Golden Parachute Agreements: Cushioning Executive Bailouts in the Wake of a Tender Offer

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In the event of a change in control of the Company, the
Chief Executive Officer is entitled to 'a severance payment from
the Company equal in amount to three times the sum of (i) the
executive's highest annual base salary in effect during the year
preceding severance plus (ii) the executive's highest annual bo-
nus award during the two years preceding severance, . . . and
the right to receive at his or her retirement a sum equal to the
actuarial equivalent of the additional retirement pension to
which the executive would have been entitled . . . had the exec-
utive accumulated three additional years of continued service
. . . . The agreements do not require that [the] executive miti-
gate the amount of payments by seeking other employment
. . . . †

Of the various methods of corporate acquisition¹ only the
tender offer enables shareholders to effectuate a change of control
without management approval.² Indeed, this mode of acquisition

† Brief for Defendant, Exhibit A, Allen v. Gulf Resources & Chem. Corp., No. 82-27756
(D. Ct. Harris County, Tex.) (Proxy Statement of Gulf Resources & Chem. Corp., Mar. 31,
1982, at 9) (formula to be applied in calculating benefits awardable under a golden para-
chute) [hereinafter cited as GRE Proxy Statement]. The GRE Proxy Statement defines a
change of control as the acquisition “of securities of the Company representing 35% or more
of the combined voting power of the Company's then outstanding securities,” or a change in
the majority of the board of directors during any 2-year period unless such change was
effectuated with the approval “of at least two-thirds of the directors then still in office who
were directors at the beginning of the period.” Id.

¹ There are numerous methods of acquisition: purchase of the target’s assets for cash,
notes, or the acquirer’s stock; tender offers; and mergers or consolidations. Z. Cavitch,
BUSINESS ORGANIZATIONS WITH TAX PLANNING § 160.02, at 160-5 (1982). See generally W.
Cary & M. Eisenberg, CASES AND MATERIALS ON CORPORATIONS 842-920 (abr. 5th ed.
1980). A statutory merger involves the combination of two corporations whereby one retains its
existence and subsumes the other. Upon compliance with certain statutory criteria, the sur-
viving corporation becomes the owner of the subsumed corporation's assets and liabilities. 2
B. Fox & E. Fox, CORPORATE ACQUISITIONS AND MERGERS § 23.02(1), at 23-11 (1982). In
contrast, an acquisition of assets involves a transfer of the seller's assets by contract rather
than by operation of law. Id. § 25.01(1), at 25-2. The acquisition need not be accomplished
in accordance with any specific criteria, and only the assets and liabilities specifically in-
cluded in the contract are transferred to the buyer. Id.

² Gilson, A STRUCTURAL APPROACH TO CORPORATIONS: THE CASE AGAINST DEFENSIVE TACTICS
has been regarded as "the principal mechanism by which management can be forcibly unseated," since an offer is made directly to the shareholders to sell their shares at a premium price. Such a takeover attempt is "hostile" when the target corporation's management, anxious to retain control, engages in various defensive tactics designed to make the target less attractive to the offeror, or render the takeover legally impossible. A recent outgrowth of the increase in hostile takeovers is a new form of defensive tactic—the golden parachute.

Golden parachute agreements are designed specifically to avert the consequences of a successful shareholder decision to change control of a corporation by preserving the status or dignity of an executive's position. The contract is triggered by a change in cor-

in Tender Offers, 33 Stan. L. Rev. 819, 819, 845-47 (1981). The board of directors is generally given the exclusive power to determine whether an acquisition is in the shareholders' best interests. See, e.g., Cal. Corp. Code § 1001(6) (West 1977). Hence, the issue usually never reaches the shareholders. Moreover, the amount of time and expertise required properly to evaluate a proposed merger or sale of assets renders this task beyond the scope of the average shareholder's abilities. Gilson, supra, at 846 & n.101. The shareholders, therefore, do not have to consider a proposed acquisition unless the board of directors has approved it by exercise of their "specialized skills." Id. at 846-47. This power of the board of directors is not exercised, however, in the tender offer context. Id. at 847 & n.104.

* Tender offers frequently give shareholders the opportunity to receive a premium of up to 72% above the market value of their stock. Gelfond & Sebastian, Reevaluating the Duties of Target Management in a Hostile Tender Offer, 60 B.U.L. Rev. 403, 419 & n.118 (1986); see also 1 M. Lipton & E. Steinberger, Takeovers and Freezeouts § 1.7.5, at 89 (Supp. 1979). Additionally, the tender offer, unlike the merger or sale of assets, contemplates a personal contract between the target corporation's shareholders and the bidder. Management is not required to investigate the terms or the merits of the offer. See Easterbrook & Fischel, The Proper Role of a Target's Management in Responding to a Tender Offer, 94 Harv. L. Rev. 1161, 1200 (1981).

* The company whose shares are sought in the tender offer is described as the target or subject company. A. Fleischer, Tender Offers: Defenses, Responses, and Planning viii (1981).

* There are two basic categories of defensive tactics: actions taken by a potentially desirable target before an offer is made to the shareholders that are intended to make the company less vulnerable, and actions taken in response to an actual takeover attempt. 1 M. Lipton & E. Steinberger, supra note 4, § 6.1, at 263.

* See Easterbrook & Fischel, supra note 4, at 1161-62; infra notes 28-32 and accompanying text.


* See id. at 1-2; McLaughlin, The Myth of the Golden Parachute: What Every Dealmaker Should Know, 17 Mergers and Acquisitions 47, 47-48 (No. 2 1982); infra notes 37-52 and accompanying text.
porate control, and guarantees an executive payment of large sums of money and other benefits if he is fired or resigns because of an alteration in his responsibilities.

Golden parachute agreements raise significant issues of fiduciary duty and fairness to the corporation, and implicate the theoretical basis of the business judgment rule. Questions as to whether it is proper to compensate a fiduciary for a duty already owed the corporation and whether golden parachutes truly serve a legitimate corporate purpose have yet to be resolved. Accordingly, after examining the tender offer as a mechanism for changing corporate control, this Note will explore the characteristics of a typical golden parachute clause. Thereafter, the various arguments both for and against these provisions will be discussed. The Note will conclude that golden parachute agreements are essentially unfair to the corporation, and unjustifiably insulate management from the market for corporate control to the detriment of the shareholders.

THE TENDER OFFER AND TARGET MANAGEMENT'S LATEST RESPONSE

The Tender Offer

A tender offer is an invitation or solicitation to shareholders of the target company to tender their shares in return for a consider-
ation of cash or securities.\textsuperscript{18} When such an offer is made, target management, pursuant to federal law, is required to publish within 10 business days a statement indicating its position on the proposed offer.\textsuperscript{19} This presents an inherent conflict of interest for target management.\textsuperscript{20} As a fiduciary, management is obligated to act in the shareholders' best interests,\textsuperscript{21} and therefore, after good-faith consideration of the various contingencies, may be compelled to support a proposed takeover.\textsuperscript{22} Concomitantly, management is

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\textsuperscript{18} 2 B. Fox & E. Fox, supra note 1, § 27.01, at 27-4. The consideration proffered in the tender offer generally is cash or stock in the acquiring corporation. \textit{Id.} This consideration is usually greater than the fair market value of the securities sought. W. Cary & M. Eisenberg, supra note 1, at 905. Unless a minimum of shares is tendered, the offeror is not obligated to complete the purchase. \textit{Id.}

The tender offer is a mechanism for obtaining control of a corporation whose management either does not favor an acquisition and thus refuses to assent to the purchase of its shares, or does not oppose but nonetheless is unwilling to support the acquisition. 2 B. Fox & E. Fox, supra note 1, § 27.01, at 27-5; 1 M. Lipton & E. Steinberger, supra note 4, § 1.1.1, at 3; see A. Fleischer, supra note 5, at 99. An acquiring corporation will opt for a tender offer when it does not desire all of the target's assets but merely enough of its stock to exercise control, 2 B. Fox & E. Fox, supra note 1, § 27.01, at 27-5, or when the acquirer is acting as a "White Knight" in aid of a corporation seeking to avoid a hostile tender offer, see 1 M. Lipton & E. Steinberger, supra note 4, § 1.1.1, at 3.

During the past 3 years there has been a dramatic increase in the number of mergers and tender offers, particularly hostile tender offers. \textit{Ward Howell Survey}, supra note 8, at 2. In 1981 alone there were more than 2300 recorded mergers. McLaughlin, supra note 9, at 47. See generally 2 B. Fox & E. Fox, supra note 1, § 27.02, at 27-14 (typical target characterized by undervalued stock); Troubh, \textit{Characteristics of Target Companies}, 32 Bus. Law. 1301, 1301-03 (1977) (characteristics of a target company).

