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Competing for Managerial Talent:
What Antitrust Can Tell Us about Antitakeover Statutes

by

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ABSTRACT

This thesis looks at the antitrust implications of state antitakeover statutes. After a wave of hostile takeovers in the 1980s, many state legislatures, lobbied by the managerial interests, enacted laws that made it more difficult for outsiders to take over target corporations. This, in turn, has led to inefficient entrenchment of management and adverse consequences for shareholders. This paper argues that such inefficiencies are inconsistent with the aims and purposes of antitrust laws.

The thesis will discuss both the theories supporting strong managerial protection and the elimination of hostile takeovers and the theories supporting the claim that takeovers are a productive method of improving the control and management of assets.

Such legislation deprives shareholders of a substantial premium, protects inefficient management, and has negative effects on the national economy as a whole. Hence, in so far as antitakeover statutes conflict with the goals of antitrust, the latter should trump the former.

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General introduction

The idea that competition plays a vital role in the current economic model is virtually beyond dispute. Competition is a key motivator, driving markets towards a more efficient use of scarce resources.[1] It is also integral in correcting market behavior, thereby promoting greater business efficiencies. The importance of competition in the U.S. present market system is reflected in antitrust policy, which cites competition as one of the most crucial principles in a free market system.

Although there is a reasonable consensus that competition encourages more efficient behavior, not all areas of law have incorporated this principle. Corporate law has been providing managers with extended defenses from hostile takeovers, therefore protecting current management from some of the consequences of sub-standard performance. To whom do investors want to grant the right to manage their investments? The most obvious answer to this question is that investors want to ensure that their capital is managed in the most efficient way possible. Therefore, they seek to delegate their capital management to the most talented and successful professional managers. Once hired, managers are expected to act in the best interests of shareholders or otherwise face the threat of replacement. Director monitoring encourages managers to align their individual goals with those of the firm, the net effect of which is to reduce inefficient managerial behavior. Absent antitakeover statutes, there arises competition

[1] William J. Kolasky, Andrew R. Dick, *The Merger Guidelines and the Integration of Efficiencies into Antitrust Review of Horizontal Mergers*, 71 Antitrust L.J. 207, 207 (2003).

between management teams for the right to manage resources. In other words, the market for corporate control itself performs a monitoring function, disciplining managers to act in a desirable manner.

Antitrust laws have been designed to deal with monopolies, market power, restraints of trade and other important matters, including mergers and acquisitions. Legislators have adopted rules governing takeovers in accordance with the major goals established for antitrust laws, competition and consumer welfare. Whether non-antitrust rules governing takeovers abide by the goals established by antitrust policy or not deserves in-depth scrutiny.

This thesis seeks to investigate the set of U.S. corporate and antitrust legislation governing takeovers. It argues that current antitakeover legislation is inconsistent with the key goals of antitrust laws. The paper provides a detailed study of the goals of antitrust laws and examines the effects of mergers and takeovers in light of these goals. The analysis presented in this thesis strongly relies upon law and economics approach in evaluating antitakeover legislation.

The paper's main argument asserts that corporate rules governing takeovers should be reconciled with antitrust doctrine. On the one hand, takeovers are subject to antitrust policy, which promotes competition and seeks to maximize consumer welfare. On the other hand, takeovers are subject to antitakeover legislation that imposes substantial restrictions on merger and acquisition activities, therefore shielding incumbent managers from the market for corporate control and enabling them to avoid the pressures of rivals and competition.

In view of the above, the most striking declaration in the analysis is that antitakeover statutes are antithetical to the nature and goals of antitrust laws. To further clarify and support this assertion, the thesis proceeds as follows. Part I briefly reviews state competition for corporate charters in the U.S. and examines the various types of antitakeover statutes. Part II focuses on different aspects of excessive takeover regulation, unjustified managerial entrenchment and limited shareholder power to check managerial activity. Part III analyzes major and minor goals of antitrust laws, examines the benefits of takeovers in terms of economic efficiency and provides support for the notion that antitakeover legislation is antithetical to the goals of antitrust laws. Part IV offers a brief conclusion. Although this thesis does not directly address Canadian law, it is relevant to Canada for several reasons. Since the economy of Canada is highly integrated with the economy of the United States, many business transactions are performed between these two countries on a daily basis. The legislation of the United States has a significant impact on Canadian business interests. Therefore, the analysis provided in this thesis is valuable for Canadian corporations conducting or intending to conduct business in the United States.

I. A REVIEW OF ANTITAKEOVER LEGISLATION

Introduction

This section analyzes the competition that arises between U.S. states in adopting legislation that attracts in-state incorporations. It will review issues relating to incorporation in the light of state competition for corporate charters, focusing on states' particular preferences in adopting corporate rules. The choice to incorporate will also be addressed, as well as the ability and determination of shareholders to reincorporate in other states. The section will include a survey of expert opinions regarding state competition for corporate charters as well as a discussion of whether this competition ultimately favors the interests of directors or shareholders.

In order to understand the complex body of legislation enacted by different states regarding takeover activity in the market, it is essential to analyze various types of antitakeover statues. This part will consider major types of antitakeover statutes, highlighting the rules that entrust managers with substantial control over corporate merger and acquisition prospects. The process through which antitakeover statutes came to exist in their current form will also be examined. In addition, this section will investigate the ultimate effects of legislation that allows managers to employ various antitakeover statutes, including the possibility that it places shareholders in a disadvantaged position.

1.1 State Competition For Corporate Charters

United States corporations are free to choose any state in which to incorporate, regardless of where they will conduct their business operations.[2] Once incorporated in a particular state, a corporation will be governed by the law of this state, in addition to the federal law.

The theory that states compete for corporate charters is widely shared by legal scholars. States have a vested interest to attract in-state incorporations for various reasons but mainly because states benefit from franchise tax and fees resulting from incorporations and from growth in overall business activity.[3] The flexibility provided for corporations in terms of the choice of state to incorporate gives the states an incentive to craft their corporate laws in ways that would be attractive for future incorporations.[4]

The question of whether the state competition for charters is effective has been vigorously discussed in the corporate literature. The existing theories of state competition are split into two: the race for the top theory[5] and the race for the bottom theory.[6]

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[2] Lucian Arye Bebchuk, *Federalism and the Corporation: The Desirable Limits on State Competition in Corporate Law*, 105 Harv. L. Rev. 1435, 1442 (1992).
[3] *Id*. at 1443.
[4] *Id*.
[5] The race for the top theory provides that state competition for charters encourages states to adopt corporate law rules that enhance shareholder value, and therefore, it serves best for the interests of shareholders. *Id*. at 1445.
[6] The race for the bottom theory holds that state competition for charters, in contrast, harms shareholders because it forces states to adopt corporate law rules that are more attractive to managers rather than shareholders. *Id*. at 1444.

Supporting the race for the bottom theory, William Cary[7] argued that Delaware, seeking new sources of revenue, had joined the race for corporate charters, favoring corporate managers in crafting its corporate law rules.[8] In Cary's opinion, Delaware often loosened constraints on managers at the expense of shareholders.[9]

Cary's views that state competition is unlikely to serve shareholders' interests have been shared by Lucian Bebchuk, Alma Cohen, and Allen Ferrell.[10]

In contrast, supporters of the state competition, Ralph Winter, Daniel Fischel, and Roberta Romano advanced the argument that such a competition leads to the top, inducing states to offer corporate law rules that benefit shareholders.[11]

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[7] William L. Cary served as chairman of the U.S. Securities and Exchange Commission between 1961 and 1964.

[8] William L. Cary, *Federalism and Corporate Law: Reflections upon Delaware*, 83 Yale L.J. 663, 664-84 (1974).

[9] *Id*. at 669.

[10] *See generally* Lucian Arye Bebchuk, *Federalism and the Corporation: The Desirable Limits on State Competition in Corporate Law*, 105 Harv. L. Rev. 1435 (1992); Lucian Arye Bebchuk & Allen Ferrell, *A New Approach to Takeover Law and Regulatory Competition*, 87 Va. L. Rev. 111 (2001) (indicating that none of the fifty states provide shareholders with the optimum regime governing takeovers and suggesting an alternative approach that would facilitate shareholder choice in takeover regulations); Lucian Arye Bebchuk & Assaf Hamdani, *Optimal Defaults for Corporate Law Evolution*, 96 Nw. U. L. Rev. 489 (2002) (advocating for the default regimes in takeover law that would be more restricting in respect to managers); Lucian Arye Bebchuk & Allen Ferrell, *Federalism and Corporate Law: The Race to Protect Managers from Takeovers*, 99 Colum. L. Rev. 1168 (1999) (arguing that after the Supreme Courts' decision in Edgar v. MITE Corp. put the constitutionality of the antitakeover statutes in question, states simply went to the drawing board to draft the antitakeover statutes that would be permissible under the decision's rationale); Lucian Bebchuk & Alma Cohen, *Firms' Decisions Where to Incorporate*, 46 J.L. & Econ. 383 (2003) (finding that states that have adopted antitakeover statutes are more successful in attracting incorporations).

[11] Daniel R. Fischel, *The "Race to the Bottom" Revisited: Reflections on Recent Developments in Delaware's Corporation Law*. 76 Nw. U. L. Rev. 913 (1982) (criticizing the race to the bottom theory and maintaining that "it is based on a fundamental misunderstanding of the corporate form of firm organization"); Ralph K. Winter, *The "Race for the Top" Revisited: A Comment on Eisenberg*, 89 Colum. L. Rev. 1526 (1989) (arguing that "the race to the top may be slow because Delaware is the only state devoted exclusively to maximizing franchise taxes"); Roberta Romano, *Competition for Corporate Charters and the Lesson of Takeover Statutes*, 61 Fordham L. Rev. 843

According to Bebchuk, Delaware, the leading state in the competition for corporate charters, considers when crafting its corporate law rules the consequences that such rules have on the number of incorporations, rather than evaluating the effects of the aforementioned rules on shareholder value.[12]

The findings presented by Bebchuk and Cohen show that states that have enacted all or most of the standard antitakeover statutes have been more successful in attracting incorporations, whereas states that do not offer antitakeover protection perform especially poorly.[13]

Although arguing that state competition generally produces effective corporate law rules, the adherents of the race for the top theory admit that the effect state antitakeover regulation on shareholder value maximization reveals that state competition is not perfect.[14]

Focusing on attracting initial incorporations and retaining the companies incorporated in-state, states specifically design the corporate law rules to increase the numbers of in-state incorporations. Bebchuk believes that states would prefer to enact rules that would be attractive to those who make the reincorporation decision, rather than rules attractive to people who make the initial incorporation decision.[15]

Since states wish to increase the number of incorporations and directors of the corporations are frequently the driving force when it comes to the matter of

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(1993) (maintaining that "[w]hile state competition is an imperfect public policy instrument, on balance it benefits investors").

[12] Bebchuk, *supra* note 2, at 1452.

[13] Bebchuk & Cohen, *supra* note 10, at 421.

[14] Roberta Romano, *A Guide to Takeovers: Theory, Evidence, and Regulation*, 9 Yale J. on Reg. 119 (1992). (reviewing various explanations of takeovers and finding agency cost reduction and synergy gains most prevailing drivers of takeovers).

