.2d at 552.

[55] *Id.*, 41 Del. Ch. at 504, 199 A.2d at 554 (citing *Bennett v. Propp*, 41 Del. Ch. 14, 22, 187 A.2d 405, 409 (Del. 1962)).

any business strategy.

The directors won because they primarily addressed the threat that the company faced.[56]

However, should the choice of business strategy lie with the shareholders, rather than the directors, the results of the corporate activity might be much better than they appeared to be later on.[57]

The aftermath of this case demonstrates that the board has too much, while the shareholders lack almost any power regarding antitakeover defenses.

In such a case, the shareholders should have the power to decide whether it is in their interests to waste corporate money for greenmail to an alleged raider.

2. *Unocal Corporation v. Mesa Petroleum Co.*

In *Unocal*, the Court upheld a discriminatory self-tender offer by the target's board against a hostile

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56 *Id.*, 41 Del. Ch. at 508, 199 A.2d at 556.

57 Klein, Ramseyer & Bainbridge, *supra* note 31, at 766.

minority shareholder.[58]

The Court held, nevertheless, that the business judgment rule applies to defensive actions only where there is a (i) threat to the corporate policy, strategy, or effectiveness and (ii) reasonableness or proportionality of defenses to this threat.[59]

Unocal emphasizes the need to protect the interests of shareholders in hostile takeovers. It applies only when a board takes a defensive action unilaterally.[60]

Conversely, where shareholders approve such action, *Unocal* does not apply.[61]

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58 *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 958-59 (Del. 1985).

59 *Id.* at 955.

60 *Williams v. Geier*, 671 A.2d 1368, 1377 (Del. 1996) (citing *Unocal*, 493 A.2d at 954-55).

61 *Emerson Radio Corp. v. International Jensen Inc.*, 1996 WL 483086, 15 (Del. Ch. 1996) (citing *Williams*, 671 A.2d at 1376-77).

3. *Unitrin, Inc. v. American General Corp.*

In *Unitrin*, the Court also upheld a self-tender offer against a hostile acquirer.[62]

This case develops the second prong of the Unocal test, i.e., the reasonableness/proportionality of defenses to the threat.[63]

Unitrin particularly determines that a defensive measure is "disproportionate if it is either draconian or is outside a range of responses considered to be reasonable."[64]

This case interprets the level of responsibility of directors in antitakeover defenses established by *Unocal*.

4. *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*

In *Revlon*, the Court held that when the directors put

[62] *Unitrin*, 651 A.2d at 1391.

[63] *Id.* at 1367.

[64] McGeever & Pino, *supra* note 13, footnote 7.

the target for sale, they may no longer defend it against a hostile bidder.[65]

This case, too, emphasizes the need for more protection for the shareholders when directors undertake certain antitakeover techniques.[66]

Following *Revlon*, it is important to be cautious with the use of defensive techniques because otherwise legal techniques can become illegal following certain circumstances.

For instance, when the target's board starts looking for a white knight to buy control in the corporation, the board must treat a black knight on equal terms with the white knight.[67]

The board, in other words, may no longer defend its corporation against the black knight.

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65 *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 182, 184-85 (Del. 1986).

66 *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 179-80 (Del. 1986).

67 *Id.* at 182.

The board must instead hold an open auction for all of the knights in order to sell control in the corporation at the highest price possible.[68]

5. *Paramount Communications, Inc. v. Time Incorporated*

In *Time*, the *Unocal* standard allowed application of the business judgment rule.[69]

Since all corporate governance decisions fall into the authority of directors, shareholders have no right to decide which way to go: Either to accept a tender offer from Paramount with immediate payment of a higher-than-market price or to merge with Warner for long-term strategic goals perceived by the board.

The directors decided to merge with Warner because it would correspond to the company's strategic purposes.[70]

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[68] *Id.*

[69] *Paramount Communications, Inc. v. Time Inc.*, 571 A.2d 1140, 1142, 1152 (Del. 1989).

[70] *Id.* at 1144, 1152, 1154.

Following satisfaction by directors of the enhanced scrutiny standard, the Court applied the business judgment rule that shielded the directors' decision.[71]

If a "transaction involves a sale of control" of the target, nonetheless, the directors must hold a public sale of the target under *Revlon*.[72]

Moreover, the directors' must at all times honor their fiduciary duty of care to "be informed of all material information reasonably available."[73]

In such cases, it would probably be fairer to allow Time's shareholders to decide which way to go: Either to accept the merger proposal from Paramount or to merge with Warner.

Such a decision should be free of any board veto power.[74] To put it differently, the board should not be able

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[71] *Id.* at 1155.

[72] Brown, Bird & Regner, *supra* note 2, at 336.

[73] *Id.* at 334-335.

[74] Lucian Arye Bebchuk, *The Case against Board Veto in Corporate Takeovers*, 69 U. Chi. L. Rev. 973, 975-76 (2002).

to deprive the shareholders of an opportunity to determine their best interests and realize them.

6. *Paramount Communications, Inc. v. QVC Networks Inc.*

Under *QVC*, "draconian" defenses fail.[75] Such defenses preclude obtaining the highest value for the shareholders where the board sells control.[76]

Such defenses are, thus, invalid and unenforceable.[77] They burden shareholders due to the directors' faults.