\textsuperscript{19} 17 C.F.R. § 240.14e-2 (1982). Management must issue one of four possible opinions concerning a tender offer: recommending the tender, rejecting the offer, expressing neutrality, or indicating its inability to take a position. \textit{Id.} In addition, management must state its reasons for the position it adopts. \textit{Id.}


\[\text{Management has the responsibility to oppose offers which, in its best judgment, are detrimental to the company or its stockholders. In arriving at such a judgment, management should be scrupulously fair in considering the merits of any proposal submitted to its stockholders. The officers' and directors' informed opinion should result from that strict impartiality which is required by their fiduciary duties. After taking these steps, the company may then take any step not forbidden by law to counter the attempted capture.}\]


\textsuperscript{22} Relevant considerations concerning the merits of a tender offer include, \textit{inter alia}, whether the shareholders will receive a fair price for the tender of their shares, whether proficient management will be obtained or retained, whether a synergistic relationship will result from the takeover, public policy, and personal employment. Lipton, \textit{Takeover Bids in}
faced with a potential loss of control. This conflict is even more pronounced in poorly managed companies, which make attractive targets for potential acquirers. Because these companies often possess conspicuously undervalued stock, potential acquirers recognize that, by purchasing a majority of the undervalued shares and installing efficient managers, the corporation's value will rise sufficiently to offset the expense of the acquisition.

In practice, management often reacts negatively to tender offers, either opposing the transaction for personal reasons or concluding that a takeover is not in the shareholders' best interests. In either event, management almost invariably engages in defensive tactics intended to render the transaction illegal or undesirable. These tactics include initiating lawsuits against the offeror, issuing new shares to reduce the offeror's percentage of...
stock in the target,30 and purchasing a competitor of the offeror to create antitrust complications.31 As can be seen, the objective of these tactics is not to convince shareholders to retain their stock interest, but rather, to “prevent the offer from being made, or if made, consummated, . . . thereby ensur[ing] that shareholders cannot make, from management’s perspective, the ‘wrong’ decision.”32 Although state fiduciary standards33 and the anti-fraud

6.5.2.1 to 6.5.2.6, at 310-20 (possible causes of action at the disposal of a target company); A. FLEISCHER, supra note 5, at 119-38 (various litigation tactics). A target company has standing to assert that an intended acquisition potentially implicates the antitrust laws, particularly with respect to lessening actual competition. 1 M. LIPTON & E. STEINBERGER, supra note 4, § 6.5.2.2, at 310-12; see, e.g., Bayertown Burial Casket Co. v. Amedco, Inc., 407 F. Supp. 811, 814-17 (E.D. Pa. 1976). Similarly, management has standing to assert that the offer ultimately may harm the target. 1 M. LIPTON & E. STEINBERGER, supra note 4, § 6.5.2.5, at 313-18.

The objective of the litigation commenced by the target company may be:
(a) to choose the most favorable forum, (b) to preclude the raider from suing to seize the initiative, (c) to “chill” the arbitrage, (d) to delay or restrain the raider while a White Knight is sought, (or) (e) to provide a psychological lift for target’s management. Id. § 6.5, at 304 (citation omitted).

30 Easterbrook & Fischel, supra note 4, at 1161; see A. FLEISCHER, supra note 5, at 148-49. By issuing new shares, target management makes it more difficult for the acquirer to obtain a sufficient amount of stock to gain control. Newly issued stock may be sold to entities friendly to the target to further diversify ownership of the corporation. Comment, Corporate Defenses to Takeover Bids, 44 Tul. L. Rev. 517, 525-26 (1970). Similarly, target management may purchase the new shares itself, or repurchase outstanding shares at a higher price than that offered by the bidder. This reduces the number of shares available to potential acquirers, increases the price of the stock, and thereby makes the target less attractive. Id. at 526.

31 8 Z. CAVITCH, supra note 1, § 166A.04[3], at 166A-99 to 166A-100; A. FLEISCHER, supra note 5, at 147; Easterbrook & Fischel, supra note 4, at 1161-62. A target company might purchase another company to expand its operations into similar geographic or product markets as that of the bidder. A purchase by a target is not valid, however, if the sole purpose of the transaction is to prevent the tender offer and the target does not have a sufficient corporate purpose for such prevention. 1 M. LIPTON & E. STEINBERGER, supra note 4, § 6.2.5, at 271-72; see Anaconda Co. v. Crane Co., 411 F. Supp. 1210, 1219-20 (S.D.N.Y. 1975); Lynch & Steinberg, The Legitimacy of Defensive Tactics in Tender Offers, 64 Cornell L. Rev. 901, 936-39 (1979).

Additional tactics include electing the board of directors to a staggered term, which extends the time needed to attain control of the board, installing charter provisions requiring supermajority vote, 1 M. LIPTON & E. STEINBERGER, supra note 4, § 6.2.2., at 265, and selling a certain percentage of stock to a White Knight, id. § 6.2.7, at 273-74.

32 Gilson, supra note 2, at 819 (footnote omitted).

33 The specific standard with which a director must comply as a fiduciary is governed by the applicable law in the state of incorporation. See Wilshire Oil Co. v. Riffe, 409 F.2d 1277, 1283 (10th Cir. 1969); Hausman v. Buckley, 299 F.2d 696, 702 (2d Cir.), cert. denied, 369 U.S. 885 (1962). Each director is bound to exercise an individual loyalty to the corporation, and to avoid situations in which his personal interests might conflict with those of the corporation. W. KNEPPER, LIABILITY OF CORPORATE OFFICERS AND DIRECTORS § 1.04, at 8 (3d
provisions of the Securities Exchange Act of 1934 serve to limit target management's defensive weaponry, the proliferation and aggressiveness of defensive tactics persist. The latest entry into the fray of hostile corporate takeovers is the golden parachute.

The Golden Parachute

Golden parachutes are designed to minimize the ramifications of a hostile tender offer by protecting the positions and responsibilities of key executives. The rights enumerated in these con-

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See generally Fuller, Restrictions Imposed by the Directorship Status on the Personal Business Activities of Directors, 26 Wash. U.L.Q. 189, 190-211 (1941); Ramsey, Director's Power to Compete with His Corporation, 18 Ind. L.J. 293, 295-309 (1943). In New York, for example, a director must act "in good faith and with that degree of care which an ordinarily prudent person in a like position would use under similar circumstances." N.Y. Bus. Corp. Law § 717 (McKinney Supp. 1981-1982); accord Cal. Corp. Code § 309(a) (West 1977). The prudent person standard of care is applied in most jurisdictions. See 3A W. Fletcher, Cyclopaedia of the Law of Private Corporations § 1035, at 28 (perm. ed. 1975).

**4** See 15 U.S.C. § 78n(e) (1979). Section 14(e) of the Securities Exchange Act of 1934 provides in part: "It shall be unlawful for any person to make any untrue statement of a material fact or omit to state any material fact . . . or to engage in any fraudulent, deceptive, or manipulative acts or practices, in connection with any tender offer or request or invitation for tenders . . . ." Id.; cf. id. § 78j(b) (manipulative and deceptive devices in security sale or purchase unlawful); 17 C.F.R. § 240.10b-5 (1982) (omission, scheme or deceptive device to defraud in sale or purchase of security).

**5** See, e.g., Barmash, Marietta's Autonomy Is Costly, N.Y. Times, Sept. 27, 1983, at D1, cols. 3-5, D4, cols. 5-6 (takeover battle between Bendix Corporation and Martin Marietta Corporation).

**6** See WARD HOWELL SURVEY, supra note 8, at 1. For a discussion of golden parachutes as defensive tactics, see infra notes 68-72 and accompanying text.

**7** Cooper, supra note 12, at 65; Morrison, Those Executive Bailout Deals, Fortune, Dec. 13, 1982, at 82; Ward Howell Survey, supra note 8, at 1, 6, 9. A survey released on September 27, 1982 by Ward Howell International, Inc., an executive search firm, indicates that 40% of the United States corporations on the Fortune 1,000 list provide employment contracts for their top officers. Ward Howell Survey, supra note 8, at 1. The survey indicates a definite trend toward providing this protection from the consequences of tender offers. Id. at 9. Generally, the larger the company or the more closely held its stock, the less likely it is that employment contracts will be present. Id. at 3; see Table 1.

**TABLE 1: PERCENTAGE OF CONTRACTS BY FORTUNE 1,000 RANK**

<table>
<thead>
<tr>
<th>Fortune rank</th>
<th>Percentage of companies with contracts</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 - 250</td>
<td>36.8%</td>
</tr>
<tr>
<td>251 - 500</td>
<td>39.4%</td>
</tr>
<tr>
<td>501 - 1,000</td>
<td>40.8%</td>
</tr>
</tbody>
</table>

Id. at 4 (Table 1). Of these contracts, 35.7% include a change of control clause creating a golden parachute. Id. at 1. Golden parachutes are employed more frequently in the apparel, furniture and chemicals fields. Id. at 4.
tracts usually vest when an officer is dismissed following a takeover or change of control, or when he leaves his position for "good reason." Some agreements, however, are triggered merely by the accumulation by one entity of a certain percentage of the corporation's shares or the replacement of a specified number of directors.

Golden parachutes typically are negotiated shortly before or during the intense flurry of activity that often accompanies publication of a tender offer. Recently, however, an increasing number of corporations have given their top executives golden parachutes despite the absence of any sign of an imminent takeover attempt. This precautionary outlook is fostered by the volatile nature of the tender offer market and the resultant realization that few corporations are immune from takeover.