[15] Bebchuk, *supra* note 2, at 1481.

reincorporating, the states try to consider directors' preferences when drafting the corporate law rules.[16]

In order for a company to migrate to another state, the reincorporation proposal must be brought to a shareholder vote by managers. It means that managers have a veto power to initiate reincorporation process in Delaware corporations. As long as the managers of Delaware corporations find Delaware law attractive, they will not initiate the reincorporation process, and therefore, the argument runs, Delaware will retain at least the same number of companies incorporated in-state, thus remaining the leader in the market for corporate charters.[17]

Furthermore, addressing the issue of reincorporation, Bebchuk argues that although the company's decision to reincorporate generally requires the approval by the company's shareholders,[18] the requirement of shareholder approval is frequently ineffective.[19]

This is because shareholders may have imperfect information about the consequences of the proposed migration at the time of the vote.[20] An educated vote requires that shareholders acquire the information about the reincorporation, analyze the effects of such a migration, and consider various issues involving the company's business operation. That is why shareholders may rationally choose to

[16] *Id*. at 1459.
[17] *Id*. at 1460.
[18] *Id*. at 1458. (citing Robert C. Clark, Corporate Law, §10.2.4, at 416-17).
[19] *Id*. at 1460.
[20] *Id*. at 1471.

be ignorant of the operational details and, instead, rely on the managerial decision to move the company to another state.[21]

In addition, managers may tie the reincorporation proposal to some other actions that shareholders are willing to take, thus voting for both these actions and the move altogether.[22]

It is worthwhile to note that both the race for the top and the race for the bottom theories agree on the issue that states favor corporate rules preferred by managers who make incorporation decisions. However, in the words of Bebchuk, the race for the top theory supporters claim that managers, influenced by market discipline, would generally seek rules that maximize shareholder value, whereas the race for the bottom theory provides that managers may seek rules that do not protect shareholders from exploitation by managers.[23]

1.2 Antitakeover legislation

The enactment of antitakeover statutes by states has been performed in several waves. The first antitakeover statutes were passed in the late 1960s along with the enactment of the Williams Act that required bidders to disclose certain information about the offers they made to shareholders and focused on the administrative approval of the proposed bids.[24] Thirty-seven states adopted first-

[21] *Id*. at 1472-75.
[22] *Id*. at 1475.
[23] *Id*. at 1456.
[24] John H. Matheson & Brent A. Olson, *Shareholder Rights and Legislative Wrongs: Toward Balanced Takeover Legislation,* 59 Geo. Wash. L. Rev. 1425, 1439 (1991).

generation antitakeover statutes in thirteen years.[25] After the Supreme Court struck down an Illinois antitakeover statute as an unconstitutional burden on interstate commerce in Edgar v. MITE Corp., these first-generation statutes were held invalid by lower courts or repealed by states because such statutes were unlikely to pass constitutional challenge.[26]

However, failure to enact proper antitakeover statutes did not stop states in drafting new antitakeover statutes that would make corporate takeovers more difficult as states initially intended. States tried to craft their antitakeover statutes in the way so that their constitutionality was unlikely to be challenged.[27]

The second-generation statutes were enacted to replace some antitakeover statutes that had been labeled as an unconstitutional restriction on interstate commerce in Edgar v. MITE Corp.[28] Second-generation antitakeover statutes were adopted by thirty-seven states within only eight years as compared to the first-generation statutes which were adopted by the same number of states within thirteen years.[29] More rapid speed of adoption of the next generation of antitakeover statutes evidences states' eagerness to craft the rules that would make takeovers more difficult. It is worth mentioning that the leading state in the corporate market, the state of Delaware, refrained from adopting the second-generation statutes until after other such statutes were upheld by the Supreme

[25] William J. Carney, *The Production of Corporate Law*, 71 S. Cal. L. Rev. 715, 735 (1998).
[26] *Id*.
[27] Lucian Arye Bebchuk & Allen Ferrell, *Federalism and Corporate Law: The Race to Protect Managers from Takeovers*, 99 Colum. L. Rev. 1168, 1181 (1999).
[28] Matheson & Olson, *supra* note 24, at 1439, citing Edgar v. MITE Corp., 457 U.S. 624 (1982).
[29] Bebchuk & Ferrell, *supra* note 27, at 1178.

Court in CTS Corp. v. Dynamics Corp. of America[30] even though other states adopted these statutes.[31] Third-generation statutes are statutes enacted after CTS Corp. v. Dynamics Corp. of America.[32]

1.2.1 Business combination statutes

A popular type of antitakeover statute is the business combination statute. This kind of statute prevents an acquirer from engaging in numerous business combinations with a target corporation for a certain period of time after an acquisition unless such transactions are approved by the target's board in advance.[33] Most commonly, business combination statutes prohibit any merger or consolidation of the corporation with the interested stockholder; any sale, lease,

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[30] CTS Corp. v. Dynamics Corp. of America, 481 U.S. 69, (1987). The CTS Court ruled that the Indiana control share acquisition statute did not discriminate against interstate commerce as it treated acquirers from Indiana and acquirers from other states equally. It was recognized that corporations were created by state law. Therefore, the state legislature had the power to introduce laws to regulate their activities.

[31] Michal Barzuza, *Price Considerations in the Market for Corporate Law*, 26 Cardozo L. Rev. 127, 190 (2004) (citing Roberta Romano, *The Need for Competition in International Securities Regulation*, 2 Theoretical Inquiries L. 387, 493-544 (2001) at 531).

[32] It is worth mentioning that there has been a controversy in dividing the antitakeover statutes into different generations. Some commentators have divided such statutes into two generations, while others have divided them into three or four generations. *See, e.g.,* William J. Carney, *The Production of Corporate Law*, 71 S. Cal. L. Rev. 715 (1998) and Lucian Arye Bebchuk, *Federalism and Corporate Law: The Race to Protect Managers from Takeovers*, 99 Colum. L. Rev. 1168, 1178-1183 (1999) (dividing antitakeover statutes in two generations), John H. Matheson & Brent A. Olson, *Shareholder Rights and Legislative Wrongs: Toward Balanced Takeover Legislation*, 59 Geo. Wash. L. Rev. 1425, 1438-1448 (1991) (dividing antitakeover statutes in three generations), Ronn S. Davids, *Constituency Statutes: An Appropriate Vehicle for Addressing Transition Costs?*, 28 Colum. J.L. & Soc. Probs. 145, 145-146 (1995) (dividing antitakeover statutes in four generations, singling out constituency statutes as the fourth-generation statutes). Controversially dividing antitakeover statues into different generation-based classifications results in misunderstandings and therefore should be eliminated. Classification of antitakeover statutes into two generations, based on the constitutionality of these statutes, seems to be the most effective approach. In this case, the first generation of antitakeover statutes would be the disclosure statutes that have been constitutionally challenged, representing a turning point in the states' intention to restrict hostile takeovers. All other antitakeover statutes should be referred to as the second generation statutes.

[33] Matheson & Olson, *supra* note 24, at 1440.

exchange, mortgage, or any other disposition of the assets of the corporation; any transaction which results in the issuance or transfer of the stock of the corporation to the interested stockholder, and the receipt of any financial benefits by the interested stockholder. The interested stockholder is generally defined as the owner of fifteen to twenty or more percent of the outstanding voting stock of the corporation.[34] Business combination statutes prohibit the aforementioned transactions unless the board of directors gives prior approval.

Statutes such as these make corporate takeovers more difficult because they provide boards with the ultimate right to determine whether to approve a transaction or not.[35] It means that managers might use such a right to only approve the transactions that they desire.

From another perspective, acquirers typically seek immediate control over the assets of the target corporation yet are prohibited from engaging in a wide range of business transactions, representing a serious obstacle to making a tender offer.[36] Quite a long freeze-out period, typically three or five years, makes corporate takeovers less attractive, thus discouraging potential acquirers from initiating an acquisition.

For example, Delaware prohibits business combinations between the corporation and the interested stockholder for a period of three years, whereas New York established a five-year freeze-out period.[37] However, the New York statute considers a stockholder interested if the latter owns twenty or more percent

[34] Del.Code Ann. tit. 8, § 203(a)(3) (2008), N.Y. Bus. Corp. Law §912 (McKinney 2008).
[35] John H. Matheson, *Corporate Governance at the Millennium: The Decline of the Poison Pill Antitakeover Defense*, 22 Hamline L. Rev. 703, 712 (1999).
[36] Julian Velasco, *Taking Shareholder Rights Seriously,* 41 U.C. Davis L. Rev. 605, 618 (2007).
[37] Del.Code Ann. tit. 8, § 203(a)(3) (2008), N.Y. Bus. Corp. Law §912 (McKinney 2008).

of the outstanding voting stock of the corporation, whereas Wisconsin and Delaware established ten[38] and fifteen percent[39] thresholds respectively for a stockholder to be considered interested.

Some statutes provide more flexibility in overriding a freeze out period. For example, New York and Pennsylvania statutes both provide that the interested stockholder can override the freeze in case the business combination is approved by shareholders at a meeting called for such purpose no earlier than five years after a person first becomes an interested shareholder of a corporation.[40]

In Delaware, if the interested stockholder owns at least 85% of the voting stock of the corporation at the moment when the transaction is consummated, the provision on the three-year freeze does not apply.[41] In addition to that, an interested stockholder may override the freeze if the business combination is approved by the board of directors and authorized at an annual or special meeting of stockholders by two-thirds of the outstanding voting stock owned by disinterested stockholders at or after the time the transaction is made.[42]

Business combination statutes generally apply to all domestic corporations in the default regime, although there are certain exceptions.[43] Some states provide the corporations with the possibility to opt out of their business combination

[38] Wis. Stat. Ann. § 180.1140 (West 2007).
[39] Del.Code Ann. tit. 8, § 203 (2008).
[40] In the New York corporations, such business combinations should be approved by the affirmative vote of the holders of a majority of the outstanding voting stock not beneficially owned by interested shareholders or any affiliate or associate of such interested shareholders, whereas in the Pennsylvania corporations the business combinations should be approved by the affirmative vote of the holders of shares entitling such holders to cast a majority of the votes that all shareholders would be entitled to cast in an election of directors of the corporation. 15 Pa. Stat. Ann. § 1721 (2007).
[41] Del.Code Ann. tit. 8, § 203 (a)(2) (2008).
[42] *Id*.
[43] Bebchuk & Hamdani, *supra* note 10, at 511.

statutes by expressly electing not to be governed by such statutes.[44] For example, Delaware corporations can opt out by adopting an amendment to the certificate of incorporation or bylaws that must be approved by the affirmative vote of a majority of the shares entitled to vote.[45]

The New York statute requires an amendment to a corporation's by-laws to be approved by the affirmative vote of a majority of votes of the outstanding voting stock of a corporation, excluding the voting stock of interested shareholders as well as their affiliates and associates.[46]

However, some states make opting out more difficult. Maryland, for instance, requires that a bylaw amendment, stating that the business combination statute does not apply to a corporation, be approved by at least eighty percent of the outstanding shares.[47] This restriction, in Bebchuk's view, makes opting out extremely difficult and practically eliminates shareholders' ability to enact amendments without management consent.[48]

1.2.2 Constituency statutes

One of the forms of antitakeover statutes is a constituency statute (also referred to as "directors' duties statutes statute"). This type of statute typically expands a board's discretion and allows them to consider non-shareholder

[44] *Id*. at 511.
[45] Del.Code Ann. tit. 8, § 203 (b)(3) (2008).
[46] N.Y. Bus. Corp. Law §912 (c) (3) (E) (d) (3) (McKinney 2008).
[47] Bebchuk & Hamdani, *supra* note 10, at 512.
[48] *Id*. at 512.

interests when making decision about tender offers.[49] Pennsylvania became the first state to enact a corporate constituency statute.[50] Constituency statutes are based on stakeholder theory and not only allow directors to consider the interests of non-shareholder groups, but also release directors from the sole purpose of maximizing shareholder wealth.[51]

Some directors' duties statutes substantially limit directors' liability and allow them to merely employ a "just say no" defense.[52] Overall, directors' duties statutes provide managers with a broad freedom whether to consider shareholder or nonshareholder interests. In other words, these statutes allow managers to legitimately support either shareholder or nonshareholder interests depending on their preference. This suggests that directors have a wider range of possible decisions to make and are free to make decisions that they might personally prefer, justifying such decision-making by the consideration of the interests of either one group or another.