After this case, an open bidding between Viacom and QVC for the control in Paramount gave the latter's shareholders about $10 billion instead of $8 billion previously approved by the board.[78]

This result also indicates that a hostile bidding may be

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75 *Paramount Communications Inc. v. QVC Network Inc.*, 637 A.2d 34, 50 -51 (Del. 1994).

76 *Id.* at 49.

77 *Id.* at 51.

78 Klein, Ramseyer & Bainbridge, *supra* note 31, at 815.

much more favorable for shareholders than a negotiated consolidation.

The hostile nature of an acquisition/merger increases the value for the target's shareholders.[79]

7. *Hilton Hotels Corp. v. ITT Corp.*

According to *Hilton*, a change of the board structure from annual to classified/staggered – an otherwise legal action – can be illegal if implemented as a defense following a threat of proxy contest.[80]

Such a change is permissible only if there is a compelling justification for it.[81]

In this case, Hilton announced its prospective proxy contest for the ITT's board.

The ITT directors then undertook a reorganization

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79 *See, e.g.*, Brown, Bird & Regner, *supra* note 2, at 333.

80 *Hilton Hotels Corp. v. ITT Corp.*, 978 F. Supp. 1342, 1348-49 (D. Nev. 1997).

81 *Id.* at 1346 (citing *Stroud v. Grace*, 606 A.2d 75, 92 (Del. 1992)).

plan of splitting ITT into three entities with the major one having a classified/staggered board, instead of ITT's annually elected board.

There was no threat by Hilton to the ITT policy/effectiveness in order to justify the plan.

Under this plan, the ITT shareholders would be unable to replace all directors in that year, but would only be able to change one third of directors.

The Court held that, in such a way, the board intended to entrench itself and disenfranchise the ITT shareholders of their right to elect directors.[82]

The Court, consequently, enjoined this plan and ruled in favor of Hilton.[83]

This ruling was essentially in favor of ITT's shareholders who so reinstated their right to elect the board.

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[82] *Id.* at 1351.

[83] *Id.* at 1352.

B. Raising Board's Antitakeover Responsibility Further

According to the major antitakeover cases above, the courts have increased the scrutiny of the directors' antitakeover actions from the traditional business judgment rule to an enhanced scrutiny standard.

This paper argues in favor of further increasing the directors' responsibility in adopting and implementing antitakeover defenses.

The directors should be subject to a higher judicial scrutiny than they have been up to date. The directors should, namely, be subject to the entire fairness standard, rather than the enhanced scrutiny standard.

This improvement would make directors more responsible and accountable for their antitakeover activities. It would finally ensure the best interests of corporations and their shareholders.

The proposed improvement confidently rests on the following justifications. First, the directors currently have

virtually limitless power in the antitakeover arena.

Second, when the directors handle antitakeover matters, a conflict of interests normally arises between them, on the one part, and the corporation and its shareholders, on the other part.

Third, the historic major corporate scandals indicate that directors tend to overreach their corporate rights and disregard their fiduciary duties.

Fourth, the corporate power of directors considerably outweighs that of shareholders.

Fifth, the shareholders are practically unable and, oftentimes, unwilling to control the directors' antitakeover actions properly.

The shareholders, therefore, need judicial protection of their interests.

All of these justifications for elevating the board's antitakeover responsibility are discussed throughout this paper.

The increase in directors' responsibility and

accountability will favor the corporation and its shareholders.

Such an increase would protect the shareholders from unreasonable antitakeover decisions of directors.

The increase would give more assurance that the directors' antitakeover actions are in the best interests of the corporation and shareholders.

This would finally assure that the directors comply with their fiduciary duties of care, loyalty, and good faith.

There can be a counterargument that the increase of the directors' antitakeover responsibility would decrease their effectiveness and, thus, damage shareholders.[84]

Such a claim should, however, stand against the risk of self-dealing of directors. In historic corporate scandals, the immense self-dealing has demonstrated to be more dangerous and damaging than anything else.

The high risk of self-dealing, thus, certainly prevails

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[84] *See, e.g.*, Stephen M. Bainbridge, *Director Primacy: The Means and Ends of Corporate Governance*, 97 Nw. U. L. Rev. 547, 573 (2003).

over the foregoing counterclaim.

Since this paper claims to minimize, if not to eliminate, this risk, any counter-arguments would appear to be inferior.

C.Preferable Corporate Governance Doctrine

When analyzing any aspect of corporate law, especially hostile corporate takeovers, it is important to make a choice among the three fundamental doctrines of corporate governance.

The matter is which of the following doctrines to prefer: Shareholder primacy, director primacy, or manager primacy.

Each of these doctrines favors a certain corporate constituency. Thus, one usually lies in the basis of analysis.

This paper rests on the shareholder primacy doctrine. As owners of the corporation,[85] the shareholders should be able not only to invest their money into the business, but

[85] Jill E. Fisch, *Measuring Efficiency in Corporate Law: The Role of Shareholder Primacy*, 31 J. Corp. L. 637, 647-48 (2006).

also be able to control the crucial corporate matters, such as takeovers.