While the types of benefits contained in a particular golden parachute will be tailored to the individual executive involved, some similarities can be observed in the contracts that have been publicized. The most common recipients are the chief executive officer, the chairman of the board, the president and some senior vice presidents. The contracts extend from 1 to 7 years in dur-

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38 Ward Howell Survey, supra note 8, at 3.
39 "Good reason" has been defined as anything from demotion to the inability to perform duties in the way in which the executive was accustomed, including incompatibility between new and incumbent management. Cooper, supra note 12, at 66. Some contracts, however, permit an executive to resign and obtain the benefits of his contract notwithstanding that his duties and responsibilities have not been altered. Masters, Execs' 'Golden Parachutes' Await First Court Challenges, Legal Times of Washington, Nov. 2, 1981, at 10, cols. 2-3.
40 Some golden parachutes define change of control as the acquisition of as little as 15% of the target's outstanding shares. Morrison, supra note 37, at 85. Change of control also may be defined in terms of a "delisting from a major stock exchange, a change in the majority of the board of directors, or the replacement of a top executive." Ward Howell Survey, supra note 8, at 3.
41 See Klein, A Golden Parachute Protects Executives, But Does It Hinder or Foster Takeovers?, Wall St. J., Dec. 8, 1982, at 56, col. 1; Ward Howell Survey, supra note 8, at 1. The argument has been made that "[f]or a key employee to look after himself with regard to uncertainties caused by tender offers should be as unassailable as corporate profits or dividends." Herzl & Colling, Controversial 'Golden Parachutes' Offer Protection, Legal Times of Washington, Aug. 21, 1982, at 10, col. 1.
42 Cooper, supra note 12, at 66; Ward Howell Survey, supra note 8, at 2. But see N.Y. Times, Apr. 26, 1983, at D5, col. 5. In response to public criticism regarding the propriety of golden parachutes, Allied Corporation eliminated all such clauses from its executives' contracts. Id.
43 Cooper, supra note 12, at 65-66; Morrison, supra note 37, at 82; Ward Howell Survey, supra note 8, at 2, 9.
44 Ward Howell Survey, supra note 8, at 3; see Cooper, supra note 12, at 66-67.
tion and typically are given to between two and five executives. The benefits range from salary incentives to health, pension and stock-purchase plans, with over fifty percent of the contracts valued at between one and five million dollars. Some contracts stipulate a lump-sum payment while others call for periodic payments.

The critical characteristic of a golden parachute is the change-of-control provision, which triggers the executive’s entitlement to the benefits provided in the agreement. The significance of the change-of-control clause makes it of paramount importance that the contract articulate the executive’s duties, responsibilities and authority, and expressly provide that he will be entitled to resign and receive the emoluments granted by the agreement when there occurs an alteration in the enumerated duties and responsibilities.

In justification of these provisions, corporate proponents of golden parachutes claim that they are necessary to attract and retain quality executives to work for a company that is a potential takeover target. This often involves luring “high caliber executive

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46 See Cooper, supra note 12, at 66-67. As Table 2 indicates, 53% of the contracts provide for benefits in excess of 5 years, while 34% extend from 1 to 4 years.

47 Id. at 66-67. Golden parachutes generally are structured to insure maintenance of current salary, benefits, position and responsibilities. WARD HOWELL SURVEY, supra note 8, at 3. Specification of “job responsibilities, reporting lines and areas of authority” is frequent, id., particularly in light of the common change-of-control provision permitting resignation upon the alteration of any of the specified items. See id.

48 WARD HOWELL SURVEY, supra note 8, at 7. Fifty-six percent of the publicized contracts entail benefits worth between one and five million dollars, while approximately 27% are worth less than one million dollars. Id. More than 14% of the contracts have potential values greater than five million dollars. Id.

49 Id. at 2.

50 See id. at 1, 3.

51 See id. at 1, 3.

52 See id. at 3.

53 See id. at 1. Corporations generally face great difficulty in obtaining and retaining
talent" from other corporations—a task not easily achieved without providing job security guarantees.64

**THE GOLDEN PARACHUTE CONTROVERSY**

It has been argued that golden parachutes are required to ensure that management is not disrupted by the departure of executives during a takeover battle.65 Such contracts are regarded as providing managerial security, purportedly necessary to conduct firm and objective opposition to a tender offer.66 While management displacement may not follow a negotiated takeover, the usual result of a bitter fight between an acquirer and a target is the firing of many target executives after the acquisition is consummated.67


Without undertaking an in-depth analysis of executive compensation, it is possible to compare a golden parachute clause with the more traditional methods of compensation. Common forms of executive compensation include salary, stock options, bonuses, deferred compensation and special pension provisions. F. Steckmest, *Corporate Performance: The Key to Public Trust* 161-62 (1982). All compensation, however, must be proportionately related to the executive’s ability, effort exerted and success attained, as well as to the profitability of the corporation. Gallin v. National City Bank of New York, 152 Misc. 679, 703, 273 N.Y.S. 87, 114 (Sup. Ct. N.Y. County 1934).

When seeking quality management, particularly chief executives, the board of directors considers compensation to be of secondary importance, since “the difference between merely good and outstanding talent is off-scale in relation to compensation differences.” F. Steckmest, *supra*, at 162. Thus, to obtain and retain qualified executives and to provide motivation within the corporate structure, it has been argued that lucrative compensation plans are in the corporation’s and the shareholders’ best interests. *Id.* at 163; Morrison, *supra* note 37, at 83. Similarly, in the context of the volatile takeover atmosphere, golden parachutes are intended to attract and retain superior executive talent. Ward Howell Survey, *supra* note 8, at 1. There is, however, a unique characteristic that distinguishes golden parachute clauses from all forms of executive compensation: while executive compensation and incentives generally are conditioned upon performance, golden parachute agreements are triggered merely by a change in control. *See id.* at 3.

64 See Cooper, *supra* note 12, at 66; Fleischer & Raymond, *supra* note 17, at 26, col. 3.
66 See Cooper, *supra* note 12, at 68; Klein, *supra* note 41, at 56, col. 1; *infra* notes 58-60 and accompanying text.

67 See Cooper, *supra* note 12, at 65. Following a friendly takeover, the acquiring company often will attempt to retain target management. The bitter disputes involved in a hostile tender offer, however, engender such resentment between new and incumbent management that it is impossible for them effectively to work together. R. Lamalie, *Acquisition Aftermath: What Happens to Executives After a Hostile Takeover* (available from Lamalie Associates, Inc., 101 Park Avenue, New York, New York 10178). Thirty-two percent of the 1300 highest paid executives hired in the 18 months preceding August 31, 1982 were fired as a result of a takeover or merger. *Holding on in a Takeover*, Bus. Week, Sept. 27, 1982, at 118. By the 3rd year subsequent to a takeover, fifty-two percent of the target company executives either have been fired or have resigned. Perham, *Surge in Executive Job Con-
Golden parachutes are intended to provide top executives with assurance that they will not lose their employment, or at least the benefits of that employment, as a result of a takeover.\textsuperscript{58} It is thus argued that with this security executives can "coolly appraise" the various implications of a tender offer without being distracted by considerations of self-interest.\textsuperscript{59} If management determines that the takeover is not in the corporation's best interests, the golden parachute beneficiary will be secure in presenting strong opposition.\textsuperscript{60}

In contrast, some question the propriety of granting executives additional benefits to induce them to act in a manner in which they already are legally bound, as corporate fiduciaries, to act.\textsuperscript{61}


\textsuperscript{58} Kleinfield, 'Golden Parachutes' for Ousted, N.Y. Times, Apr. 6, 1982, at D17, cols. 1-2. One corporate official stated: "[Golden parachute] agreements are designed to encourage the employees to remain in the employ of the Corporation and to reinforce and encourage their continued attention and dedication to their duties without distraction in the face of a change in control." \textit{WARD HOWELL SURVEY, supra} note 8, at 9; see Fleischer & Raymond, \textit{supra} note 17, at 27, col. 2.

\textsuperscript{59} Cooper, \textit{supra} note 12, at 66; Fleischer & Raymond, \textit{supra} note 17, at 26, col. 3; Herzl & Colling, \textit{supra} note 41, at 10, cols. 1-2; Masters, \textit{supra} note 39, at 10, col. 2. The "principal argument" in favor of golden parachutes is that since target executives are, in effect, "financially at the mercy of the would-be acquirer," the golden parachute clause will enable them to evaluate the tender offer "strictly on its merits to the shareholder." Morrison, \textit{supra} note 37, at 82.

\textsuperscript{60} Cooper, \textit{supra} note 12, at 66. The "insulation" provided by golden parachutes ostensibly permits an objective analysis of the advantages and disadvantages of a takeover, \textit{id.; WARD HOWELL SURVEY, supra} note 8, at 1, and fosters dedication to the corporation without the additional pressure caused by a threat to job security, \textit{see} Wall St. J., Apr. 13, 1982, at 21, col. 2. Executives, "[b]y equipping themselves with golden parachutes—generous severance packages whose ripcords can be pulled when and if control of their company actually changes hands—are able to avoid the fight-and-you’ll-be-fired trap." Cooper, \textit{supra} note 12, at 65.