However, one should note that some of the directors' duties statutes explicitly specify that they apply to tender offers, while others do not provide any particular contexts where they might apply. For example, Iowa's statute explicitly provides that directors may consider the shareholder interests or the interests of the corporation's employees, suppliers, creditors, and customers, when considering a tender offer or proposal of acquisition, merger, consolidation, or

[49] Matheson & Olson, *supra* note 24, at 1449.
[50] Davids, *supra* note 32, at 149.
[51] *Id*. at 147.
[52] Matheson & Olson, *supra* note 24, at 1450.

similar proposal.[53] Unlike Iowa's statute, Massachusetts's statute allows directors to consider constituency interests regardless of whether it is related to a tender offer or not.[54]

According to Davids, twenty-eight states enacted constituency statutes during the decade following Pennsylvania's enactment of a corporate constituency statute.[55] However, one must note that while the majority of states permits management to consider non-shareholder interests, Connecticut mandates the board to consider expanded interests.[56] In addition, in some states permitting the consideration of expanded interests, corporations may opt in for coverage under the local constituency statute, whereas in other states the application of constituency statutes is automatic.[57]

Addressing the issue of judicial interpretation of constituency statutes, Davids mentions that because there was a decline in hostile takeovers beginning in 1988 and because most constituency statutes were passed in the late 1980s, there are not many cases that shed light upon the judicial interpretation of constituency statutes.[58]

1.2.3 Fair price statutes

States have designed fair price statutes to deal with coercive two tier tender offers. In a typical two-tier offer, the bidder, either friendly or hostile,

[53] Iowa Code Ann. § 490.1108A (West 2008).
[54] Mass. Gen. Laws Ann. ch.156B § 65 (West 2008).
[55] Davids, *supra* note 32, at 156.
[56] *Id*. at 158.
[57] *Id*. at 159.
[58] *Id*. at 162.

offers to acquire the stock of the target company in a two-step transaction. In the first stage an acquirer offers a higher price for the shares, and once the bidder obtains control, he buys the remaining shares at a lower price.[59]

Coercive two-tier offers are thought to force shareholders to tender their shares in the first tier for the fear that if they do not tender and the acquirer is nevertheless successful in the bid, they will be offered a much lower price for the shares in the second tier.[60]

Fair price statutes are designed to protect nontendering shareholders in the first stage of two-tiered offers from losing their investment.[61] After successful acquisition of a controlling interest in the target, a suitor may attempt to squeeze nontendering shareholders out by forcing them to accept a lower price than initially offered in the first stage of the tender offer.[62] Fair price statutes provide nontendering shareholders with the option of selling their shares at a fair price, that is, a price that should not be lower than that offered by the suitor in the first stage.[63]

Bidders are typically required to offer a fair price to all target shareholders unless otherwise specified by the law. For example, Georgia's statute provides that a non-fair price offer should be recommended by at least two-thirds of the continuing directors and approved by a majority of the noninterested

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[59] Yair Listokin, *What Do Corporate Default Rules and Menus Do? An Empirical Examination* (Yale Law School Working Paper, May 2005), 20, available online <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=924578>
[60] *Id*.
[61] Matheson & Olson, *supra* note 24, at 1445.
[62] *Id*.
[63] *Id*.

shareholders.[64] Maryland's statute establishes greater requirements and provides that a non fair price offer should be recommended by the board of directors and approved by eighty percent of the votes entitled to be cast by outstanding shares of voting stock of the corporation and two-thirds of the shares not held by the bidder.[65]

Fair price statutes typically require the bidder to pay the highest price possible calculated according to the methods specified in the statutes. For example, the code of Virginia specifies one of the methods used to determine the highest price paid to shareholders as the higher of the fair market value per share of such class or series on the announcement date or on the determination date, multiplied by the ratio of (i) the highest per share price paid by the interested shareholder for any shares acquired by it within the two-year period immediately preceding the determination date to (ii) the fair market value per share on the first day in a two-year period on which the interested shareholder acquired such shares.[66]

According to Yair Listokin, out of twenty-seven states that enacted fair price statutes between 1983 and 1991, three states made the application of the fair price statutes mandatory and twenty-three states made them applicable by default, allowing corporations to opt out of the statutes.[67]

[64] Ga. Code Ann., § 14-2-1111 (2007).
[65] Md. Code Ann., [Corps. & Ass'ns] § 3-602 (b) (2007).
[66] Va. Code Ann. § 13.1-725 A 2 (a) (3) (2007).
[67] Listokin, *supra* note *59*, at 20.

1.2.4 Control share acquisition statutes

Another form of antitakeover statute is a control share acquisition statute. This type of statute provides the shareholders with the right to determine whether the acquirer of the stock garners voting rights. Such statutes require a person acquiring more than a certain percent (typically between 20% and 50%) of the stock of the target corporation to obtain approval of the corporation's disinterested shareholders of such acquisition, allowing the bidder to exercise the voting rights of its control stake.[68] For example, Indiana's law establishes that the acquirer of twenty percent or more of a target's shares is unable to vote unless the acquirer is granted the voting rights by a majority of shareholders.[69] In a shareholder vote on the voting power of the control shares, however, the shares of the acquiring person, either shares owned before the acquisition or after, are not permitted to vote.[70]

In case the majority of shareholders do not grant the voting rights to the acquirer, the target corporation may redeem its shares at fair market price.[71] In case the vote was successful for the acquirer, dissenting shareholders may choose to be cashed out at the highest price per share paid by the acquirer in its control share acquisition.[72]

Restrictions imposed by control share acquisition statutes represent a significant limitation on the possibilities to do corporate takeovers. Because

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[68] Marshall L. Small, *Corporate Control Transactions*, SD39 ALI-ABA 313, 316 (1998).
[69] Matheson & Olson, *supra* note 24, at 1442.
[70] Some states restrict the voting rights of an acquiring person unless otherwise decided by a resolution of shareholders of the issuing public corporation at a special or annual meeting of shareholders. *See, e.g.* Ariz. Rev. Stat. Ann. § 10-2725 (West 2007).
[71] Small, *supra* note 68, at 316.
[72] *Id*. at 316.

acquirers have to meet the requirement to garner voting rights and, therefore, are faced with an additional difficulty while performing an acquisition, control share acquisition statutes, in some cases, discourage potential acquirers from acquiring stocks in other corporations. In the words of John Matheson and Brent Olson, such statutes thwart hostile takeovers because the bidders are less likely to obtain the shareholder approval.[73]

1.2.5 Disclosure statutes

A disclosure statute is a type of statute that requires an offeror to file certain disclosure materials in addition to the information that is required under the Williams Act.[74] Disclosure statutes are primarily designed to provide shareholders with sufficient information about the tender offer in order to allow them to make informed decisions. Championed by Minnesota, several states enacted second generation disclosure statutes.[75]

Missouri's takeover bid disclosure statute requires that an offeror must file a registration statement with the commissioner of securities and deliver such a statement to the target company. Notwithstanding other information to be disclosed under the Missouri's disclosure statute, the statement should include information, including any plans to liquidate the target company, any major change related to the company, the potential impact on the residents of the state,

[73] Matheson & Olson, *supra* note 24, at 1443.
[74] 15 U.S.C.A. § 78l (2004).
[75] Haw. Rev. Stat § 417E-2 (2007), Tenn. Code Ann. §48-103-101 to 113 (2007), Minn. Stat. Ann. § 80B.01 to 13 (West 2008), Mo. Ann. Stat. § 409.506 to 566 (West 2007).

and the investment rating in case debt securities or preferred stock are used as a source of funds in making the takeover bid.[76]

Disclosure statutes also establish civil and criminal penalties for any violation of such statutes. For example, according to Oklahoma Take-Over Disclosure Act of 1985 any person who violates any provision of this act shall be guilty of a felony and may be fined and/or imprisoned not more than five years.

1.2.6 Shareholder rights plan

The shareholder rights plan statute enables corporations to adopt a poison pill to thwart hostile takeovers. The poison pill is an antitakeover device that is used once any significant transfers or concentrations of controlling stock or voting power occur.[77] This device provides shareholders of the corporation with the opportunity to buy common, preferred stock, or both in the acquiring company or surviving corporation at a discount, to exchange stock of the target with a package of securities of the target, to convert a special preferred stock of the target to a fair price set by the plan, or to acquire special voting powers.[78]

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[76] Mo. Ann. Stat. § 409.516 (West 2007).

[77] P. John Kozyris, *Corporate Takeovers at the Jurisdictional Crossroads: Preserving State Authority over Internal Affairs While Protecting the Transferability of Interstate Stock through Federal Law*, 36 UCLALR 1109, 1156 (1989).

[78] The poison pill plans entitling shareholders to buy stock in the acquiring company at lower prices are called flip-over provisions. For example, the rights holders can purchase $300 worth common stock of the acquiring company for $150. Flip-in provisions enable common stockholders of the issuer to purchase stock in the issuer at a discount following certain triggering events, generally self-dealing transactions involving the issuer. The right to tender common stock to the target for a package of securities is granted by the back-end provisions of the shareholder rights plan. Voting provisions of the shareholder rights plan stipulate two versions, where in one version common stockholders are issued preferred stock, granting them certain supervoting privileges under certain circumstances; and in another version they are issued securities with voting rights that increase with the length of time the securities are held. *See* Suzanne S. Dawson, Robert J. Pence, David S. Stone, *Poison Pill Defensive Measures*, 42 BUSLAW 423, 427 (1987).

Being a very strong antitakeover defense, the poison pill is relatively easy to adopt. In most cases the adoption of this antitakeover defense is performed by a resolution of the board of directors and does not require the approval of the issuer's stockholders, unless additional common or preferred stock must be authorized in order to implement the plan.[79]

Poison pills are generally exercisable upon the occurrence of events such as a merger, the announcement or commencement of a tender offer for a specified percentage of the issuer's capital stock, or other business combinations.[80] In this case the triggering threshold is crossed and the poison pill is triggered. However, until the moment the poison pill is triggered, the target's board is authorized to redeem the rights under the shareholder plans.[81] Because the rights are redeemable prior to a triggering event, in some circumstances bidders prefer to negotiate a friendly transaction.

When a friendly transaction is not possible, hostile bidders have the option of launching a proxy fight in order to replace the target's board of directors with a new management team.[82] The poison pill may be redeemed by the decision of the new board of directors and the takeover will proceed. However, the launch of the proxy contest is impeded by the adoption of the staggered board provisions

[79] *Id*. at 431.
[80] *Id*. at 423.
[81] *Id*. at 424.
[82] Julian Velasco, *The Enduring Illegitimacy of the Poison Pill***,** 27 J. Corp. L. 381, 383-384 (2002).

establishing different terms for directors, therefore imposing a serious delay on efforts to take control of the target's board.[83]

Another option to proceed with the takeover regardless of the poison pill execution is to bring an action against the target's board of directors claiming the board is breaching its fiduciary duties by refusing to redeem the poison pill rights.[84] If the court finds that the breach of fiduciary duties has taken place, it may order the target company to redeem the aforementioned rights and allow the takeover to continue.[85]

One should note, however, that directors are protected by the business judgment rule when employing antitakeover defenses in response to a hostile takeover, and, in addition, sometimes actions or inactions of directors to adopt antitakeover defenses are not considered a breach of fiduciary duties.[86] Bidders, wishing to claim a breach of fiduciary duties, will have to prove, *inter alia*, that directors did not use due care, were not disinterested in such actions, and lacked good faith.[87]

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[83] The percentage of IPO firms with staggered boards rose from 34% in early 1990s to 82% in 1999. *See* John C. Coates IV, *Explaining Variation in Takeover Defenses: Blame the Lawyers*, 89 Cal. L. Rev. 1301, 1376 (2001).