If the purpose – the end-axis – of the two major corporate governance doctrines – shareholder primacy and director primacy – is maximization of the shareholder wealth,[86] it is important to empower the shareholders to control important decisions to reach this purpose.

The takeover decisions are extraordinary and, consequently, outside of the regular activities of any corporation.[87]

In this connection, even though the directors can solely handle the regular corporate matters, the shareholders should have a right of approval/veto of takeover decisions and other extraordinary matters.

Otherwise, a management's purpose that is totally different from that of shareholders may easily come first due to a temptation to self-dealing.

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86 *Id.* at 551, 563.

87 Stephen M. Bainbridge, *The Business Judgment Rule as Abstention Doctrine*, 57 Vand. L. Rev. 83, 129 (2004).

The choice of corporate governance doctrine is the basis of any academic analysis of the corporate law issues.

For instance, two groups of prominent corporate law specialists Lucian Arye Bebchuk, John C. Coates IV, and Guhan Subramanian, on the one part, and Stephen Bainbridge, Mark Gordon, Patrick McGurn, Leo Strine, and Lynn Stout, on the other part – each group having its own academic and professional supporters – have opposite views not only in corporate governance doctrines,[88] but also in hostile takeover defenses.[89]

They both are consistent in their principal views on these two different yet related areas of corporate law. Mr. Bebchuk with his group argues in favor of shareholders,

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88 *Compare* Lucian Arye Bebchuk, *The Case for Increasing Shareholder Power*, 118 Harv. L. Rev. 833 (2005), *with* Bainbridge, *supra* note 84.

89 *Compare* Lucian Arye Bebchuk, John C. Coates IV & Guhan Subramanian, *The Powerful Antitakeover Force of Staggered Boards: Further Findings and a Reply to Symposium Participants*, 55 Stan. L. Rev. 885, 887 (2002), *with* Stephen M. Bainbridge, *Director Primacy in Corporate Takeovers: Preliminary Reflections*, 55 Stan. L. Rev. 791 (2002).

while Mr. Bainbridge with his group advocates in favor of directors.[90]

This paper is more supportive of the former's view.

D. Non-Application of Business Judgment Rule

The business judgment rule should not apply to management decisions regarding hostile takeovers.

This is because there is a high temptation of the directors, particularly insiders, to act in their own (rather than shareholders') interests in the case of a takeover.[91]

A tender offer, for instance, may highly likely terminate the directors' employment with the target company.

This naturally causes directors primarily to protect themselves against such a tender offer even if it favors the

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[90] Bebchuk, Coates IV & Subramanian, *supra* note 89, at 886-88, 917.

[91] *Unocal*, 493 A.2d at 954.

interests of shareholders.[92]

When a tender offer is made, a conflict may very likely arise between the interests of directors, on the one part, and those of the corporation and shareholders, on the other part.[93]

If there were no prospect of such a conflict, the proposed merger/acquisition would likely be friendly, instead of being hostile, because the acquirer would negotiate with the directors sharing the same interests with the shareholders.

1. Application of Entire Fairness Standard

Notwithstanding the current judicial approach to the contrary,[94] decision-making in hostile takeovers presents a

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[92] *Id.* at 1377.

[93] Robert Bruce Ajemian, *Outside Directors and the Modified Business Judgment Rule in Hostile Takeovers: a New Test for Director Liability*, 62 S. Cal. L. Rev. 645, 665 (1989); Block, Hoff & Cochran, *supra* note 49, at 95.

[94] *See Unitrin*, 651 A.2d at 1372.

similar conflict of interest as in regular board matters.[95]

In fact, the takeovers present an even larger conflict of interests because the whole board and not just certain director(s) – has an interest in maintaining its position and power.

Antitakeover defenses are, therefore, a special type of corporate decisions requiring special treatment.[96] "The directors are of necessity confronted with a conflict of interest, and an objective decision is difficult."[97]

Since a regular conflict of interests eliminates the

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95 *Cheff*, 41 Del. Ch. at 504, 199 A.2d at 554 (Del. 1964) (stating that, in the case of a hostile takeover, the "directors are of necessity confronted with a conflict of interest, and an objective decision is difficult"); Stephen M. Bainbridge, *Unocal at 20: Director Primacy in Corporate Takeovers*, 31 Del. J. Corp. L. 769, 862 (2006); Ajemian, *supra* note 93, at 647-48, 662; Klein, Ramseyer & Bainbridge, *supra* note 31, at 767.

96 *See* Douglas M. Branson, *The Rule that Isn't a Rule – The Business Judgment Rule*, 36 Val. U. L. Rev. 631, 650-53 (2002); Bainbridge, *supra* note 87, at 129.

97 *Unocal*, 493 A.2d at 955 (citing *Bennett*, 187 A.2d at 409).

shield of the business judgment rule,[98] a similar result should be in the case of any hostile takeover.

Like with any conflict of interests, the directors should be subject to the entire fairness standard.

The directors would, thus, have a burden to prove that their antitakeover decision is fair to, and in the best interests of, the corporation and its shareholders.[99]

Some courts long ago proposed application of the entire fairness standard in the case of "struggle for control."[100]

This proposal, however, lacks attention in the modern literature on the application – or instead non-application – of business judgment rule in hostile takeovers.