It has been argued, however, that there is no certainty that a golden parachute will foster objectivity, since

\textit{A}n increase in independence could make a target management either more or less intransigent depending on a variety of strategic and psychological factors (including the exact design of the golden parachute agreements) about which it is very difficult to make general predictions. Intransigence is in itself difficult to evaluate; it may lose the deal completely or obtain a better price from the original offeror or from someone else.\textsuperscript{62}

Herzel & Colling, \textit{supra} note 41, at 10, col. 2.

\textsuperscript{61} See Cooper, \textit{supra} note 12, at 68; Morrison, \textit{supra} note 37, at 83. Some statutes empower the board of directors to manage "the business and affairs of the corporation." \textit{See, e.g.}, \textit{CAL. CORP. CODE} § 300(a) (West 1977); \textit{N.Y. BUS. CORP. LAW} § 701 (McKinney 1963); F. KEMPIN & J. WIESEN, \textit{LEGAL ASPECTS OF THE MANAGEMENT PROCESS} 357 (2d ed. 1976); F. STEEKMEST, \textit{supra} note 53, at 185. In their capacity as managers, directors are fiduciaries of the corporation and thus are bound to act solely in the interests of the corpo-
Additionally, at a time when management should be concerned with an impending takeover's impact on the corporation and the shareholders, it appears that by devoting corporate time and resources to ensure their personal security, executives are acting in derogation of their common-law duties.62

A further criticism of the golden parachute is that it amounts to an unnecessary squandering of corporate assets.63 Certain opponents of the golden parachute base this criticism upon the notion that rather than inducing executives to remain with a company during a takeover battle, golden parachutes merely invite executives to resign,64 often without cause,65 and collect the stipulated benefits. Some corporate insiders, however, regard the golden parachute as wasteful, based upon their belief that, with or without a golden parachute, management will battle a hostile takeover. They note that the urge to preserve one's managerial position, with its attendant aura of prestige and control, provides more incentive to weather a takeover crisis than mere pecuniary guarantees.66 One executive has stated that there is no "tendency... to 'give up' during a takeover fight. This would be the least likely time for a team member to leave—it would be so disloyal, he or she would lose face."67

Finally, there is some debate concerning whether the golden parachute is even a viable defensive tactic. While traditional defensive tactics are designed to prevent tender offers from being completed,68 the golden parachute is aimed primarily at ameliorat-

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62 WARD HOWELL SURVEY, supra note 8, at 9; Morrison, supra note 37, at 84-85.
63 See Cooper, supra note 12, at 66-67; Klein, supra note 41, at 56, col. 1.
64 Masters, supra note 39, at 10, col. 3. Some believe that "[golden parachutes] could discourage an acquiring company, not because of the payments it would be required to make, but because top executives would have a strong incentive to leave the company." Id.
65 See id. at 10, cols. 2-3; Morrison, supra note 37, at 85.
66 Morrison, supra note 37, at 86; see Cooper, supra note 12, at 66. Loss of power and prestige may be more devastating to an executive than forfeiture of salary. Morrison, supra note 37, at 86.
67 McLaughlin, supra note 9, at 48.
68 See Easterbrook & Fischel, supra note 4, at 1161-62; supra notes 27-32 and accompa-
ing the effects of a successful takeover on target management. It is argued, moreover, that in a billion-dollar corporate takeover, the amount involved in a golden parachute may constitute less than one percent of the cost of the acquisition and therefore golden parachutes will have little deterrent impact. Some commentators, however, assert that such clauses are effective defensive tactics not only because a potential acquirer must consider the amount of money involved in the parachute, but also because capable target management might leave in reliance on their rights under the contract. Particularly when golden parachutes are employed with other tactics, they may "reinforce a negative attitude and slow down a necessary acquisition."  

ANALYZING THE GOLDEN PARACHUTE: THE BUSINESS JUDGMENT RULE AND FAIRNESS

The business judgment rule dictates that directors and officers will not be held liable for a mistake of law or fact that causes the corporation harm if they acted in good-faith exercise of their business judgment. The rule permits a presumption that directors...
have acted in good faith if the action arguably was in the corporation's best interests. Courts will scrutinize a corporate transaction, however, if it appears that a director was interested in the outcome. If a conflict of interest is shown, the transaction will be upheld if the director proves that he disclosed the material facts of his interest to the board and that the contract was approved, in good faith, by a majority of disinterested directors. Upon failing to make this showing, the director must establish the fairness of the transaction to the corporation.

The Business Judgment Rule

State statutes generally empower the board of directors to manage the business and affairs of the corporation. The board is responsible for representing and furthering shareholder interests, and for approving all major strategic business decisions.

...
While corporation statutes authorize the board to evaluate the implications of mergers and sales of assets, thereby permitting directors to control such management displacement mechanisms, these statutes are silent with respect to management participation in tender offers. Courts have held, however, that directors may approve defensive tactics to defeat a tender offer that they deem not to be in the corporation's best interests. It appears that the courts, in applying a traditional business judgment analysis to golden parachutes, will permit directors a similar prerogative upon the assertion of an arguably legitimate corporate purpose. It is suggested, however, that the premises underlying the business judgment rule are not always applicable to the modern corporation, and that the business judgment rule is thus an inappropriate standard by which to judge the validity of golden parachutes.

Modern corporate law prescribes that the board of directors is the final arbiter of all major decisions involving the corporation. tracts for the corporation where the management is vested in the board of directors” (footnote omitted); F. Kempin & J. Wiesen, supra note 61, at 295-308 (stockholders can only influence corporate affairs by means of their voting rights exercised at a meeting).

80 F. Steckmest, supra note 53, at 185; see W. Knepper, supra note 33, § 1.03, at 6.

81 See supra note 2.

82 See, e.g., Northwest Indus., Inc. v. B.F. Goodrich Co., 301 F. Supp. 706, 712-13 (N.D. Ill. 1969). In Northwest, B.F. Goodrich Co. and Gulf Oil Corp. engaged in a joint venture. Id. at 708. In 1965, the companies considered having one purchase the other’s interest. Id. Before any terms were agreed upon, however, Northwest Industries announced that it would commence a tender offer. Id. Within 1 day, Goodrich offered Gulf $35 million for Gulf’s interest, and on the following day, Goodrich’s Board of Directors approved the transaction. Id.

Northwest Industries requested a preliminary injunction, alleging that “the consideration was grossly inflated in order to guarantee that a substantial block of stock would be held by interests friendly to Goodrich’s present management.” Id. Denying the request, the court discussed the duty of management with respect to a tender offer:

Management has the responsibility to oppose offers which, in its best judgment, are detrimental to the company or its stockholders. In arriving at such a judgment, management should be scrupulously fair in considering the merits of any proposal submitted to its stockholders. The officers’ and directors’ informed opinion should result from that strict impartiality which is required by their fiduciary duties. After taking these steps, the company may then take any step not forbidden by law to counter the attempted capture.

Id. at 712-13. The court required an impartial evaluation by management, yet ignored its observation that “whenever a tender offer is extended and the management of the threatened company resists, the officers and directors may be accused of trying to preserve their jobs at the expense of the corporation.” Id. at 712.

83 See, e.g., Cal. Corp. Code § 300(a) (West 1977). The power infrastructure of the corporation is described as “pyramidal.” W. Cary & M. Eisenberg, supra note 1, at 118. Under this “received” model of the corporation, the stockholders comprise the base of the pyramid and elect the next level: the board of directors. Id.; see, e.g., N.Y. Bus. Corp. Law §
This decisionmaking power embraces transactions between officers and the corporation, such as employment contracts. Courts generally will not question the board's judgment, since it is presumed that the board acts as an impartial formulator of corporate policy. Some commentators suggest, however, that the board is not impartial, that the modern board is dominated by the officers, particularly the chief executive officer. It is submitted that an examination of the actual corporate structure will demonstrate the inconsistency inherent in presuming directorial impartiality in transactions involving officers.

In determining that a director is disinterested in a transaction,

703(a) (McKinney 1963). The board is responsible for appointing the final level: the officers. W. CARY & M. EISENBERG, supra note 1, at 118; see, e.g., ILL. ANN. STAT. ch. 32, § 157.43 (Smith-Hurd Supp. 1982-1983). The board may delegate certain managerial functions to the officers "provided that the business and affairs of the corporation shall be managed and all corporate powers shall be exercised under the ultimate direction of the board." CAL. CORP. CODE § 300(a) (West 1977); see F. STECKMEST, supra note 53, at 185; W. KNEPPER, supra note 33, § 1.03, at 6.

The "received" model is based upon the theory that the board is the ultimate decisionmaker with respect to selecting officers, determining policy and managing the general business affairs of the corporation. Eisenberg, Legal Models of Management Structure in the Modern Corporation: Officers, Directors, and Accountants, 63 CALIF. L. REV. 375, 376 (1975). Under this model, therefore, officers are subordinate to the board. See id.


See supra note 74 and accompanying text.

See, e.g., J. BAKER, DIRECTORS AND THEIR FUNCTIONS—A PRELIMINARY STUDY 131-32 (1945); M. MACE, DIRECTORS: MYTH AND REALITY 108 (1971); Eisenberg, supra note 83, at 375-84.