[84] Velasco, *supra* note 82, at 383.

[85] *Id*. at 383.

[86] Sarah S. Nickerson, *The Sale of Conrail: Pennsylvania's Anti-Takeover Statutes Versus Shareholder Interests*, 72 Tul. L. Rev. 1369, 1384 (1998) (citing Steven M.H. Wallman, Draftsmen's Comments to 15 Pa. Cons. Stat. Ann. § § 1711-1718, in 2 Pennsylvania Associations Code and Related Materials 178-90 (William E. Zeiter ed., 1991)).

[87] *Id*. at 1383. The fiduciary obligation of corporate directors include the duty of care, requiring them to act with a degree of reasonable care, and the duty of loyalty, requiring them to place the corporation's interests before self-interest. The board's actions may be challenged by a plaintiff, if the latter demonstrates that directors acted with gross negligence. Gross negligence may be claimed, for example, when the board acted in bad faith or engaged in self-dealing, or there is no rational basis for the directors' actions. In Unocal Corp. v. Mesa Petroleum Co. the Delaware Supreme Court adopted a standard of reviewing the board's actions in defeating an unsolicited takeover. Having undertaken any measures against possible or real takeover, the board has to demonstrate that there were "reasonable grounds for believing that a danger to corporate policy and effectiveness existed" and that the defensive measure adopted was "reasonable in relation to

1.2.7 Antigreenmail statutes

The repurchase of the company's own stock at a premium price from a shareholder holding a significant percentage of the company's outstanding shares represents a greenmail.[88] It occurs when a shareholder acquires a significant amount of a company's stock and then offers the issuer the opportunity to buy back the shares at a higher price or otherwise a takeover bid would be initiated. In this case, managers either give way to a takeover or buy back the shares at a substantial premium.[89]

Some statutes enacted antigreenmail statutes that generally prohibit the target company from repurchasing its own stock at price higher than the fair market value. For example, Minnesota's statute provides that a publicly held corporation shall not purchase any shares entitled to vote for more than the market value in the case where shares are owned by a shareholder for less than two years.[90] The statute, however, provides the corporation's shareholders with the right to approve the purchase by a majority of the voting power of all shares entitled to vote.[91]

Another statute designed to address the greenmail is a disgorgement statute, requiring shareholders to disgorge any profits made on the sale of stock of

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the threat posed." The authors state that the Unocal court pointed out that the first criterion would be met if the board demonstrates that it acted in good faith and conducted reasonable investigation. *See* Dennis J. Block, Jonathan M. Hoff, H. Esther Cochran, *Defensive Measures in Anticipation of and in Response to Unsolicited Takeover Proposals*, 1053 PLI/Corp 787, 791-793 (1998) (citing Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, (1985)).

[88] Eric Engle, *Green With Envy? Greenmail Is Good! Rational Economic Responses to Greenmail in a Competitive Market for Capital and Managers*, 5 DePaul Bus. & Com. L.J. 427, 427 (2007).

[89] *Id*.

[90] Minn. Stat. Ann. § 302A.553 Subd. 3. (West 2008).

[91] *Id*.

a target corporation in some circumstances. Thus, Pennsylvania's statute states that any profit made by a controlling person or group with respect to the issuer shall belong and be recoverable by the issuer, in case the profit occurs within 18 months after the person or group obtained the status of a controlling person or group during the period commencing 24 months prior to, and ending 18 months after, the date the person or group obtained the aforementioned status.[92]

Commentators supporting antigreenmail measures claim that disgorgement statutes are more effective in deterring the greenmail than previous antigreenmail statutes,[93] whereas opponents of this approach argue that disgorgement statutes are overprotective and deter even *bona fide* bidders from making offers.[94]

Claiming that greenmail payments decrease shareholder value, some commentators state that a good method to address this problem would be a federal ban.[95]

Conclusion

The above section has reviewed the evolution and growth of antitakeover legislation with a specific focus on the major types of antitakeover statutes. The investigation has revealed that antitakeover legislation was developed gradually, initially seeking to impose additional disclosure requirements on prospective

[92] 15 Pa. Stat. Ann. § 2575 (2007).
[93] Mark E. Crain, *Disgorgement of Greenmail Profits: Examining a New Weapon in State Anti-Takeover Arsenals*, 28 Hous. L. Rev. 867, 883 (1991) (citing Wallman & Gordon, *Pennsylvania's Anti-Raider Legislation*, INSIGHTS (P-H), Aug. 1990, at 40-41).
[94] William C. Tyson, *The Proper Relationship between Federal and State Law in the Regulation of Tender Offers*, 66 Notre Dame L. Rev. 241, 347 (1990).
[95] Note: *Greenmail: Targeted Stock Repurchases and the Management-Entrenchment Hypothesis*, 98 Harv. L. Rev. 1045, 1065 (1985).

bidders. However, as managers discovered that antitakeover statutes could provide them with increased immunity from takeover bids they did not favor, the popularity of these statutes grew. Consequently, states began to work harder to satisfy managers' demands and win their support in order to attract incorporations. The final result is a cleverly crafted body of antitakeover legislation that allows corporate directors to thwart off nearly any takeover bid made to shareholders.

Most of the antitakeover statutes seem to excessively restrict takeover activity and, therefore, should be repealed. However, there are several types of antitakeover statutes that are beneficial rather than detrimental. Fair price statutes, though they occasionally discourage bidders from initiating takeovers, serve as an effective tool to protect shareholder investment after a successful change in corporate control. This type of statute diminishes the coercive nature of two-tier tender offers, relieving the pressure on shareholders to tender their shares in the first tier. Another antitakeover statute that deserves a positive evaluation is the antigreenmail statute. It discourages bidders from purchasing the stock of a corporation with the intention of selling it back to the company at a premium. Threatened by a possible takeover bid from a manipulative bidder, target managers are often willing to purchase the corporation's shares back in order to prevent both a hostile takeover and consequential loss of their positions. The ability of management to respond to the greenmail by repurchasing the corporation's stock increases agency costs and ultimately promotes managerial entrenchment.

A discussion of the multitude and complexity of these antitakeover statutes will form the basis of the next chapter.

II. OVERREACHING OF TAKEOVER LEGISLATION

Introduction

The preceding part has reviewed a complex body of antitakeover legislation that provides target management with effective tools to resist takeovers. Aside from providing managers with extensive antitakeover defenses, state legislatures adopted a restrictive regime that by default applied to companies. One section of Part II will inquire as to whether shareholders have the option to opt out of the restrictive regime, should they be so willing. This part of the thesis will proceed by investigating matters concerning the overprotection of management from takeovers, allowing managers to obtain private benefits at the expense of shareholder value without being held accountable for their actions. It will review possible ways to check managerial performance and determine whether takeovers may serve as part of the system of corporate checks and balances. This part will consider two competing theoretical perspectives that view antitakeover statutes either as beneficial to shareholder interests (stockholder interests hypothesis) or as detrimental (management entrenchment hypothesis).

2.1 Excessive regulation of takeovers

The state law has produced an enormous body of antitakeover regulations that excessively restrict takeovers.[96] Although states generally allow companies to opt out from antitakeover provisions, those who maintain that antitakeover legislation unduly restricts takeovers argue that companies should have more freedom in choosing whether or not the antitakeover regulations should apply to them.[97] Bebchuk and Hamdani suggest that an opt in regime, a regime that would not restrict takeovers by default but still make it possible for companies to opt into the restrictive regime by introducing opt-in charter provisions, would be less draconian.[98] In case the restrictive regime that applies to companies by default excessively deters tender offers, one could easily guess that it results in shareholder value decrease.[99] Under the opt-out regime shareholders might not be able to vote for opting out because managers might choose to ignore initiating a charter amendment to opt out of the restrictive regime.[100] The fact that managers prefer a legal regime that enables them to impede takeover bids, in the view of Bebchuk and Ferrel, is not doubtable.[101] A prospect of imminent hostile takeovers keeps managers in the fear of losing their jobs, therefore inducing them to make takeovers as difficult to mount as possible. A regime substantially

[96] Bebchuk & Ferrell, *supra* note 10, at 117.
[97] Bebchuk & Hamdani, *supra* note 10, at 510.
[98] *Id*.
[99] *Id*.
[100] *Id*. at 511.
[101] Bebchuk & Ferrell, *supra* note 10, at 134.

restricting takeovers allows managers to enjoy benefits of control and other private benefits.[102]

Furthermore, numerous defensive tactics give managers the ability to not only defeat tender offers that otherwise would be approved by shareholders, but also to extract side payments from a potential acquirer even when not being opposed to a takeover.[103] The argument suggests that the availability of vast takeover defenses may encourage managers to simply benefit from a possible takeover at the expense of a potential acquirer or shareholders.

States establish different ways of opting out of default rules.[104] Companies may choose to opt out of most default rules through amendments either to the bylaws or the charter.[105] The main and the most significant difference between these two options of opting out is that amendments to the bylaws may be initiated by either shareholders or managers, whereas amendments to the charter can only be initiated by the board.[106] Therefore, in order to opt out of some default rules there should be an agreement between shareholders and managers upon the amendment of the charter, requiring managers to initiate the amendment and shareholders to approve it.[107] Some states, such as Delaware, ban the option to opt out of antitakeover rules through amendments of the bylaws, requiring, instead, to make amendments to the charter.[108] Interestingly, while limiting shareholders' ability to opt out of default antitakeover provisions without

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[102] *Id*.
[103] *Id*.
[104] Bebchuk & Hamdani, *supra* note 10, at 511-512.
[105] Brett H. McDonnellk, *Sticky Defaults and Altering Rules in Corporate Law*, 60 SMU L. Rev. 383, 402 (2007).
[106] *Id*. at 402.
[107] *Id*.
[108] Bebchuk & Ferrell, *supra* note 27, at 1188.

the board's consent, Delaware allows managers to initiate the adoption of charter provisions that limit directors' liability.[109]

However, even though a majority of states followed the route of allowing companies to opt out through amendments to the bylaws, several states impose an additional restriction, requiring the bylaws amendments to be approved by supermajority of shareholders.[110]

Notwithstanding that antitakeover statutes reduce shareholder value, companies rarely opt out of these provisions, a topic which will be more fully discussed in the following section. In Delaware, only 6% of IPO firms are reported to opt out of business combination statute. In other states the opt-out rate is decreased to 2% in respect to antitakeover statutes.[111]

Incumbent managers have been granted vast opportunities to impede takeover bids, and one of the most potent tools in thwarting takeovers off, in the view of Bebchuk and Ferrel, is the poison pill.[112] Following a wave of takeovers in the 1980s, the poison pill was designed to help managers resist hostile takeovers.[113] Over 50% of all large-cap companies in the United States adopted poison pill plans by 1990.[114] Shareholders, however, when purchasing stock in the 1980s, could not have predicted that a new defense would become so