Most importantly, the courts fail to address and implement this proposal in their decisions.

This paper, therefore, advocates application of the

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[98] *Bennett*, 187 A.2d at 409; Ajemian, *supra* note 93, at 662.

[99] *Bayer v. Beran*, 49 N.Y.S.2d 2, 7 (N.Y. Sup. 1944).

[100] Ajemian, *supra* note 93, at 662.

entire fairness standard instead of the enhanced scrutiny standard.

The entire fairness standard would replace the enhanced scrutiny with a strict scrutiny.

2. Alternatives to Entire Fairness Standard

The strict scrutiny standard is the most appropriate for any antitakeover activity.

It may, nonetheless, be difficult to persuade the courts outright to apply this standard instead of the enhanced scrutiny standard.

So, if the entire fairness approach currently appears to be unrealistic, there are a couple of alternatives.

One of them is that the directors must at least prove that they had no conflict of interests with the target and its shareholders. Only after such proof followed by traditional enhanced scrutiny can the business judgment rule apply to the board's reaction to a hostile takeover.

Another alternative to the above entire fairness approach is to apply the "compelling justification" test from

Blasius Industries, Inc. v. Atlas Corp.[101]

While this standard applies where the board disenfranchises shareholders of their rights to vote or sell stocks, it can also be applicable to determine if certain defense is draconian.[102]

3. Justifications for Non-Application of Business Judgment Rule

This strict approach to application – or rather non-application – of the business judgment rule develops the *Unocal* standard.

In that case, the Court applied an "enhanced scrutiny" standard instead of the traditional business judgment rule.

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[101] *See, e.g.*, Gregory W. Werkheiser, *Defending the Corporate Bastion: Proportionality and the Treatment of Draconian Defenses from Unocal to Unitrin*, 21 Del. J. Corp. L. 103, 123 (1996) (citing *Blasius Industries, Inc. v. Atlas Corp.*, 564 A.2d 651, 661 (Del. Ch. 1988)).

[102] *Id.* at 123-24.

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This standard is also called "intermediate" as being in between the business judgment rule and the entire fairness approach.[104]

The enhanced scrutiny standard puts the burden of proof on the directors to show that there were both (i) a threat to the target's policy/effectiveness and (ii) a reasonable response to that threat.[105]

It is only after such a proof that the business judgment rule would apply.

The non-application of the business judgment rule that this paper advocates goes even further. It requires a higher

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[103] James Cole, Jr., Richard J. Grossman & Keith A. Pagnani, *It's a Hostile World: Creating and Implementing Takeover Defenses*, 1469 PLI/Corp 275, 313 (2005).

[104] Elizabeth M. McGeever, *Scrutinizing Hostile Takeover Defenses*, SB93 ALI-ABA 503, 505 (1997); *see also* Elizabeth M. McGeever & Eric M. Anderson, *Responding to Hostile Takeovers*, SL085 ALI-ABA 267, 269 (2006).

[105] Cole, Jr., Grossman & Pagnani, *supra* note 103, at 314.

degree of scrutiny.

Under *Unocal*, in order for the enhanced scrutiny standard to apply, the board's actions must be "defensive."[106]

This approach, however, is incomplete. A higher scrutiny standard should also apply where the board's actions are friendly to the acquirer.

This is because the directors are still highly likely to be self-motivated. They are still considering retaining their positions, salaries, bonuses etc.[107] This self-interest may easily lead to a decision favoring the acquirer, while disfavoring the target and its shareholders.

Under *Unocal*, the chances that the directors will meet the "enhanced scrutiny" standard are proportional to the amount of independent directors on the board.[108]

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[106] *Id.* at 318.

[107] *See, e.g.*, Ajemian, *supra* note 93, at 664; John Armour & David A. Skeel, Jr., *Who Writes the Rules for Hostile Takeovers, and Why? The Peculiar Divergence of US and UK Takeover Regulation*, ECGI Law Working Paper No. 73/2006 at 7, Geo. L.J. (2007).

[108] Cole, Jr., Grossman & Pagnani, *supra* note 103, at 318.

The more there are independent directors on the board, the higher chances of the directors to meet this strict scrutiny standard.

It appears that the *Unitrin* case requires that, in order to be effective, a defense must be both non-draconian and within a range of reasonableness.[109]

The Delaware Supreme Court, however, actually requires that a defense be only non-draconian if a court cannot "clearly conclude that [such defense] was within a range of reasonableness."[110]

A defense, therefore, does not necessarily have to be within a range of reasonableness.[111] This makes defense easier and again emphasizes the need for a more strict approach to review of directors' antitakeover activity.

Some scholars, thus, note that, notwithstanding the enhanced scrutiny standard of *Unocal*, directors still have

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109 *Unitrin*, 651 A.2d at 1389; McGeever, *supra* note 104, at 507.

110 *Unitrin*, 651 A.2d at 1390-91; McGeever, *supra* note 104, at 511.

111 McGeever, *supra* note 104, at 516; Werkheiser, *supra* note 101, at 131.

almost unlimited power in defensive actions.[112]

Since 1995 and at least until 1997, all defenses in Delaware have successfully passed the *Unitrin* "draconian" test.[113]

This situation gives further support to the strict scrutiny or entire fairness standard that this paper proposes.