In the typical large, publicly-held corporation, policymaking and management are conducted by the officers, often to the exclusion of the board. Eisenberg, supra note 83, at 377. Indeed, the board rarely influences corporate affairs. Id. at 376-84; see Moscow, The Independent Director, 28 BUS. LAW. 9, 9 (1972). Primarily as a result of time constraints, information, composition, selection and tenure, the board is prevented from exercising, to any meaningful extent, the role that it is given in the statutes. Eisenberg, supra note 83, at 378-83. See generally J. BAKER, supra note 86, at 11-27 (common constraints on directors). Thus, there is a "drastic skew" between the received model of the corporation and the working model—"the virtually inevitable result" of the various constraints under which the board must operate. W. CARY & M. EISENBERG, supra note 1, at 173.

Most boards spend a minimal amount of time in preparation for board meetings, which generally are held no more than 12 times per year. Id. at 378. In addition, most directors lack a personal staff and must rely upon information gathered by the persons whom they purportedly monitor. Id. at 380; see J. JURAN & J. LOUDEN, THE CORPORATE DIRECTOR 287-89 (1966). Frequently, executives will deny the board access to certain information. Eisenberg, supra note 83, at 380.
courts commonly place undue emphasis upon the absence of pecuniary benefit, often to the exclusion of other, equally compelling factors. The one of these factors is the almost universal subordination of directors to the wishes of the chief executive officer, to whom they owe their election or appointment. In choosing his nominees, the chief executive officer "take[s] into consideration whether the candidate can be counted on not to rock the boat." This power of selection encompasses both outside or "independent" directors, as well as inside directors who serve the corporation in some other capacity. These inside directors, who often supply legal, investment, or commercial services to the corporation, naturally are interested in retaining the corporation's business. Additional ties to

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88 See Panter v. Marshall Field & Co., 646 F.2d 271, 300 (7th Cir. 1981) (Cudahy, J., concurring in part and dissenting in part), cert. denied, 454 U.S. 1092 (1982). Courts traditionally have viewed the presence of a majority of outside or independent directors as dispositive of the issue of management dominance. See, e.g., Beard v. Elster, 39 Del. Ch. 153, 165, 160 A.2d 731, 738 (1960); Blish v. Thompson Automatic Arms Corp., 50 Del. Ch. 538, 593, 64 A.2d 581, 604 (1946). Conversely, the presence of interested directors has been held sufficient to subject a transaction to a fairness analysis. See, e.g., Treadway Cos. v. Care Corp., 638 F.2d 357, 382 (2d Cir. 1980). Criticizing such reliance upon the absence of pecuniary interest in a transaction as determinative of director disinterest, Judge Cudahy stated that "the very idea that, if we cannot trace with precision a mighty flow of dollars into the pockets of each of the outside directors, these directors are necessarily disinterested arbiters of the stockholders' destiny, is appallingly naive." Panter, 646 F.2d at 300 (Cudahy, J., concurring in part and dissenting in part); see Eisenberg, supra note 83, at 375-84.

89 See W. KNEPPER, supra note 33, §§ 1.10-1.11, at 25-27; Eisenberg, supra note 83, at 381-83. According to Professor Eisenberg:

[M]ost directors in most publicly held corporations are closely tied to the chief executive—either economically, through an employment, professional, consulting, or supplier relationship with the corporation, or psychologically, through friendship, prior employment, or the fact that they have been selected and indoctrinated by the chief executive and hold their seats at his pleasure.

Eisenberg, supra note 83, at 404 (footnotes omitted).

90 Eisenberg, supra note 83, at 382; see M. MACE, supra note 86, at 99.

91 Eisenberg, supra note 83, at 381-83. Whether a board member is an outside director with no executorial duties or an inside director serving concomitantly as an officer, there generally is some degree of dependence on the chief executive officer. Id. at 381-82. Moreover, it is increasingly common for the chief executive officer also to serve as chairman of the board. W. KNEPER, supra note 33, § 1.09, at 23.

92 See Eisenberg, supra note 83, at 382; Moscow, supra note 87, at 11. Twenty to twenty-five percent of all outside directors in large corporations are lawyers or investment bankers. Eisenberg, supra note 83, at 382. Thus, it is anomalous to consider the presence of outside directors as dispositive on the issue of good faith:

Not only is the outside director selected by the control group that he presumably will regulate, he is often the lawyer, commercial banker, or investment banker for the corporation with obvious potential conflicts between his roles as a supplier and as a director. The constituency of the outside director is a combination of his own interests, the interests of the control group that selected him, and
the chief executive officer may derive from friendship. 93

Due to the board's pecuniary and psychological dependence on
the chief executive officer, he is usually accorded undivided loyalty
regardless of the wisdom of his policies. 94 Any diversion from the
expected conduct of rubberstamping all management proposals is
viewed as an act of disloyalty, likely to hasten a director's re-
moval. 95 A director appointed by the chief executive is "likely to
regard himself as serving at the latter's sufferance." 96 At the very
least, most directors are interested in maintaining their own bene-
fits and prestige, and thus would hesitate to oppose the chief exec-
utive. 97 It is suggested that this corporate atmosphere creates a si-
tuation in which officers are capable of self dealing under the
protection of the business judgment rule.

Management's control over the board creates a potential con-
ict of interest in any corporate transaction involving an executive.
A transaction that relates to a present or potential tender offer is
no exception. 98 Since the tender offer is a method of management
displacement, a presumption should arise that executives are inter-

an undefined standard of the interests of shareholders. . . . Furthermore, even if
an outside director wants to exercise a meaningful judgment, he is limited by
other activities and business custom in the attention that he gives to corporation
business, as well as by the quality of information made available to him by man-
agement. Despite more time and attention, the selection process and absence of a
clearly defined constituency to represent would prevent the outside director from
fulfilling a significant function.

Moscow, supra note 87, at 11.
92 Eisenberg, supra note 83, at 382.
93 The modern board virtually has become a "rubber-stamp" of management policy. Id.
at 377. Particularly in the case of inside directors, it is doubtful that they would be inclined
to disagree with policy decisions made by the executives prior to a board meeting. Id. at 381;
see W. Knepper, supra note 33, § 1.10, at 25.
94 See Eisenberg, supra note 83, at 383.
95 Id. ("[p]erhaps even more important than the power of selection, investing the chief
executive with control over outside directors, is the fact that in life as in law the power to
hire implies the power to fire"). Directors who exercise a course of independence risk not
being renominated at the end of their term. Id. at 383 n.40; see Coffee, Beyond the Shut-
Eyed Sentry: Toward a Theoretical View of Corporate Misconduct and an Effective Legal
96 Panter v. Marshall Field & Co., 646 F.2d 271, 300-01 (7th Cir. 1981), cert. denied,
454 U.S. 1092 (1982); Gelfond & Sebastian, supra note 4, at 436; Gilson, supra note 2, at
465.
97 The inherent conflict of interest posed by a hostile tender offer has been recognized
both judicially and academically. See, e.g., Tyco Laborstores, Inc. v. Kimball, 444 F. Supp.
292, 298 (E.D. Va. 1977); Northwest Indus., Inc. v. B.F. Goodrich Co., 301 F. Supp. 706, 712
(N.D. Ill. 1969); Gelfond & Sebastian, supra note 4, at 420, 436; Gilson, supra note 2, at 823-
26.
ested in the success of their initiatives concerning the bid. Accordingly, the directors, who undoubtedly will feel compelled to comply with management's wishes, also must be considered interested. It is suggested, therefore, that these transactions are not properly the subject of a deferential, business judgment analysis.

The business judgment rule contemplates a free enterprise system in which the courts will refrain from substituting their judgment for that of the directors when complex business decisions are at issue. There is a difference, however, between corporate activity in managing a business enterprise and that of using capital and distributing profits and losses. According to one commentator, business management "involves corporate functioning in competitive business affairs in which judicial interference may be undesirable," while financial distribution concerns "only the corporation-shareholder relationship, in which the courts may more justifiably intervene to insist on equitable behavior." It is submitted that this distinction should be drawn with respect to golden parachutes. These contracts are neither the product of corporate risk or initiative, nor the result of a complex business decision. Moreover, golden parachutes do not involve considerations in which "the director's expertise is likely to be greater than the court's." Given management's domination of the board and the

99 See Easterbrook & Fischel, supra note 4, at 1175. To the extent that a target's management is inefficient, their interest in preventing a takeover increases. Id.; cf. Gelfond & Sebastian, supra note 4, at 436 (hostile tender offer "unavoidably involves forces tending to shape decisions that are not necessarily for the benefit of all shareholders").

100 See Eisenberg, supra note 83, at 382-83; supra notes 94-97 and accompanying text.

101 See Gelfond & Sebastian, supra note 4, at 436-37.


103 Note, Protection for Shareholder Interests in Recapitalizations of Publicly Held Corporations, 58 COLUM. L. REV. 1030, 1066 (1958) (footnote omitted).

104 Id.

105 Id.

106 Cf. Easterbrook & Fischel, supra note 4, at 1198-99 (determining whether to accept or reject a tender offer does not involve a complex business decision).