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[109] *Id*.
[110] Bebchuk & Hamdani, *supra* note 10, at 512.
[111] Guhan Subramanian, *The Influence of Antitakeover Statutes on Incorporation Choice: Evidence on the «Race» Debate and Antitakeover Overreaching*, 150 U. Pa. L. Rev. 1795, 1831 (2002) (citing Robert Daines, Michael Klausner, *Do IPO Charters Maximize Firm Value? Antitakeover Protection in IPOs*, 17 J.L. Econ. & Org. 83, 96. (2001)).
[112] Bebchuk & Ferrell, *supra* note 10, at 119.
[113] Bebchuk & Hamdani, *supra* note 10, at 513.
[114] Bebchuk & Ferrell, *supra* note 10, at 123.

widespread and potent.[115] Providing management with the unilateral power to adopt the poison pill plans, states have given managers the tools to perform a significant change in the fundamental structure of the corporation without the shareholder approval.[116]

Taking into consideration the uncertainty of the effects of the poison pill on shareholder value, public officials should have provided companies with an opportunity to choose an option most suitable for them, i.e. they should have offered an opt-in regime under which shareholders were to sanction the use of the poison pills by approving a relevant charter provision.[117] Being a significant impediment to a takeover, poison pills definitely suit managers' interests.[118]

Therefore, even if poison pills have a negative effect on shareholder value, managers may still be willing to maintain the default provisions and avoid initiating amendments to it.[119] Under the opt-out regime shareholders cannot vote against the use of the poison pill, even though they might disapprove it.[120]

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[115] *Id*.
[116] *Id*. The poison pill turned out to be a very potent defensive measure, allowing managers to resist takeovers. A possible way to combat this antitakeover defense was to commence a proxy fight and replace the target board with board members who would presumably redeem the poison pill. However, potential targets utilized supplementary measures to oppose this takeover tactic. These measures included staggered boards and dead hand provisions. The latter ensures that only the original directors who were in place when the poison pill was adopted have the power to dismantle the pill. This defense mechanism was designed to discourage acquirers from mounting a proxy fight with the purpose of redeeming the poison pill. Although dead hand provisions are controversial and have been challenged in some jurisdictions, they are still legal in states such as Pennsylvania and Georgia. Dennis J. Block, *Public Company M&A: Directors' Fiduciary Duties and Recent Developments in Corporate Control Transactions*, 1717 PLI/CORP 9, 139 (2009). *See also* Quickturn Design Systems v. Shapiro, 721 A.2d 1281 (Del. 1998). (holding that a delayed redemption provision in a poison pill violated Delaware statutory law since it would prevent future directors' ability to discharge their fiduciary duties to protect fully the interests of the acquiring company).
[117] Bebchuk & Hamdani, *supra* note 10, at 513-514.
[118] *Id*. at 514.
[119] *Id*.
[120] *Id*.

However, instead of adopting a regime that would be preferable for shareholders at least in the first time, states generally allowed managers to enact poison pills without shareholder approval.[121] When courts challenged the managers' power to adopt poison pills, legislatures enacted statutes explicitly authorizing the boards to adopt poison pills.[122]

In retrospect, managers had been enjoying the support of the states in respect to antitakeover policy before a massive wave of takeovers in the 1980s.[123] In the late 1970s and early 1980s, when managers started to initiate charter amendments restricting takeovers, it turned out that shareholders were not willing to vote for severe antitakeover provisions, instead voting only for antitakeover arrangements addressing the pressure to tender problem.[124] Not finding support of shareholders, managers worked effectively to get more restrictive antitakeover protections from states.[125]

Because the boards typically have the power to redeem the poison pills, managers have an option to classify the boards to prevent a hostile bidder from gaining control over the target and redeeming the poison pill.[126] In case the target's board is classified, a bidder needs to win two separate elections for the board.[127] In addition to increasing the costs of takeover, antitakeover provisions require bidders to put a significant amount of time and effort in order to perform a takeover.

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[121] *Id*.
[122] *Id*.
[123] Bebchuk & Ferrell, *supra* note 27, at 1187.
[124] *Id*.
[125] *Id*.
[126] Bebchuk & Hamdani, *supra* note 10, at 515.
[127] *Id*. at 516.

If antitakeover provisions were adopted partially and were applied separately, they would not serve as a serious impediment to takeovers. However, because states typically adopt several kinds of antitakeover statutes under the default regime, such statutes unnecessarily deter potential bidders and excessively protect managers.

2.2 Unjustified managerial entrenchment

2.2.1 Overprotection of management

Evidence from studies has shown that target companies as a group tend to underperform the market.[128] In addition, it has been revealed that companies that become targets are generally poorly managed.[129] In a regulated market, where takeovers are difficult to perform, management would have little incentives to improve.[130]

The efficient-market hypothesis suggests that the threat of hostile takeovers stimulates managers to perform better, inducing them to seek an increase in share price, because the higher the share prices are, the less incentive hostile bidders have to mount takeovers.[131]

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[128] J. Robert Brown, Jr., *In Defense of Management Buyouts*, 65 Tul. L. Rev. 57, 86 (1990) (referring to Smiley, *Tender Offers, Transaction Costs and the Firm*, 58 REV. ECON. & STATISTICS 22, 24 (1976)).
[129] *Id*.
[130] *Id*.
[131] *Id*.

Takeovers are believed to discipline management and encourage them to serve the best interests of the corporation.[132] According to Gilson "The tender offer is the critical mechanism through which the corporate structure imposes constraints on certain forms of managerial self-dealing."[133]

In the absence of personal financial incentives, corporate managers may become disengaged and avoid putting their maximum effort into managing the affairs of the corporation.[134] Managers, unable to enjoy all of the benefits of their performance, may find it appealing to consume perquisites without taking justified steps towards the maximization of the firm value.[135] The lag in managerial performance may result from a great number of actions and inactions that may not be obvious to shareholders.[136] For example, managers may hire under-qualified personnel, put little effort into contracting companies that offer better deals, fail to determine the best strategy for the company and so on.

Shareholders of the corporation may be the disciplining and monitoring force, however, because monitoring managerial performance can be a difficult and arduous procedure, many shareholders choose to be passive investors seeking liquid holdings.[137] Firstly, a shareholder must have an incentive to learn the details of management and investigate the current state of the corporation's affairs.[138] Secondly, if the existence of excessive agency costs is discovered, a

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[132] Frank H. Easterbrook & Daniel R. Fischel, *The Proper Role of a Target's Management in Responding to a Tender Offer*, 94 Harv. L. Rev. 1161, 1170 (1981).
[133] Ronald J. Gilson, *A Structural Approach to Corporations: The Case against Defensive Tactics in Tender Offers*, 33 Stan. L. Rev. 819, 845 (1981).
[134] Easterbrook & Fischel, *supra* note 132, at 1170.
[135] *Id*.
[136] *Id*.
[137] *Id*. at 1171.
[138] *Id*.

shareholder has to persuade other shareholders to replace managers.[139] Understanding that the game is not worth the candle, shareholders prefer to sell their shares if they are dissatisfied by the manner in which the corporation is being managed.[140]

The cost of a shareholder check on managerial performance is increased with every antitakeover charter amendment.[141] Management entrenchment hypothesis holds that because the monitoring costs are high, shareholders have little incentive to monitor management efficiency, thus giving managers a broad freedom in managing corporations and insulating them from the shareholder check.[142] As a result, shareholder value is reduced because overprotected managers may run companies inefficiently without being held accountable for their actions. Adoption of antitakeover defenses causes a decrease of the stock price of corporations and insulates managers from the threat of being replaced.[143] The current market price of a stock is a product of all available information about the company, including the information on the likelihood of a tender offer.[144] If

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[139] *Id*.
[140] *Id*.
[141] J. Kenneth Moritz, *Toward Standards for Managers Subject to Hostile Bids: The Tri-Level Model*, 50 U. Pitt. L. Rev. 269, 278 (1988).
[142] *Id*. The managerial entrenchment hypothesis states that antitakeover provisions result in present value loss for the firm because they entrench inefficient managers, allowing them to shirk their responsibilities to shareholders without the threat of being displaced. Supporters of this hypothesis maintain that antitakeover statutes unreasonably protect firms with weak governance from a transfer of control, although it is highly desirable for the increase of shareholder value and efficient allocation of resources in the economy. It is believed that threat of hostile takeovers is the most effective method of stimulating improvement in managerial performance. Barry D. Baysinger, Henry N. Butler, *Antitakeover Amendments, Managerial Entrenchment, and the Contractual Theory of the Corporation*, 71 Va. L. Rev. 1257, 1258 (1985).
[143] Moritz, *supra* note 141, at 279.
[144] *Id*.

the likelihood that the target's shareholders will receive a tender offer at a high premium is minimal, then the stock price typically goes down.[145]

Therefore, some scholars assert that any defensive measure against hostile takeovers available for managers results in managerial job security and reduced shareholder value.[146]

2.2.2 System of checks and balances

Some commentators note that corporate raiders perform a monitoring function and are part of the system of corporate checks and balances between shareholders and management.[147] According to Moritz, the decisions of the management teams are checked in the following ways: "1) through delegation of power from shareholders, 2) through management's fiduciary duty to shareholders, 3) through judicial enforcement of duties owed to shareholders, and 4) by raiders."[148]

The corporate structure presupposes that shareholders of the corporations delegate to managers the power to make decisions on a day-to-day basis.[149] Shareholders perform the check on the management's decisions through the shareholder vote.[150] Shareholders vote on the most important corporate matters,

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[145] *Id*.
[146] *Id*. at 278.
[147] Moritz, *supra* note 141, at 272. *See also* Gilson, *supra* note 133, at 850 (analyzing responsibility between management and shareholders in tender offers). According to Gilson, "[m]anagement's interest in remaining in office creates a conflict which the traditional standards of care and loyalty are incapable of policing. In this setting, the tender offer provides a self-executing check on management's discharge of its responsibility as holder of primary control over the acquisition process."
[148] Moritz, *supra* note 141, at 272.
[149] *Id*.
[150] *Id*.

such as the approval of a merger, as well as approval of the management team.[151] With their ability to oust the incumbent managers, shareholders can perform a check of managerial decisions. The shareholder check disciplines managers by posing the threat of an ouster in the elections for directors.[152] Although disciplining managers to some extent, this form of check turns out to be ineffective when the number of shareholders increases. In a publicly held corporation where a lot of shareholders own small stakes, shareholders are not typically willing to delve into the intricacies of the matters being voted on and consequently may fail to make informed decisions because they believe that their vote is insignificant to the final outcome.[153] Since shareholders of widely held corporations tend to follow managerial recommendations when voting on a particular issue, one may easily guess that managers of such corporations are able to control the shareholder vote.[154]

Another check on management decisions is the fiduciary duties that managers owe to shareholders.[155] Because managers have fiduciary obligations in making decisions on behalf of the corporation, they face a constant threat of direct or derivative actions against them for breach of the fiduciary duties.[156] As noted, this disciplining factor serves as a check on managerial performance.[157]

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[151] *Id*. at 273.
[152] *Id*. at 272.
[153] *Id*. at 273.
[154] *Id*.
[155] *Id*.
[156] *Id*. at 274.
[157] *Id*.