Such a development of the antitakeover law would disfavor directors' entrenchment, support shareholders' franchise, and emphasize the "established principles of

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[112] McGeever, *supra* note 104, at 507, 516; Dennis J. Block & Matthew I. Kliegman, *Defensive Measures in Anticipation of and in Response to Unsolicited Takeover Proposals*, 1158 PLI/Corp 255, 264 (2000); Block, Hoff, Cochran, *supra* note 49, at 99-100, 103; Cherno & Raymond, *supra* note 40, at 43, 78 (stating: "All that can be said with confidence is that defensive techniques, no matter how extreme, are far more likely to be upheld if they are done in reaction to an acquisition bid by someone perceived to be a corporate raider, who is not offering to acquire all of the target company's stock.").

[113] McGeever, *supra* note 104, at 516.

corporate democracy."[114]

Under such a landmark takeover case as *Unitrin*, it furthermore appears that the target may successfully employ any number of strong defenses to thwart a hostile acquirer.

It can, in particular, combine such powerful defenses as poison pill, advance notice provisions regarding shareholder proposals, and, on top of that, stock repurchase.

While the Court notes that such defenses must be "within a range of reasonableness,"[115] this range is quite vague.[116] It is hard, if ever possible, to determine it.

Unitrin, hence, instructs that "a court applying enhanced judicial scrutiny should be deciding whether the directors made a reasonable decision, not a perfect

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[114] *See Unitrin*, 651 A.2d at 1378.

[115] *Id.* at 1386 (citing *Unocal* and *QVC*).

[116] Werkheiser, *supra* note 101, at 131.

decision."[117]

This again supports the above generalization that defending is rather easy to abuse and should, thus, be subject to a stricter standard of scrutiny.

When a target has more than one antitakeover defense, they must be subject to review not only separately, but also altogether.[118]

Court "should evaluate the board's overall response, including the justification for each contested defensive measure, and the results achieved thereby. Where all of the target board's defensive actions are inextricably related, the principles of *Unocal* require that such actions be scrutinized collectively as a unitary response to the perceived threat."[119]

The strict standard that this paper suggests would make the board more responsible and accountable. It would make the target more open to acquisition if the board fails

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[117] *Unitrin*, 651 A.2d at 1385.

[118] *Id.*

[119] *Id.*

to perform properly.[120]

This situation would anyway result in a maximization of the shareholders value, by either the current management or an acquirer.

Moreover, given the huge compensation packages that the directors enjoy nowadays, this strict approach would be absolutely fair to them. The more the directors earn, the more responsible and accountable they must be towards shareholders.

An increase of the directors' antitakeover responsibility is also justified by transnational business policy. The United States is one of the world's major capital markets actively attracting foreign businesses.[121] Upon entering this market, the businesses become subject to the U.S. corporate law.

In view of this transnational development, it would be

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[120] White, *supra* note 1, at 188.

[121] Perry E. Wallace, *The Globalization of Corporate Governance: Shareholder Protection, Hostile Takeovers and the Evolving Corporate Environment in France*, 18 Conn. J. Int'l L. 1, 37 (2002).

highly advantageous for the U.S. to proclaim more protections for shareholders.

This is because many foreign companies, particularly European ones, entering the U.S. market operate under shareholder, rather than director, primacy.[122]

When deciding to enter the U.S. market, the foreign company shareholders would feel much more confident because of having substantial corporate rights.

4. Draconian Defenses as Justification of Strict Scrutiny Standard

A defense is "draconian" if it is coercive or preclusive.[123]

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[122] *See, e.g.*, Armour & Skeel, Jr., *supra* note 107, at 1-3, 8 (stating that the UK takeover law favors shareholders much more than its US counterpart); Lucian A. Bebchuk, *Letting Shareholders Set the Rules*, 119 Harv. L. Rev. 1784, 1795 (2006); John Armour, Simon Deakin & Suzanne J. Konzelmann, *Shareholder Primacy and the Trajectory of UK Corporate Governance*, ESRC Centre for Business Research, University of Cambridge, Working Paper No. 266 at 22 (2003).

[123] Klein, Ramseyer & Bainbridge, *supra* note 31, at 816.

The courts assess whether any defense is draconian with regard to the target and its shareholders, but not the acquirer.[124]

Which defenses may fall within the meaning of "draconian" is not so clear.[125] It should probably be a question of fact.[126]

It is so far only clear that this uncertainty allows the board a broad power in any antitakeover decision-making.[127]

This unlimited power, in turn, fuels this paper's argument in favor of a strict scrutiny of the board's antitakeover actions.

There is also a sound argument that some

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[124] Werkheiser, *supra* note 101, at 119.

[125] Andrew E. Bogen, *Corporate Governance in Takeover and Buyout Transactions*, 700 PLI/Corp 353, 362 (1990).

[126] *See* McGeever, *supra* note 104, at 506.