107 Gelfond & Sebastian, supra note 4, at 435. A decision whether to reject a tender offer does not involve the type of business decision contemplated by the business judgment rule. Easterbrook & Fischel, supra note 4, at 1198-99. Similarly, a determination that a
concomitant implication of conflicting interests, it is evident that application of the business judgment rule is misplaced in the context of golden parachutes.\textsuperscript{108} The propriety of the golden parachute, it is suggested, should be determined through the vehicle of fairness.\textsuperscript{109}

\textbf{Fairness}

Application of a fairness standard to golden parachutes is consistent with the recent trend in corporate control cases to subject management decisions to more objective scrutiny. For example, in \textit{Weinberger v. UOP, Inc.},\textsuperscript{110} the Delaware Supreme Court held that when a freezeout merger\textsuperscript{111} is challenged as a fraudulent attempt to eliminate minority shareholders, the merger must be entirely fair to the minority, regardless of the existence of a valid business purpose.\textsuperscript{112} The \textit{Weinberger} court stated that “[t]he concept of fair-

particular employee should receive a golden parachute should not be accorded the judicial deference implicit in a business judgment analysis. A court “need not gather costly information nor induce managers to incur inefficiently large costs of decisionmaking to stave off litigation.” \textit{Id.} at 1199.

\textsuperscript{108} \textit{See Panter v. Marshall Field & Co.}, 646 F.2d 271, 300 (7th Cir. 1981) (Cudahy, J., concurring in part and dissenting in part) (citing Gelfond & Sebastian, \textit{supra} note 4, at 435-37), \textit{cert. denied}, 454 U.S. 1092 (1982). In \textit{Panter}, Judge Cudahy noted: [T]he great danger becomes the channeling of the directors’ expertise along the lines of their personal advantage—sometimes at the expense of the corporation and its stockholders. Here, courts have no rational choice but to subject challenged conduct of directors and questioned corporate transactions to their own disinterested scrutiny. Of course, the self-protective bias of interested directors may be entirely devoid of corrupt motivation, but it may nonetheless constitute a serious threat to stockholder welfare.

\textit{457 A.2d} at 300 (Cudahy, J., concurring in part and dissenting in part).

\textsuperscript{109} \textit{See infra} notes 110-41 and accompanying text.

\textsuperscript{110} 457 A.2d 701 (Del. 1983). In \textit{Weinberger}, a class action plaintiff challenged the validity of a cash-out merger. \textit{Id.} at 703. The plaintiff asserted that the consideration paid to UOP’s minority shareholders “was grossly inadequate and that as a consequence the merger was unfair and should be set aside.” \textit{Weinberger v. UOP, Inc.}, 426 A.2d 1333, 1335 (Del. Ch. 1981).

\textsuperscript{111} A freezeout occurs when a group of shareholders who own a controlling interest in the corporation purchase the “entire equity interest” of other investors with cash, debt, or preferred stock. 1 M. LIPTON & E. STEINBERGER, \textit{supra} note 4, § 9.1, at 419; Areeda & Turner, \textit{Williamson on Predatory Pricing}, 87 YALE L.J. 1337, 1357 (1978). Professors Areeda and Turner regard freezeouts as coercive by definition, noting that “minority stockholders are bound by majority rule to accept cash or debt in exchange for their common shares, even though the price they receive may be less than the value they assign to those shares.” Areeda & Turner, \textit{supra}, at 1357.

\textsuperscript{112} 457 A.2d at 704. The Delaware Supreme Court held that an expanded appraisal remedy and the broad discretion of the chancellor to redress a plaintiff in whatever fashion the facts required rendered superfluous an inquiry into the business purpose of a transac-
ness has two basic aspects: fair dealing and fair price. Among the factors deemed relevant by the court were the timing of the transaction; "how it was initiated, structured, negotiated, [and] disclosed to the directors"; and the means of obtaining the approvals of the directors and shareholders. Additional considerations were of an economic nature. The clear import of Weinberger is its indication of judicial willingness to inquire into the merits of a transaction when a potential conflict of interest is present, regardless of an arguable business purpose.

Similarly, the law of parent-subsidiary mergers requires a defendant to establish the entire fairness of a transaction. In Sterling v. Mayflower Hotel Corp., the Supreme Court of Delaware stated that "since [majority stockholders] stand on both sides of the transaction, they bear the burden of establishing its entire fairness, and it must pass the test of careful scrutiny by the courts." In determining whether a parent-subsidiary merger satisfies this test, the court must consider all relevant factors.

A common thread connecting freezeout and parent-subsidiary mergers is that both demand similar fiduciary obligations from the management participants. As the potential for self-dealing in
these transactions is apparent, the courts properly subject them to the strictest scrutiny. It is suggested that golden parachutes should be evaluated similarly, since officers, by virtue of their dominance over the board, stand on both sides of the negotiations.

Courts generally consider all relevant facts and circumstances when examining the fairness of a corporate transaction. This standard, therefore, is of imprecise definition. The factors of fair dealing and fair price, however, seem to be at the foundation of any fairness analysis.

In considering fair dealing, the court must examine the relationships between the parties. As fiduciaries, directors and officers must act solely to benefit the cestui; hence, they must forego any personal advantage that may result from their positions. It is thus suggested that compensating an executive following a takeover, particularly one whose services the shareholders evidently did not wish to retain, is inherently unfair to the shareholders.

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120 See, e.g., Sterling, 33 Del. Ch. at 298, 93 A.2d at 110. Situations amenable to self-dealing are not properly the subject of a business judgment analysis. In the context of mergers, when one corporation dominates the other corporation, “there is some element of or potential for self-dealing in the transaction.” Nathan & Shapiro, supra note 113, at 45. When the parties making a transaction are on both sides of that transaction, “then the presumption and deference to sound business judgment are no longer present. Intrinsic fairness, tested by all relevant standards, is the criterion.” David J. Greene & Co. v. Dunhill Intl, Inc., 249 A.2d 427, 431 (Del. Ch. 1968); cf. Carrad, The Corporate Opportunity Doctrine in Delaware: A Guide to Corporate Planning and Anticipatory Defensive Measures, 2 Del. J. Corp. L. 1, 1-15 (1977) (directors, officers and controlling stockholders have both affirmative and negative fiduciary obligations).

121 See Gelfond & Sebastian, supra note 4, at 448.

122 Moore, supra note 113, at 676.

123 Nathan & Shapiro, supra note 113, at 46.

124 Pepper v. Litton, 308 U.S. 295, 311 (1939); Borden v. Sinskey, 530 F.2d 478, 489-90 (3d Cir. 1976); Guth v. Loft, 23 Del. Ch. 255, 270, 5 A.2d 503, 510 (1939); see 6 Z. Cheshire, supra note 1, § 127.02[1], at 127-4; 3 W. Fletcher, supra note 33, § 850, at 175-76; W. Knepper, supra note 33, § 1.04, at 8; Corporate Director’s Guidebook, supra note 61, at 1599 (director should not derive a “personal profit or gain or other personal advantage” by dealing in his corporate capacity with a third party); see also Fuller, supra note 33, at 190-211 (discussing various conflicts of interest); Ramsey, supra note 33, at 295-309 (examining the different areas where conflict of interest may occur).

With respect to the board, it has been stated that the primary purpose of the board of directors “is the representation and safeguarding of the stockholders’ interests.” M. Nicholson, Duties and Liabilities of Corporate Officers and Directors 111 (1972). Similarly, officers are bound by a strict rule of honesty and fair dealing and must act solely in the corporation’s interests. W. Fletcher, supra note 33, § 850, at 175-76. See generally J. Bishop, The Law of Corporate Officers and Directors—Indemnification and Insurance §§ 3.01-.07, at 3-2 to 3-24 (1981) (liability as a result of status or conduct).

125 It appears superfluous to sanction golden parachutes as contracts intended to permit executives the financial security necessary to oppose a tender offer considered adverse to the
Golden parachutes merely insulate management from the consequences of a concerted shareholder decision.

Additional considerations involved in fair dealing include the manner of negotiation, how the transaction was presented to the directors, and the degree of shareholder involvement in approving the transaction. Perhaps the most egregious aspect of golden parachutes is that they often are negotiated without shareholder approval immediately before or after a tender offer has been initiated. Additionally, while the board must authorize the contract, to ignore management's participation in the instigation of these contracts, and its dominance over the board, exalts form over substance.

shareholders' interests. The presumption that executives will oppose such a takeover more vehemently is ill-founded, since, regardless of the golden parachute, managers do not want to lose their company. The golden parachute could create a laissez-faire attitude in that management is now assured that, even if the takeover occurs, it will nevertheless receive compensation. See McLaughlin, supra note 9, at 48; Morrison, supra note 37, at 86.

Moreover, executive compensation and perquisites are directly structured for adaptation to the threat of displacement. See F. STECKMEST, supra note 53, at 161-64. Once under contract, there is “an implied duty that an employee act solely for the benefit of his employer in all matters within the scope of employment.” Maryland Metals, Inc. v. Metzner, 282 Md. 31, 38, 382 A.2d 564, 568 (1978). In light of the fiduciary duties of both directors and officers, the market-structured compensation packages such parties receive, and their contractual obligations, it is suggested that golden parachutes are merely a wasteful form of self-enrichment. If a corporate manager needs such a contract to foster personal objectivity, it is submitted that he already is acting in derogation of his fiduciary duty.