Shareholders have an option of resorting to the judicial system to maintain the shareholder check on management performance.[158] By all odds, judicial enforcement serves as a good means for shareholders to ensure that the managers they hired work for their best interest.[159] However, as any other method, the judicial system is a part of the system of check and balances and has its limitations.[160] Bringing forth a lawsuit requires a significant commitment from shareholders.[161] They have to spend time and effort identifying inefficient managers, and incur significant expenses.[162] Furthermore, shareholders may be discouraged from initiating any legal actions because they risk losing cases against these inefficient managers, resulting in no eventual gain. Besides, managers might underperform their functions without showing any breach of fiduciary duties.[163] Moreover, managerial decisions are protected by the business judgment rule. The judicial review of managerial decisions under the business judgment rule is quite often limited to ensuring that the decisions were made in good faith and managers were not engaged in self-dealing.[164] There is no reason

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[158] *Id*.
[159] *Id*.
[160] *Id*.
[161] *Id*. at 275.
[162] *Id*.
[163] *Id*.
[164] Easterbrook & Fischel, *supra* note 132, at 1195. There is a view that business judgment rule should not be applied by courts in a certain class of hostile takeover cases. In particular, business judgment rule should not protect managers in cases in which shareholders seek injunctive relief. This suggestion is based on the arguments that takeover decisions differ from ordinary business decisions that managers make on a daily basis and should therefore be reviewed under a different standard. It is proposed that: "If the shareholder seeks an injunction ... courts should repudiate the business judgment rule and focus on four considerations to decide whether the defensive measure would increase shareholder wealth: (1) performance of the target corporation; (2) bid premium; (3) structure of the bid; and (4) structure of the defensive tactic." Following the first criteria, courts should evaluate earnings and stock prices of the target under current management and determine whether the target underperformed the market. Assessment of the bid premium will help courts understand whether the management reasonably applied antitakeover defenses in order to increase shareholder wealth. Courts should further learn whether the bid was made for only a certain

to assume that courts would scrutinize every business decision without possessing sufficient knowledge and experience in business matters.[165] Furthermore, courts cannot serve the function of policing managerial conduct better than the market forces.[166] In addition, if courts were to scrutinize, the number of suits aiming at reviewing managers' conduct would increase dramatically, in turn causing an increase in costs.[167]

It follows that shareholders resort to the judicial system when they are willing to expend substantial efforts in monitoring and bringing lawsuits as well as when there is a greater chance of success in litigation.[168]

Noting that all three aforementioned methods of monitoring incumbent managers are effective to a limited extent, Moritz suggests that corporate raiders might complement the shareholder check.[169] Raiders have substantial incentives to monitor the performance of corporations in order to find companies that are inefficiently run, but show potential for profitability under improved management.[170] Shareholders benefit in two ways by allowing raiders to monitor the corporate market and make hostile bids for underperforming companies. First, shareholders might sell their shares at a premium. Second, the threat of a hostile

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number percentage of shares or for all shares. Two-tiered tender offers can be coercive because they put shareholders in a prisoner's dilemma and therefore justify a wider range of defensive tactics than offers for all shares. Finally, it is asserted that courts should analyze whether the antitakeover defenses adopted by the management are reasonable when compared to the threat posed by the hostile tender offer. Thomas C. Pelto, Sr., *False Halo: The Business Judgment Rule in Corporate Control Contests*, 66 Tex. L. Rev. 843, 844-869 (1988).

[165] *Id*. at 1196.

[166] *Id*.

[167] *Id*.

[168] Moritz, *supra* note 141, at 275.

[169] *Id*.

[170] *Id.* at 276.

takeover would force management teams to perform better and in turn, maximize profit .[171]

The market for corporate control provides options for disciplining incumbent managers. The threat of a change in corporate control disciplines managers and erects obstacles to actions that would decrease shareholder value.[172] There are two possible means of changing corporate control: proxy fights and tender offers.[173]

Proxy fights as a means of corporate control change were widely used until the 1960s.[174] However, because of high agency costs and the risk of a financial loss on an unsuccessful proxy fight, this form of corporate control contest gave way to tender offers that have been thought as a more efficient way to remove an undesirable management team.[175]

When major shareholders are managers of the corporation, they have strong incentives to maximize the firm value as they are the ultimate recipients of the corporation's profit.[176] It follows that the smaller the percentage of the shares owned by managers, the more incentives managers might have to consume excessive perquisites.[177]

Since various American states enacted measures that make hostile takeovers practically impossible, proxy fights remained an alternative means of

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[171] *Id*.
[172] Stephen Mahle, *Proxy Contests, Agency Costs, and Third Generation State Antitakeover Statutes*, 15 J. Corp. L. 721, 732-734 (1990).
[173] *Id*. at 734.
[174] *Id*.
[175] *Id*. at 734-736.
[176] *Id*. at 737.
[177] *Id*.

challenging corporate control.[178] Proxy fights are usually initiated by proxy contest dissidents who own smaller equity stakes than those investors making tender offers. It is argued that proxy fights tend to produce a lower firm value following the change in corporate control as opposed to a corporate control change as a result of a tender offer.[179] Moreover, the high risk involved in a proxy fight greatly diminishes the likelihood of it being initiated.[180]

It has been suggested that proxy fights are undertaken by those who do not have sufficient financial capability to make a tender offer.[181] The evidence shows that pending tender offers tend to be more successful than proxy fights when put to a shareholder vote because shareholders foresee greater profits resulting from a takeover than from a proxy fight.[182]

According to Easterbrook and Fishel, stock markets, unless very inefficient, make it impossible for a bidder to acquire a target company for less than its fair market value as established by stock markets.[183] Hence shareholders will not lose their investment in any case if they are given a possibility to tender their shares to a bidder. Tender offers are usually made at a premium, thus benefiting target shareholders.

In the view of Easterbrook and Fishel, the source of this stock premium is the difference between the current value of the underperforming target and the

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[178] *Id*. at 738.
[179] *Id*.
[180] *Id*.
[181] Paul H. Edelman & Randall S. Thomas, *Corporate Voting and the Takeover Debate*, 58 Vand. L. Rev. 453, 475 (2005).
[182] *Id*. at 476 (citing Randall S. Thomas & Catherine T. Dixon, *Aranow & Einhorn on Proxy Contests for Corporate Control* 1-7 (3d ed. 1999). At 1-9).
[183] Easterbrook & Fischel, *supra* note 132, at 1168.

potential value that can be achieved under different circumstances.[184] Potential bidders analyze market circumstances in seeking potential targets in addition to monitoring the performance of potential targets' management teams.[185] When target management underperforms the market, the target value is reduced. In this case, bidders may maximize the efficiency of the target by replacing the inefficient management, selling unproductive units and reducing agency costs.[186]

When a takeover occurs, Easterbrook and Fishel argue, not only do target shareholders benefit because they sell their shares at a premium, but nontendering shareholders benefit as well through the increased price of the shares.[187]

2.2.3 Bidder Overpayment

Some commentators suggest that tender offers, while benefiting target shareholders, might be cost inefficient for bidders as a result of overpayment.[188] Although positive gains will still be produced for the target's shareholders, acquisitions typically result in negative returns for the bidders.[189]

Bidding companies might not show positive returns because they tend to overpay while initiating a takeover.[190] In cases when overpayment occurs, takeovers seem to show decreased efficiencies.[191] Regarding the overpayment phenomenon, some scholars cite economic changes taking place after a takeover

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[184] *Id*. at 1173.
[185] *Id*.
[186] *Id*.
[187] *Id*. at 1174.
[188] Brown, *supra* note 128, at 96.
[189] *Id*.
[190] *Id*. at 98.
[191] *Id*.

has been completed to explain the overpayment.[192] They maintain that at the time the takeover is planned, bidders reasonably anticipate positive returns.[193] However, because of the economic changes, the takeover does not produce the expected increase in efficiencies.[194]

One should note, however, that unfavorable market conditions or dramatic economic changes should not serve as key arguments in depicting a takeover as an action that decreases a bidders' shareholder value. Such economic factors affect every company regardless of whether a takeover has occurred or not.

2.2.4 Stockholder interests hypothesis

Some scholars view antitakeover statutes as beneficial in terms of increasing shareholder value because these statutes tend to reduce the coercive effects of hostile takeovers.[195] Scholars mention the effects of two-stage tender offers as an example of these coercive effects.[196] In the first instance, the bidder offers to purchase shares at a premium higher than the current market price.[197] The bidder's purchase of a controlling stake in the target company is followed by the forced sale of the remaining shareholders' shares at a lower price.[198] Thus, proponents of the stockholder interests hypothesis hold that two-stage tender offers either cause a decrease of shareholder value or force non-tendering

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[192] *Id*. at 99.
[193] *Id*.
[194] *Id*.
[195] P.R. Chandy, Charles M. Foster, Jr., Michael K. Braswell, Stephen L. Poe, *The Shareholder Wealth Effects of the Pennsylvania Fourth Generation Antitakeover Law*, 32 Am. Bus. L.J. 399, 420 (1995).
[196] *Id*.
[197] *Id*.
[198] *Id*.

shareholders to sell their shares when the offer is first proposed due to the fear of losing their initial investment.[199]

However, one should note that in order to reduce the negative effects of the two-stage tender offers, the enactment of only one type of antitakeover statute may be necessary. A fair price statute, requiring the bidder to pay the fair price for the shares in the second stage of the tender offer, is sufficient to secure shareholders' investments and prevent coercive pressure on shareholders to sell their shares at the initial bid price. Therefore, the enactment of all other types of antitakeover statutes cannot be justified by negative effects of two-stage tender offers.[200]

The stockholder interests hypothesis is further supported by the assertion that antitakeover defenses operate in the interests of shareholders, delaying the takeover process and allowing management to mount various defensive tactics.[201] As a result, bidders are forced to negotiate with management instead of shareholders, resulting in a higher price paid by the bidder.[202]

However, the question of whether the requirement to negotiate with the target management instead of target shareholders is more efficient remains unclear. According to Easterbrook and Fishel, the target's managers may have a

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[199] *Id*.

[200] The adoption of only fair price statutes is also justified by its less detrimental effect on takeovers. Romano refers to the research conducted by Hackl and Testani indicating that: "[they] find a steeper decline in successful takeovers in control share acquisition statute states than in other states, including those with fair price regulation. Stock price studies also find more significant negative abnormal returns on the enactment of business combination freeze, control share acquisition and disgorgement statutes than fair price and other provisions." Romano, *supra* note 14, at 170.

[201] Chandy *et al, supra note* 195, at 421.

[202] *Id*.

personal interest in resisting a hostile takeover because once the target company has been taken over, they could lose their jobs.[203] Once they have acquired all of the information about the tender offer and the bidder during the course of negotiations, target's managers may withhold some of this information from shareholders, depriving them of the chance to evaluate the tender offer and choose the best option. Furthermore, managers may misuse their power by influencing the attitude of shareholders towards the tender offer.

Supporters of the stockholder interests hypothesis also claim that antitakeover constraints enhance competitive bidding and develop auctions, increasing the price paid by the bidder for the target company's shares.

2.2.5 Auctions in takeovers

Analyzing possible drivers for auctions, it is maintained that there are no criteria that differentiate managers' legitimate efforts to increase the price paid for the shares by setting up an auction from merely resisting a takeover to protect their personal interests.[204]

Easterbrook and Fishel consider two different rules for managerial conduct when a tender offer is made. The first rule suggests that managers do not mount any defenses against the prospective takeover. In this case, the arguments runs, there will be no competing bidders and the takeover would be performed at the lowest premium that induces the shareholders to sell their shares.[205]

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[203] Easterbrook & Fischel, *supra* note 132, at 1175.
[204] *Id*.
[205] *Id*. at 1177.