[127] Block & Kliegman, *supra* note 112, at 264.

non-draconian defenses may still be unreasonable.[128]

Conversely, certain draconian defenses may be reasonable and, thus, should be enforceable.[129] An example can be the discriminatory self-tender offer by Mesa in *Unocal*.[130]

Since *Unocal* preceded *Unitrin*, the latter's proportionality standard might have barred the defenses permitted by *Unocal*.[131]

Under *Unitrin*, it appears that the non-draconian defenses are reasonable.[132]

The Court, thus, "reduced the [*Unocal*] proportionality test to the limited role of screening out only the most

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[128] Julian Velasco, *Structural Bias and the Need for Substantive Review*, 82 Wash. U. L.Q. 821, 889 (2004).

[129] *Id.*

[130] *Id.*

[131] *Id.*

[132] *Id.* at 879.

extreme behavior."[133]

This reiterates that the requirement that a defense be "within a range of reasonableness" is simply a fiction.

This further supports an idea to raise the level of scrutiny of directors' defensive conduct.

Whether certain defense can be draconian depends on the individual characteristics of such defense and relevant circumstances.

Some of the most widely used defenses usually avoid being draconian. For example, a poison pill is a "legitimate and effective anti-takeover device."[134]

A poison pill is usually not preclusive as it retains the proportions of ownership between the shareholders. It also gives shareholders equal opportunities in exercising their rights to purchase more shares pro rata to their current holdings.

A poison pill is unlikely to be preclusive if there is at

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133 *Id.*

134 Aquila, *supra* note 4.

least a theoretical possibility for the acquirer to obtain control of the target's board and then redeem the pill.[135]

While it may be appropriate to incorporate a poison pill in advance of any takeover threat,[136] a decision on whether to redeem this pill upon any future takeover threat will be subject to a separate analysis under *Unocal*.[137]

This approach supports the idea that a separate and, accordingly, higher scrutiny is necessary with regard to defensive behavior of directors.

While arguing in favor of raising directors' responsibility in the antitakeover field, this paper does not suggest that any of the available defenses should be eliminated.

The paper instead insists that the directors must apply these defenses correctly and in the best interests of shareholders.

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[135] McGeever, *supra* note 104, at 515.

[136] Bogen, *supra* note 125, at 362.

[137] *Id.* at 362-63.

In the next section, this paper, in fact, suggests some alternative defenses that would better protect the interests of shareholders.

Implementation of such defenses would allow directors to meet or even avoid, as the case may be, the strict scrutiny standard.

E. Alternative Defenses

Notwithstanding the wide variety of defenses currently available and developing[138], it is still important to suggest alternative ones.

Such defenses should serve the interests of shareholders and be subject to their approval.

One of such defenses should aim at shielding the corporate shareholding.

The target may specifically provide in a certificate of incorporation or in a separate agreement between shareholders and directors that certain companies –

[138] Block, Remz & Toes, *supra* note 8, at 221.

probably target's competitors – may not own shares of the given target.

Or, at least, that they may not own more than a certain percentage of the target's shares, for instance five percent.

The takeovers logically involve companies that are in the same or similar business, namely competitors. It may, thus, be quite possible to determine which companies would be subject to the above shareholding restriction.

This defense may be another shark repellant against hostile takeovers. It would protect the shareholders' proportionate ownership in the corporation.

It is important to caution that this defense may encounter a few problems.

First, it would restrict the shareholders' rights to sell their shares to competitors.

Second, this defense would limit the target's ability for friendly corporate consolidations with its competitors.

On the other hand, this defense precludes monopolization of businesses and, thus, promotes

competition. This strongly emphasizes the public policy of economic competition.

Moreover, the shareholders and directors can always change or eliminate this defense by way of amendment to the certificate or agreement.

These advantages may well outweigh the above problems.

Another innovative shark repellant should aim at shielding the management of the target.

A similar provision in the certificate of incorporation or agreement between the shareholders and directors may provide that certain individuals related with the target's competitors may not become directors or officers of the target.

While this defense may encounter similar problems as the one regarding shielding the corporate shareholding described above, it still may prevail on its similar advantages.

Finally, there is also a sound argument to replace the

takeover defenses by voluntary dissolution.[139]

This approach requires amendment of the law whereby a majority of shareholders would be able to vote for dissolution of the company at any time.[140] Such a vote would result in management's duty to auction the company for the highest price.[141]

These alternative defenses would fall within the power of shareholders and should, thus, favor them. When approved by the shareholders, these defenses would also allow the board to satisfy the strict security standard.

To meet this standard even better, the paper next recommends practical ways of antitakeover protection.

F. Practical Recommendations for Hostile Takeover Defending

In order to defend itself effectively, each corporation

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139 Park McGinty, *Replacing Hostile Takeovers*, 144 U. Pa. L. Rev. 983, 987 (1996).

140 *Id.* at 988.

141 *Id.* at 987.

should first familiarize itself with the takeover law.

In the United States, corporate takeovers and defenses are primarily subject to case law. They are also subject to statutory corporate and antitakeover law.

On a federal level, the Williams Act, in particular, covers tender offers. On a state level, antitakeover statutes regulate certain defenses.

To be effective, any defense has to comply with at least two requirements.[142] First, it must correspond to the applicable law.[143] Second, it should have a valid business objective other than antitakeover.[144]

When creating an arsenal of defenses for prospective threats, a target should be careful so as not to overdo.