128 Moore, supra note 113, at 676; see Nathan & Shapiro, supra note 113, at 46-47.
127 See Kleinfield, supra note 58, at D1, col. 2. One recent development in the controversy concerning shareholder approval of golden parachute provisions has been a proposal by a special panel named by the Securities and Exchange Commission recommending that such provisions be approved by the shareholders of a corporation. See Noble, S.E.C. Panel Asks Curb On Golden Parachutes, N.Y. Times, May 14, 1983, at 33, col. 5.
125 See Eisenberg, supra note 83, at 375-84; supra notes 86-97 and accompanying text; cf. Coffee, supra note 96, at 1132-47 (difficulties inherent in board control over decisionmaking). In light of the dominance that executives routinely exercise over the board, it is suggested that judicial examination of contracts involving corporate executives individually should be subjected to a fairness analysis similar to that applied to contracts benefitting a majority of the board.

In a takeover context, where conflicts of interest permeate both management and directoral decisionmaking, Panter v. Marshall Field & Co., 646 F.2d 271, 300 n.1 (7th Cir. 1981) (Cudahy, J., concurring in part and dissenting in part) (quoting Gelfond & Sebastian, supra note 4, at 436-37), cert. denied, 454 U.S. 1092 (1982), the fairness test is an appropriate standard. While director interest does not necessarily imply unfairness, and conflict of interest may not be presumed, it is suggested that executive domination is a sufficient ground to subject a golden parachute agreement, which is peculiarly related to hostile tender offers, see WARD HOWELL SURVEY, supra note 8, at 9, to a fairness analysis.
The second factor in an examination of fairness is price.\textsuperscript{130} With respect to mergers, fair price is determined by examining "assets, market value, earnings, and any other factors or elements that are unique to a company, directly affecting the intrinsic or inherent value of its stock."\textsuperscript{131} In the context of executive severance-pay agreements, fair price most likely would be determined by an examination of the consideration given to and provided by the beneficiaries of the golden parachute. It is submitted that such an examination reveals an uneven distribution in favor of the golden parachute beneficiary.

First, although it is conceded that hostile tender offers may engender great tension and require considerable effort to combat,\textsuperscript{132} a contract providing an executive with several million dollars for less than 1 month of trauma does not appear to involve adequate consideration on the part of the executive.\textsuperscript{133} Hence, the minority shareholders, those that retain their shareholder status

\textsuperscript{130} Moore, supra note 113, at 676.

\textsuperscript{131} Id. With respect to mergers, fair value may be defined as "the price or price range at which a rational willing buyer and a rational willing seller would exchange the stock or other security in question in an arm's-length transaction, assuming that each had knowledge of all the relevant facts . . . ." Nathan & Shapiro, supra note 113, at 48.

Evidently, the criterion of fair value is a constant in judicial evaluations of situations wherein management has an opportunity to self-deal. Traditional compensation must be in proportion to the executive's ability, services and time devoted to the company, difficulties involved, responsibilities assumed, success achieved, amounts under jurisdiction, corporation earnings, profits and prosperity, increase in volume or quality of business or both, and all other relevant facts and circumstances; nor should it be unfair to stockholders in unduly diminishing dividends properly payable.

Gallin v. National City Bank of New York, 152 Misc. 679, 703, 273 N.Y.S. 87, 114 (Sup. Ct. N.Y. County 1934) (citations omitted). By applying similar concepts to golden parachutes, it will be demonstrated that they are inherently unfair to the shareholders.

\textsuperscript{132} See Wachtell, Special Tender Offer Litigation Tactics, 32 Bus. Law. 1433, 1433-35 (1977).

\textsuperscript{133} See Cohen v. Ayers, 596 F.2d 733, 739-40 (7th Cir. 1979) (payments made without "fair consideration" are gifts). A tender offer involves a very short period of time. The offer must be kept open at least "twenty business days from the date such tender offer is first published or sent or given to security holders," 17 C.F.R. § 240.14e-1(a) (1982), and within 10 business days, target management must express its opinion on the offer's merits. Id. § 240.14e-2.

Regardless of the short period of time involved in a tender offer, executives owe a pre-existing duty to the shareholders and therefore the binding quality of golden parachutes is questionable. See DeCicco v. Schweizer, 221 N.Y. 431, 433, 117 N.E. 807, 808 (1917) ("where A is under a contract with B, a promise made by one to the other to induce performance is void"); see also Maryland Metals, Inc. v. Metzner, 282 Md. 31, 37-38, 382 A.2d 564, 568 (1978); Williams v. Queen Fisheries, Inc., 2 Wash. App. 691, 694-95, 469 P.2d 583, 585-86 (1970).
after a takeover, unnecessarily are forced to accept a loss of corporate assets. Second, with respect to those who eventually will tender their shares, there is a possibility that the offer will be adjusted downward in consideration of the golden parachute provision. Third, the amount of money accorded executives through such a provision often will exceed an executive's apparent worth to the corporation. Indeed, since many target companies are those with low stock values, and, presumably, poor management, a job security provision, as magnanimous as a golden parachute, seems indelibly stamped with impropriety. For instance, one corporation awarded its top executives benefits well in excess of the corporation's earnings for the year in which the golden parachute contract was arranged. Finally, since it is doubtful that many executives would resign during a takeover and forfeit the prestige and benefits associated with their positions, and since, following a take-

134 Since the benefits included in a golden parachute are paid by the acquiring corporation, those shareholders who retain their status subsequent to a takeover will suffer decreased dividends. See Rogers v. Hill, 289 U.S. 582, 590 (1933) (compensation paid to officers is deductible from corporate earnings).

135 The golden parachute must be viewed as an added expense of the tender offer, something which decreases the premium to be offered to the shareholders. See Easterbrook & Fischel, supra note 4, at 1173 (origin of premium is the decrease in agency expenditures).

136 See 2 B. Fox & E. Fox, supra note 1, § 27.02, at 27-14; Easterbrook & Fischel, supra note 4, at 1165-74; see also 1 M. Lipton & E. Steinberger, supra note 4, § 1.3, at 9 (a typical target characteristic is undervalued stock). Ideally, management should maintain the corporation's stock at optimum levels, Cooper, supra note 12, at 68, and thus avoid takeovers. See Ward Howell Survey, supra note 8, at 9.

137 See supra note 1 and accompanying text; infra note 138 and accompanying text.

138 See GRE Proxy Statement, supra note 1, at 9. As of June 8, 1982, Gulf Resources and Chemical Corporation estimated that its Chairman of the Board and Chief Executive Officer, Robert H. Allen, would be entitled to golden parachute benefits of more than $5.5 million. Brief for Defendant, Exhibit B, Allen v. Gulf Resources & Chem. Corp., No. 82-27756 (D. Ct. Harris County, Tex.) (Gulf Resources & Chem. Corp. Calculation of Estimated Benefits Under Severance Benefit Agreements as of June 8, 1982). The total amount of benefits awarded to employees exceeded $18 million. Id. The corporate earnings from continuing operations for 1981 totaled $12.6 million. Id. at 13.

Other golden parachutes recently have received much publicity. Several high-level executives at American Brands were guaranteed “[b]ase salary . . . for three years,” “profit-sharing, pension and health and related benefits.” Cooper, supra note 12, at 66. Celanese Corporation provides certain of its executives with golden parachutes entailing “[a] sum equal to annual base salary multiplied by 4 or multiplied by the difference between the executive’s age at that time and 65, whichever is the lesser number,” as well as the “[e]quivalent of pension benefits due whether or not the executive has completed ten years’ service.” Id.; see id. at 66-67.

139 Cooper, supra note 12, at 66; cf. Herzel & Colling, supra note 41, at 10, col. 3 (“Golden parachute agreements, no matter how favorable, . . . [are not] an adequate substitute for highly desirable jobs in which [executives] have invested large parts of their lives”).
over, efficient managers generally obtain employment at similar or better positions with greater benefits, or are retained by the acquirer at higher compensation rates, a golden parachute provision appears superfluous.

THE MARKET FOR CORPORATE CONTROL

There are several market mechanisms that monitor management performance such as competition in the product market, capital market, market for managerial services, and market for corporate control. It is submitted, however, that while certain of these mechanisms may protect shareholders from managerial inefficiency, the market for corporate control is the sole mechanism that guards against self-dealing. Competition in the product market, for example, provides little constraint in this regard, for it is dubious to suggest that self-dealing will lead to less success in the product market. Similarly, the capital market—reflecting
the market price of the corporation's shares—an—does not necessarily constrain self-dealing, since stock value will decrease "only to the extent the corporation cannot finance its activities through retained earnings and debt." Thus, as long as the corporation has available cash reserves, the capital market is an ineffective constraint. Finally, the market for managerial services does not always constrain management, because the employers of managers are themselves managers with similar interests in job security.