Under the second rule, managers, resisting a takeover by all possible means, would create an auction. Any resistance to a tender offer prevents a takeover from proceeding, causing a delay that can be used by another bidder to find out more about the tender offer and enter the fray.[206] Target management might disclose additional information about the company to encourage other potential offers that may result in bids at a higher premium.[207] One should bear in mind that as the cost of the takeovers increases, fewer tender offers are made because the increased winning price discourages potential acquirers from placing a bid.[208] Therefore, target management might mount takeover defenses and initiate an auction because they fear for their jobs when the takeover is completed.[209]

Auctions, in the view of Easterbrook and Fishel, invariably cause an increase in the premiums paid to the shareholders. The authors suggest that by participating in the auction, bidders are forced to pay as high a price as the stock would be worth under the most efficient management.[210] As mentioned above, the high cost of takeovers causes a decline in bids. This, in turn, loosens constraints on managerial behavior, reducing the disciplinary function of the markets for corporate control.[211]

Some commentators maintain that auctions, as they are typically unable to maximize target revenues both ex ante and ex post, should be generally

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[206] Romano, *supra* note 14, at 156.
[207] Easterbrook & Fischel, *supra* note 132, at 1178.
[208] Romano, *supra* note 14, at 157.
[209] Easterbrook & Fischel, *supra* note 132, at 1171.
[210] *Id*. at 1177.
[211] Romano, *supra* note 14, at 157.

discouraged.[212] However, it is suggested that auctions may be desirable in some circumstances. Depending on the environment of the takeover auction, some authors single out common value and independent value auctions.[213] In a common value takeover auction, there are several bidders that are willing to place a bid because all of them would achieve approximately the same value once the target is taken over.[214] An example of a common value auction could be a tender offer aiming to acquire the undervalued target and extract expected value from the company by replacing the inefficient management and reducing agency cost.[215] However, if bidders value the target firm differently, for example, when synergy gains would be different for all bidders, then it is an independent value auction.[216] Depending on the goals pursued, the auctions may be both desirable and undesirable.[217] With respect to social efficiency, some auctions should be banned.[218] The independent value auction might be appropriate because it helps identify the bidder that is acquiring the company for certain reasons and values the target company higher than others.[219] However, common value auctions are not desirable because they force bidders to make higher bids, decreasing the number of bidders and the likelihood of cost-efficient takeovers.[220]

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[212] *Id*. at 160; Easterbrook & Fischel, *supra* note 132, at 1177-1201.
[213] Romano, *supra* note 14, at 160 (citing Peter Cramton & Alan Schwartz, *Using Auction Theory to Inform Takeover Regulation*, 7 J.L., ECON., & ORG. 27 (1991)).
[214] *Id*. at 160-161.
[215] *Id*.
[216] *Id*.
[217] *Id*. at 161-162.
[218] *Id*. at 162.
[219] *Id*. at 161.
[220] *Id*. at 161-162.

That said, auctions may be appropriate in the case where the goal of the auctions is target revenue maximization.[221] In this case, bidders pay higher prices, thus benefiting target shareholders.[222]

Suppose that an auction is triggered. The greater the variety of antitakeover defenses that the target management can use, the greater the chance that managers will use all available defenses to resist a takeover. If all or almost all available defenses are mounted, the price may increase dramatically and discourage potential bidders from proceeding with the takeover. As Easterbrook and Fischel note: "…[A]ny auctioneer understands that determined efforts to collect the highest possible price may lead to no sale at all in the short run."[223] If a tender offer is defeated, the management preserves their positions and shareholders do not receive any premiums. It follows that a vast variety of antitakeover defenses may cause an unjustified managerial entrenchment instead of increasing shareholder value.

Conclusion

An examination of the regulatory regimes applied to antitakeover legislation has shown that states have established antitakeover regimes favoring the managers' perspective. States have enabled managers to mount numerous antitakeover defenses without the prior consent of shareholders. Moreover, some

[221] *Id*. at 162.
[222] *Id*.
[223] Easterbrook & Fischel, *supra* note 132, at 1175.

states have made the opt-out process from undesirable rules unnecessarily complicated, thereby limiting shareholders' ability to express their disapproval of the established direction. The above analysis suggests that managers have been granted an excessive protection from takeovers. This section has highlighted the importance of takeovers as an alternative mechanism for effective monitoring of managerial performance. It is therefore suggested that by providing target management with extensive means with which to resist takeovers, states have undermined a key check on managerial decisions. Excessive regulation of takeovers protects managers from the threat of being replaced, loosening constraints on their behavior and insulating them from accountability to shareholders.

III. ANTITRUST IMPLICATIONS

Introduction

This part of the thesis focuses on antitrust law, providing an analysis of the goals that antitrust laws aim to achieve and determining whether or not these goals are overlooked by antitakeover legislation. Antitrust law has been designed with two purposes in mind: to restrict agreements that unreasonably restrain interstate trade or commerce and to condemn any conduct that monopolizes commerce.[224] The fundamental pieces of legislation in the antitrust doctrine are

[224] Section 1 of the Sherman Act prohibits anticompetitive conduct: "Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal." 15 U.S.C.A. § 1 (2004).

the Sherman and Clayton Acts.[225] The key matters related to antitrust laws that are essential for this thesis are the goals of antitrust laws and the regulation of mergers and acquisitions by antitrust laws.

This thesis advances a theory that antitakeover statutes are antithetical to the purposes of antitrust laws. In support, this section reviews the goals of antitrust laws as well as the benefits of mergers and acquisitions. In order to achieve consensus between the existence of antitakeover statutes and antitrust laws, it is essential to consider the purposes of antitrust policy. This part of the thesis will investigate the objectives of antitrust laws most often cited as the most important goals of antitrust policy. Although the main focus is on the major goals, minor goals of antitrust laws will also be analyzed in light of their relevance to antitakeover laws. A central feature of the U.S. corporate and antitrust environment is the presence of efficient and reasonable rules governing corporate relations. Therefore, it is imperative to also survey the benefits of mergers and acquisitions.

Section 2 prohibits monopolization and attempts to monopolize: "Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign nations, shall be deemed guilty of a felony, and, on conviction thereof, shall be punished …." 15 U.S.C.A. § 2 (2004).

[225] Section 7 of the Clayton Act prohibits mergers and acquisitions "where in any line of commerce or in any activity affecting commerce in any section of the country, the effect of such acquisition, of such stocks or assets, or of the use of such stock by the voting or granting of proxies or otherwise, may be substantially to lessen competition, or to tend to create a monopoly." 15 U.S.C.A. § 18 (1996).

3.1 Major goals of antitrust laws

3.1.1 Competition

Historically, the purpose of American antitrust law has been to promote competitive conduct by prohibiting unreasonable restraints on competition, and to increase consumer welfare by protecting against price discrimination and monopolistic behavior.[226] Antitrust policy aims to prevent monopolies and encourage competition between producers for the benefit of consumers. Firms, having to compete with each other for customers, must offer a wide selection of goods and services, high quality products and excellent service at competitive prices.[227]

Where competition is lacking, firms establish higher prices for their products, and have few incentives to improve the quality of their goods or services, innovate, or provide better customer care. When challenged, competing firms seek new methods of production, explore innovative technologies, and invest in research and development. Firms, facing the constant threat of competitors encroaching on their market, tend to perform more efficiently, improve management, upgrade equipment, enhance effectiveness of distribution chains, and employ other innovative ways of achieving operational efficiency.

Besides providing optimal prices for consumers and the aforementioned efficiency gains, free competition is associated with certain political benefits. In a

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[226] Burton D. Garland, Jr., Reuven R. Levary, *The Role of American Antitrust Laws in Today's Competitive Global Marketplace*, 6 U. Miami Bus. L.J. 43, 43 (1997).

[227] Thomas J. Schoenbaum, *The International Trade Laws and the New Protectionism: The Need for a Synthesis with Antitrust*, 19 N.C. J. Int'l L. & Com. Reg. 393, 396 (1994) (referring to the example of the classic statement of the United States Supreme Court in Northern Pac. Ry. Co. v. United States, 356 U.S. 1, 4 (1958)).

competitive market system, distribution of income takes place without government intervention.[228] Rivalry between competitors leads to "creative destruction", where the most innovative and efficient firms succeed, forcing their lagging competitors to exit the market. Supply and demand regulates the distribution of income impersonally without requiring the government to exercise its power.[229] A competitive market system promotes freedom of independent entrepreneurship and innovation while decreasing the need for government interference in private matters.[230] Therefore, competition provides a self-regulating mechanism that can respond promptly to economic and societal needs without government involvement.

3.1.2 Efficiency goals

Some commentators support the view that the main objective of Congress in enacting the antitrust laws was the increase of economic efficiency.[231] Others, however, argue that Congress was also interested in pursuing goals such as the prevention of industrial concentration, the promotion of small business, and

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[228] Sam D, Johnson, A. Michael Ferrill, *Defining Competition: Economic Analysis and Antitrust Decisionmaking*, 36 Baylor L. Rev. 583, 588 (1984).

[229] *Id*. at 589. Jonathan B. Baker recently observed that an antitrust regulatory regime provides three options that may be adopted in the political system: market power, price controls and competition. Under the first regime, the government would not prohibit cartels but instead would protect producers from competition and new entries. As we can see, this regime favors producers. Unlike the market power regime, the price control regime establishes low prices for consumers and helps transfer surplus from producers to consumers. Both regimes harm either producers or consumers and, depending on who has the power to lobby a certain regime, antitrust law would adopt either a pro-producer or a pro-consumer policy. An alternative regime that would suit the needs and purposes of both interest groups would be a competition regime protected by antitrust enforcement. Competition policy allows both interest groups to obtain efficiency gains that would otherwise be unavailable. Jonathan B. Baker, *Competition Policy As a Political Bargain*, 73 Antitrust L.J. 483, 486 (2006).

[230] Johnson, *supra* note 228, at 589.

[231] Robert H. Lande, *Wealth Transfers as the Original and Primary Concern of Antitrust: The Efficiency Interpretation Challenged*, 34 Hastings L.J. 65, 68 (1982).

curbing the political power of large corporations.[232] An alternative view on Congress' ultimate goals, expressed by Robert Lande, suggests that when enacting antitrust laws, the main congressional concern was the unfair distribution of consumers' wealth among firms with market power.[233] Congress' motivation included the promotion of competition and providing consumers with the opportunity to buy products priced at competitive levels.[234] The creation of monopolies would deprive consumers of the benefits provided by free competition. Since monopoly pricing results in a transfer of wealth from consumers to the monopolist, Congress expressed a desire to condemn firms with market power and prevent them from obtaining monopoly profits.[235]

Monopoly pricing results in maximizing monopoly firms' profit, depriving consumers of much of the extra value they would otherwise obtain under free competition.[236] Consumers, having to pay more for products in a monopolistic market, either buy the product at high prices, or refuse to purchase it altogether. Both of these scenarios reduce consumer welfare. Reduced demand, however, does not necessarily force monopolists to reduce the prices.[237] On the one hand, a monopolist intentionally reducing the output for a product results in a price increase as scarcity dictates that consumers will be willing to pay more for the fewer products available. On the other hand, reduced consumer demand resulting from higher prices may still be profitable for monopolists. Consider the situation

[232] *Id*. at 69.
[233] *Id*. at 70.
[234] *Id*.
[235] *Id*. at 72.
[236] Richard A. Posner, *Natural Monopoly and Its Regulation*, 21 Stan. L. Rev. 548, 550 (1969).
[237] *Id*. at 551.

where a monopolist charged $3 for one item and sold 100 items per month. Once the monopolist raises the price up to $5 per item, the demand will fall because a certain group of consumers would not be able or willing to pay a higher price. Let us say that the demand would fall to 60 items per month. Charging a price of $3 per item, monopolist obtained revenue of $300 per month ($3 x 100 = $300), and once the volume of sales fell to 60 items, resulting from the price increase up to $5, the monopolist would be obtaining the same revenue of $300 ($5 x 60 = $300). This hypothetical example shows that under some circumstances, monopolists will not have incentives to reduce prices as a result of decreasing demand for their products.