A target that is too defensive may become unattractive for prospective acquirers, even friendly ones. This,

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[142] Melissa M. Kurp, *Corporate Takeover Defenses After QVC: Can Target Boards Prevent Hostile Tender Offers without Breaching Their Fiduciary Duties?*, 26 Loy. U. Chi. L.J. 29, 49-50 (1994).

[143] *Id.*

[144] *Id.*

furthermore, benefits the target's competitors who are less defensive and, thus, easier to acquire.[145]

It is also important to consider the time for adoption and implementation of any defense.

It is vital for the target to protect itself in advance, rather than after a takeover threat shows up.[146]

Defenses in advance enjoy less scrutiny than those after a takeover threat.[147] Such defenses usually enjoy the traditional business judgment rule rather than the *Unocal* enhanced scrutiny standard.[148]

Furthermore, it is important to consider the differences between the adoption of antitakeover defenses at the initial public offering stage and their maintenance

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145 Hannes, *supra* note 52, at 477-78, 489.

146 David A. Katz, *Preparation to Deal with a Hostile Takeover in Europe: Takeover Response Checklist*, 1347 PLI/Corp 1149, 1151 (2002).

147 Kurp, *supra* note 142, at 32.

148 *Id.* at 48-49.

afterwards.[149]

Some defenses, for instance a stock repurchase program and an employee stock option plan, should always be implemented in advance of any takeover threat.[150]

Such defenses should also be not for defensive but rather for any other business purposes.

A defense independent of any takeover would likely secure a shield of the business judgment rule.[151]

This defense is, thus, more likely to avoid the *Unocal's* enhanced judicial scrutiny.[152]

There is always a risk that a certain arsenal of antitakeover defenses may be considered draconian and, hence, unenforceable.

This risk can vary in degree depending on each specific

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149 *See generally* Lucian Arye Bebchuk, *Why Firms Adopt Antitakeover Arrangements*, 152 U. Pa. L. Rev. 713 (2003).

150 Block, Hoff & Cochran, *supra* note 49, at 129-33.

151 *See Unitrin*, 651 A.2d at 1372.

152 *Id.*

corporation and situation. It is, thus, important to seek a legal assessment of this risk.

The board must always care about maximizing the value for the target's shareholders. An efficient way to do this in any antitakeover situation is to conduct an auction. [153]

This statement particularly rests on the case of re-privatization of the largest Ukrainian steel works discussed in the following section of this paper.

It is important to note, however, that "the highest bid does not necessarily translate into the best value for the shareholders,"[154] particularly when the exchange involves complex economic parameters.

In the case of *In re RJR Nabisco, Inc. Shareholders Litigation*, for example, the result of bidding for RJR was

[153] *See, e.g.*, Brown, Bird & Regner, *supra* note 2, at 337; Cole, Jr., Grossman & Pagnani, *supra* note 103, at 322.

[154] Block, Hoff & Cochran, *supra* note 49, at 107.

that two of "the bids were substantially equivalent."[155] They both offered a combination of cash and securities.

The RJR's board favored a proposal with a lower per share price, but with a higher equity interest and more valuable convertible debentures and other financial aspects of exchange.[156]

To avoid any confusion in such a situation, the approval of acceptance of a proposal should lie with the shareholders.

This approval would help directors to discharge their fiduciary duties properly. It would furthermore allow shareholders to express their interests in such crucial corporate events as takeovers.

As a separate matter, it is important for the board to consider the disadvantages of a leveraged recapitalization for the shareholders.

Such recapitalization "substitutes corporate equity

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155 *In re RJR Nabisco, Inc. Shareholders Litigation*, 1989 WL 7036, 11 (Del. Ch.), 14 Del. J. Corp. L. 1132, 1152 (Del. Ch. 1989).

156 *Id.*, WL 7036 at 12, 14 Del. J. Corp. L. at 1153.

with corporate debt."[157]

Since this substitution negatively affects the corporation, it is a quite risky and dangerous defense.[158]

As long as recapitalization essentially resembles a sale of the corporation,[159] it must be subject to *Revlon* duty to get the highest price.[160]

It is furthermore important to consider antitrust issues. Some large takeover deals fail due to anti-monopoly restrictions.[161]

The target should, hence, assess the possibility of the acquirer's failure to obtain a merger approval, before undertaking any defense.

Antitrust can be an effective defense by the target pointing out relevant antitrust problems of a possible

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157 Wooten, *supra* note 35, at 520.

158 *Id.* at 523-25.

159 *Id.* at 533.

160 *Id.* at 539.

161 *See* Brown, Bird & Regner, *supra* note 2, at 320.

takeover to the state or federal authorities.[162]

However, the board must be careful so as not to overuse this defense in case the acquirer later makes a satisfactory offer.

This is because the "antitrust litigation is a genie that is not always easy to put back in the bottle."[163]

So, to use this defense effectively, the board should seek its approval from the shareholders.

There is an argument that the ability of the target to apply the antitrust defense depends on whether the takeover is complete or partial.[164]

If the takeover is complete, then the target may not seek antitrust defense because it does not suffer "antitrust

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[162] *See id.* at 329-330.

[163] *Id.* at 330.