The market for corporate control on the other hand, does protect against self-dealing. Within this market there are four mechanisms by which managerial displacement may be effectuated: the merger, the sale of assets, the proxy fight, and the tender offer. Of these four mechanisms only the tender offer effectively can accomplish the desired monitoring function. The merger and sale of assets can be accomplished only if management initially approves the transaction. Without approval, the issue will not reach the shareholders. Concerning the proxy fight, the return on a shareholder's investment is generally too minimal to make such a challenge profitable. The challenger in a proxy fight must use personal funds, whereas management may resist the challenge with corporate resources. Thus, unless a challenger owns a substantial number of shares, a proxy fight is not a worthwhile or realistic venture.

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149 Id. at 838.
150 Id. at 839 (footnote omitted).
151 Id.
152 Id.; see M. MACE, supra note 86, at 163-69; Mace, Directors: Myth and Reality—Ten Years Later, 32 Rutgers L. Rev. 293, 296 (1979).
153 Gilson, supra note 2, at 842; see Manne, supra note 146, at 114-19.
154 Gilson, supra note 2, at 844; see Easterbrook & Fischel, supra note 4, at 1168-74.
155 Gilson, supra note 2, at 843. Management control over both mergers and sales of assets essentially preempts any possibility of market mechanisms effectively monitoring managers. See id.; Manne, supra note 146, at 117-18. Mergers and sales of assets are unique in that, "[g]enerally speaking, managers' incentives and interests coincide with those of their shareholders in every particular except one: they do not have incentive, as managers, to buy management services for the company at the lowest possible price." Manne, supra note 146, at 117 (footnote omitted). It is doubtful that management will ever disinterestedly recommend a change in control. See id. at 118.
156 Gilson, supra note 2, at 843.
157 Id.; Manne, supra note 146, at 114-15.
158 A shareholder who challenges management in a proxy fight will not be reimbursed for his efforts unless he succeeds, and unless he possesses a sufficient amount of shares the return on his investment will be too small to make such a challenge profitable. See Clark, Vote Buying and Corporate Law, 29 Case W. Res. 776, 783-84 (1979); Gilson, supra note 2, at 843.
Since the tender offer is the only adequate monitor of managerial self-dealing, management control over this mechanism appears inappropriate. Courts, however, generally have held that management is required to oppose a tender offer that it considers adverse to the shareholders' interests. Purportedly in furtherance of this mandate, management has promulgated golden parachutes. Such provisions, it is submitted, reduce the potential for management displacement and ensure incumbent target management a buffer against the economic forces that presumably monitor its actions. Although it is stated that shareholders, as corporate owners, assume the risks of doing business, this assumption is not absolute, because shareholders cannot be expected to acquiesce in management self-dealing. Because management "can be expected, if otherwise unconstrained, to maximize its own welfare rather than the shareholders," it is essential to maintain the one effective constraint on management's activities—the market for corporate control in the context of the tender offer. To condone the use of golden parachutes is to provide executives with almost absolute insulation from the effects of economic forces and

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160 Gilson, supra note 2, at 844; see Easterbrook & Fischel, supra note 4, at 1174-80; cf. Gelfond & Sebastian, supra note 4, at 436-37 (management domination over the board renders "nonexamination, business judgment approach in hostile tender offer cases inappropriate"). Management discretion to employ defensive tactics to avert a tender offer lessens the effectiveness of such offers as constraints upon management, since transaction costs will be increased and the incentive to initiate a tender offer will decrease. Gilson, supra note 2, at 845; see Easterbrook & Fischel, supra note 4, at 1174-80.

161 See, e.g., Northwest Indus., Inc. v. B.F. Goodrich Co., 301 F. Supp. 706, 712 (N.D. Ill. 1969). In Northwest, the court stated that, under New York law, a decision by management to oppose an offer must be made impartially and in good faith. Id.; see Easterbrook & Fischel, supra note 4, at 1173; see also Herzl, Schmidt & Davis, Why Corporate Directors Have a Right to Resist Tender Offers, 3 CORP. L. REV. 107, 109-12 (1980) (resistance to tender offers may be beneficial to shareholders).

162 See Cooper, supra note 12, at 66; Klein, supra note 41, at 56, col. 1. Proponents of golden parachutes assert that the contracts are necessary to "ensure that acquisition or merger proposals that do come along will be weighed dispassionately by the people in charge . . . ." Klein, supra note 41, at 56, col. 1.

163 See Ward Howell Survey, supra note 8, at 2.


165 Gilson, supra note 2, at 840; see Easterbrook & Fischel, supra note 4, at 1170. Undoubtedly, some managers "will find it advantageous to shirk responsibilities, consume perquisites, or otherwise take more than the corporation promised to give them." Easterbrook & Fischel, supra note 4, at 1170.

166 See Gilson, supra note 2, at 836-40.
to emasculate the most effective means by which shareholders may exercise their rights of ownership.\textsuperscript{166}

CONCLUSION

It is ironic that the judicial permissiveness of the business judgment rule,\textsuperscript{167} founded upon principles of laissez faire\textsuperscript{168} and the belief that economic forces will compel management to act both efficiently and in the shareholders' best interests,\textsuperscript{169} is used to shield management from the economic forces that monitor it.\textsuperscript{170} It is unsettling also that this distortion of the theory of economic incentives\textsuperscript{171} may be carried over into the context of the golden para-

\textsuperscript{166} Cf. West v. Camden, 135 U.S. 507 (1890) (contract to keep an officer permanently in his position is void). Several observations are appropriate. If a golden parachute is designed to ensure management objectivity and continuity so they confidently can resist a takeover, see Ward Howell Survey, supra note 8, at 1, such a contract, in the event a takeover occurs, pays for a job poorly done. If the intent is to attract and retain good management, see Morrison, supra note 37, at 83, the golden parachute nonetheless permits good management to leave following a takeover. Because the target company frequently is inefficiently managed, the golden parachute insulates poor managers from their own ineffectiveness. The ultimate effect is to infringe on the shareholder's right of ownership, and to insulate management from the most effective monitor of its conduct—the market for corporate control. The market for corporate control provides "shareholders both power and protection commensurate with their interest in corporate affairs." Manne, supra note 146, at 112; see Easterbrook & Fischel, supra note 4, at 1168-74.

\textsuperscript{167} Editorial Note, supra note 102, at 568. Judicial permissiveness encourages initiative by permitting a director, acting in good faith, broad discretion in the management of corporate affairs, without fear of liability in the event his personal interests conflict with the corporation's. Id. Rarely is a director subjected to liability in the absence of a clear showing of fraud. The logic of such judicial restraint is that directors are involved in a complex and uncertain business, and the courts are ill-equipped to substitute their judgment for the board's. See J. Louden, The Director 21 (3d ed. 1982); Manne, The "Higher Criticism" of the Modern Corporation, 62 Colum. L. Rev. 399, 421-22 (1962).

\textsuperscript{168} Note, supra note 74, at 600; Editorial Note, supra note 102, at 565. The theory that human motives should be permitted to influence the economy without restraint was basic to the laissez-faire philosophy of the nineteenth century. Editorial Note, supra note 102, at 565.

\textsuperscript{169} See Editorial Note, supra note 102, at 570-71. The need for economic incentive arises from the characteristic separation of ownership and control in the modern, publicly held corporation. See Easterbrook & Fischel, supra note 4, at 1170. Modern corporate managers generally do not possess a recognizable proprietary interest in the corporation and, since they do not reap the full benefits of their labor, often are less than diligent in overseeing corporate affairs. See id. at 1170; Manne, supra note 146, at 113; Editorial Note, supra note 102, at 113.

\textsuperscript{170} See Gilson, supra note 2, at 822; Editorial Note, supra note 102, at 564. The business judgment rule "reflects a conclusion that the management action in question will not be reviewed at all." Gilson, supra note 2, at 822 (footnote omitted); Editorial Note, supra note 102, at 564.

\textsuperscript{171} By ensuring that management is insulated from the adverse consequences of a take-
chute. As stated by one commentator, "[t]o the extent that the business judgment rule presupposes effective nonlegal constraints on management decisions, it is inconsistent with management control over tender offers."[173]

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over, the golden parachute clause frustrates the theory of economic incentives:

[T]he greatest benefits of the takeover scheme probably inure to those least conscious of it. Apart from the stock market, we have no objective standard of managerial efficiency. Courts, as indicated by the so-called business judgment rule, are loath to second-guess business decisions or remove directors from office. Only the take-over scheme provides some assurance of competitive efficiency among corporate managers and thereby affords strong protection to the interests of vast numbers of small, non-controlling shareholders.

Manne, supra note 146, at 113. Although numerous commentators have argued in favor of defensive tactics, see, e.g., Lipton, supra note 22, at 106-12, it is suggested that they have overlooked the critical role played by the market for corporate control, see Smiley, Do Tender Offers Damage Stockholders, reprinted in THE ATTACK ON CORPORATE AMERICA 97, 99-101 (M. Johnson ed. 1978).

172 See WARD HOWELL SURVEY, supra note 8, at 8; Fleischer & Raymond, supra note 17, at 27, col. 1; Klein, supra note 41, at 56, col. 3. Commentators have postulated that judicial scrutiny of golden parachutes will be guided by the business judgment rule. See, e.g., Klein, supra note 41, at 56, col. 3.

173 Gilson, supra note 2, at 844 (footnote omitted); see Gelfond & Sebastian, supra note 4, at 436-37.