[164] Andrew Zuckerman, *Standing of Targets of Hostile Takeovers to Enjoin Their Acquisition on Antitrust Grounds*, 1992/1993 Ann. Surv. Am. L. 447, 449-50 (1994).

injury" required but rather benefits from the takeover.[165]

The purpose of antitrust law is to protect the competition, rather than a competitor.[166]

To the contrary, if the takeover is partial, the target may apply antitrust defense because it remains an independent competitor.[167]

It is, moreover, important to consider the legal status of the target and the acquirer.[168]

For example, being an insurance or other financial institution company may trigger special regulatory restrictions regarding control.[169]

It is also important to consider the national security

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165 *Id.*

166 *Id.* at 482.

167 *Id.* at 449-50.

168 *See* Brown, Bird & Regner, *supra* note 2, at 330.

169 *Id.*

issues.[170]

Finally, the development and implementation of any antitakeover defense should be individual for each company.[171]

G. Privatization: People's Interests First

As this paper demonstrates, in any takeover activity, it is most important to protect the interests of shareholders first.

As a primary corporate constituency, the shareholders of a public corporation resemble – even though not replace – the people as the ultimate owner of a state-owned corporation.

A situation where neither shareholders' nor directors' interests should come first – an exceptional case – is a privatization of national property.

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[170] *See id.* (providing an example of a failed takeover attempt by China).

[171] Aquila, *supra* note 4.

It requires a primary focus on the interests of the people of the relevant country/state.

This is because the people – acting in person of the state authorities – are the ultimate owners of the property. They must be able to influence privatization by virtue of relevant legal regulation.

Such regulation should provide for a re-privatization if, and only if, grave violations take place in the course of initial privatization.

To effect re-privatization, such violations must considerably affect the value that the people receive for the property.

This was the case in Ukraine where a few people close to the former President privatized the largest steel works Kryvorizhstal for $800 million,[172] less than half the price

[172] *2005: The Year in Review, Sale of Kryvorizhstal Hailed as Huge Success*, The Ukrainian Weekly, No. 3, Vol. LXXIV (January 15, 2006) (citing the Financial Times (London), October 26 Editorial), http://www.ukrweekly.com/Archive/2006/030612.shtml.

another bidder offered.[173]

This grave violation caused invalidation of the privatization and led to re-privatization of the works a year later.

Mittal Steel, the world's largest steelmaker, re-privatized by public auction the works for $4.8 billion.[174]

As a result, the national budget of Ukraine received six times more consideration for the works than it received from the initial privatization.

This tremendous difference in price was not due to any market value change or initial owner improvements. It was merely a fair market value of the works.

The re-privatization, hence, served the interests of the people of Ukraine as it should have.

A re-privatization prospect is a good tool in

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[173] Niall Green, *Behind the Collapse of Ukraine's "Orange Revolution,"* ICFI (April 6, 2006), http://www.wsws.org /articles/2006/apr2006/ukra-a06.shtml.

[174] *2005: The Year in Review, Sale of Kryvorizhstal Hailed as Huge Success, supra* note 172.

controlling the performance by the property owner of the terms and conditions of the privatization contract with the government.

It often provides that in the case of certain grave violations, a court may rescind the contract and restitute the parties.

This makes it possible for the owner's competitors to challenge the owner's rights during a certain period of time necessary to perform certain contract conditions.

Such a time can be as long as tens of years. This, in and of itself, can be an effective tool for a hostile takeover by competitors should the current owner fail to honor his obligations.

This re-privatization was obviously in the best interests not only of the people of Ukraine, but also of the initial shareholder, i.e., the Government of Ukraine.

This case emphasizes the importance of protecting the ultimate business owner, *i.e.*, the people.

This corporate constituency in a government-owned corporation is very similar to shareholders in a

private-owned publicly-traded corporation.

This similarity adds to the argument that it is the interests of these constituencies that should come first and before the interests of the management.

This further emphasizes the need for enhanced scrutiny of the management's actions in case of change of control.

IV. Conclusion

As this paper has demonstrated, there are numerous problems regarding hostile corporate takeovers and defenses against them.

The most fundamental problem is that of unlimited power of directors and their corresponding lack of responsibility and accountability in the antitakeover area.

This problem touches the very essence of corporate governance: Whose interests prevail and how.

The paper focused on the major problems of antitakeover defenses that the target's board implements.

These defenses favored the directors, often, if not always, at the expense of shareholders.

In case of a hostile takeover, the conflict of interests between the directors and the shareholders is imminent.

The paper, hence, suggested a viable solution to the problem: To raise the level of directors' responsibility.

To effectuate this solution, the courts should raise the standard of judicial scrutiny of the directors' antitakeover activity from the enhanced scrutiny to a strict scrutiny.

The level of scrutiny should, in particular, reach that of the entire fairness standard. The directors must, namely, have a burden to prove that their antitakeover defenses were in the best interests of the target and its shareholders.

It is only after such a raise in the directors' responsibility that the defenses will become fair as to the corporation and its shareholders.

This improvement would stimulate the directors to discharge their fiduciary duties properly.

Such a development would, therefore, generally

advance the corporate governance law and practice.

To conclude, this paper provided you with a framework for you to defend your business against hostile corporate takeovers.

Should you need legal aid with your hostile takeover defenses or other corporate law issues, please feel free to contact us.