A monopolistic market redistributes income in an inefficient manner, enriching monopolists while extracting wealth from consumers.[238]

Monopolistic practices are widely known to produce undesirable consequences, such as lower output, stifled innovation, and reduced service.[239]

When a monopolist reduces output, the resources used to produce the product are diminishing, resulting either in a transfer of these resources to industries that need them less, or in a serious drop in resource sales.[240] Production of goods at suboptimal levels, rent-seeking, as well as inappropriate use of

[238] *Id*. at 550.
[239] Alon Y. Kapen, *Duty to Cooperate under Section 2 of the Sherman Act: Aspen Skiing's Slippery Slope*, 72 Cornell L. Rev. 1047, 1048 (1987).
[240] Lande, *supra* note 231, at 72.

economic power all cause a misallocation of resources.[241] Misallocation of resources[242], in turn, reduces society's total wealth.[243]

Let us look at the example of a bakery that, enjoying monopoly power, raises the prices for its products and reduces the output. For the production of bakery products, the bakery needs flour, yeast, eggs, and other commodities, as well as the proper equipment. As a result of reducing output, suppliers of such commodities will have less demand for their products. Producers of flour, for example, will be forced to use wheat for production of wheat grits in excess, instead of flour. While the market will offer a plentiful supply of wheat grits that is less valuable to consumers, the supply of bakery products will still be insufficient. Less demand for products in numerous spheres of economy results in fewer purchases at the grocery stores, clothing stores, real estate agencies, and the like.

A situation where the market is producing less of one product and more of another than would have been consumed by society without the distorting effects of artificially high prices is termed allocative inefficiency.[244] This concept refers to economic efficiency that also includes such criteria as productive efficiency[245]

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[241] Richard S. Markovits, *Second-Best Theory and the Standard Analysis of Monopoly Rent Seeking: A Generalizable Critique, a "Sociological" Account, and Some Illustrative Stories*, 78 Iowa L. Rev. 327, 336 (1993).

[242] Misallocation of resources is a situation where more output could be obtained from the resources provided that these resources were used in a different, more efficient, manner. Monopolies are believed to misallocate resources. In a case where a competitive firm and a monopolistic firm receive normal profits, the latter always causes misallocation of resources because it produces less than the efficient level of output. Arleen J. Hoag, John H. Hoag, Introductory economics 184 (3rd ed., 1996).

[243] Lande, *supra* note 231, at 72.

[244] David F. Shores, *Antitrust Decisions and Legislative Intent*, 66 Mo. L. Rev. 725, 760 (2001).

[245] The situation where firms' resources are used in the most efficient manner is referred to as "productive efficiency". Lande, *supra* note 231, at 78. According to Richard Lipsey and Colin Harbury, firms are efficient in terms of productive efficiency if they are operating so that costs are

and Pareto optimality. These are the criteria sometimes used in formulating antitrust goals.[246] A widely known goal of antitrust is to enhance allocative efficiency, impairing productive efficiency as little as possible.[247] Another view maintains that antitrust policy is supposed to increase social welfare, while keeping the sum of losses caused by allocative and productive inefficiency at the lowest levels possible.[248]

One of the well-known antitrust jurisprudents, Judge Bork, argues that the goal of the antitrust laws is to promote economic efficiency.[249] The argument that antitrust policy's goal is to maximize consumer welfare through the efficient allocation of resources is also supported by Professors Areeda and Turner.[250] An interesting consideration regarding the maximization of consumer welfare is that all people, regardless of their status and wealth, are consumers at one time or another.[251] It follows that antitrust policy seeks to maximize the wealth of every single individual.[252] However, all people have different preferences, therefore,

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minimized. Productive efficiency increases under conditions of perfect competition, however, one should note that a monopolist could achieve a great productive efficiency due to the large scale of production. Richard G. Lipsey & Colin Harbury, First Principles of Economics 168 (Oxford: Oxford University Press 1992).

[246] Monopoly causes allocative inefficiency in the following ways: by underproducing monopolist's product, forcing other firms to use resources in an inefficient manner (because monopolists reduce output, the sales of resources used in production of monopolists' products fall, resulting in price reduction. Other firms, using underpriced resources, have less incentives to adopt allocatively-cheap production processes to save resources), deterring others from performing research into more efficient production processes, or by inducing others to make allocatively-inefficient QV investments. Markovits, *supra* note 241, at 338.

[247] Herbert Hovenkamp, *Antitrust's Protected Classes*, 88 Mich. L. Rev. 1, 12 (1989).

[248] *Id*. at 13.

[249] Herbert Hovenkamp, *Distributive Justice and the Antitrust Laws*, 51 Geo. Wash. L. Rev. 1, 1 (1982) (citing R. Bork, The Antitrust Paradox: A Policy at War with Itself, 90-91 (1978)).

[250] *Id*. at 4, citing P. Areeda and D. Turner, Antitrust Law p. 103 (1978).

[251] *Id*. at 5.

[252] *Id*.

satisfying everyone's needs without making anyone worse off is a daunting task, and some would even argue, impossible.[253]

The concept of Pareto optimality refers to the situation where resources are allocated efficiently with respect to production and consumers' wants and needs.[254] A particular distribution of resources is Pareto optimal when no further improvements can be made where at least one person is better off without making anyone else worse off.[255] Members of society would not voluntarily participate in transactions that make them worse off, instead choosing to abandon the transaction altogether.[256] Therefore, voluntary transactions, being mutually beneficial, would constitute Pareto optimality.[257] In a Pareto optimal exchange there are only winners and no losers. However, in the reality of a vibrant and diverse society, the theory is not supported fully in practice.

Consider the following illustration where a person trades computers at a very attractive price. Several other consumers have purchased computers at a specified price and are satisfied with the transaction. The chance that other consumers would not be as pleased with the purchase as the new owners of the computers always exists. Some people might deem this purchase to be unfair because they recently purchased the same product at a higher price; or, for instance, people might think that the purchasers do not deserve to possess these products because they need them less.

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[253] *Id*. at 5-6.
[254] *Id*. at 8.
[255] *Id*.
[256] *Id*.
[257] *Id*.

Another group of scholars offers a different look into the concept of Pareto superiority. Herbert Hovenkamp maintains that one must consider whether a transaction is Pareto superior, rather than Pareto optimal. Pareto superiority involves giving priority to one situation over another on the basis of which one is more efficient.[258] The notion of Pareto superiority involves ranking activities as either more or less efficient compared to others without having to discard the activity although it is only partly efficient. This approach seems to be more reasonable because the state of Pareto optimality is almost impossible to reach, whereas the concept of Pareto superiority may prove to be an effective instrument in measuring efficiency.

Several theorists note that another useful efficiency-related notion is Kaldor-Hicks efficiency.[259] Kaldor-Hicks efficiency serves the purpose of measuring efficiency more frequently than Pareto optimality, permitting to net-out gains and losses.[260] Under a Kaldor-Hicks notion, a transaction outcome is efficient if those who are made better off could have compensated those who are made worse off all the while maintaining a positive net gain in welfare.[261] In other words, "…[a] proposed action is Kaldor–Hicks efficient if the 'winners' gain enough to be able to compensate the 'losers' and still come out ahead."[262] The compensation does not necessarily have to occur in reality, but should exist

[258] *Id*. at 9.
[259] *Id*. at 10.
[260] *Id*.
[261] William S. Dodge, *An Economic Defense of Concurrent Antitrust Jurisdiction*, 38 Tex. Int'l L.J. 27, 35 (2003).
[262] White, Mark D. *A Kantian Critique of Neoclassical Law and Economics, Review of Political Economy* 240, 18(2), April 2006, 235–252.

hypothetically.[263] Otherwise, if those who are made better off actually compensate those made worse off, the latter would be just as well off as the former and this situation would be considered a Pareto improvement rather than Kaldor–Hicks efficiency.[264]

To illustrate the difference between the aforementioned means of evaluating efficiency, one could consider the following. The condemnation of monopolies by the United States makes consumers better off to the greater extent than it does make monopolists worse off, and is therefore Kaldor-Hicks efficient.[265] However, under Pareto optimality rules, prohibition of monopolies is not efficient because the monopolist is made worse off.[266]

According to Posner's variation of Kaldor-Hicks efficiency, a legal rule that condemns monopolies would be wealth maximizing. This occurs if those who lose from the adoption of a legal rule prohibiting monopolies would be willing and able to pay less for non-adoption of such a rule than those who benefit from this rule (consumers) would be willing and able to pay for its adoption.[267]

3.1.3 Consumer protection

The previously mentioned antitrust goal of promoting free competition seeks to provide consumers with all of the benefits competition offers. Therefore, the notion of consumer protection holds an important place in antitrust

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[263] *Id*.
[264] *Id*.
[265] Dodge, *supra* note 261, at 36-37.
[266] *Id*.
[267] Hovenkamp, *supra* note 249, at 10 (referring to Posner's wealth-maximization proposal, R. Posner, The Economics Of Justice, 88-115 (1981)).

jurisprudence. The debate over the goals of antitrust laws suggests that the fundamental objective is to prevent consumers from paying unfairly high prices to producers.[268] Firms possessing strong market power are able to artificially raise prices and extract wealth from consumers, thereby depriving consumers of welfare while reaping the benefits of monopoly profits.[269] Preventing an unjustified increase in consumer prices forms the basis of the consumer welfare model. The consumer welfare concept is widely regarded by courts and antitrust scholars as a guiding principle of the antitrust laws.[270] The antitrust jurisprudence, however, does not provide a clear and unambiguous definition of consumer welfare.[271] This term has been debated ever since its introduction and still the debate remains of interest. The following definition of "consumer welfare" has given rise to heated discussions and controversial opinions among law and economics scholars: "Consumer welfare is greatest when society's economic resources are allocated so that consumers are able to satisfy their wants

[268] John B. Kirkwood & Robert H. Lande, *The Fundamental Goal of Antitrust: Protecting Consumers, not Increasing Efficiency*, 84 Notre Dame L. Rev. 191, 192 (2008).
[269] Lande, *supra* note 231, at 93.
[270] J. Thomas Rosch, *Monopsony and the Meaning of "Consumer Welfare": A Closer Look at Weyerhaeuser*, 2007 Colum. Bus. L. Rev. 353, 354 (2007).
[271] "The term consumer welfare is the most abused term in the modern antitrust analysis." From the economical point of view, consumer welfare constitutes consumer surplus that accrues to consumers, being a part of the total surplus. *See* Joseph F. Brodley, The Economic Goals of Antitrust: Efficiency, Consumer Welfare, and Technological Progress, 62 N.Y.U. L. Rev. 1020, 1032-1033 (1987). Consumer surplus is the amount that consumers save by purchasing a product for a price that is lower than they would be willing to pay for it. Producer surplus is defined as the amount between the revenues and the production costs. In other words, it is the amount that producers benefit when they sell a product at a price that is higher than they would be willing to sell for. The combination of consumer surplus and producer surplus constitutes the total surplus and provides the degree of social welfare. *See* Katalin Judit Cseres, Competition Law and Consumer Protection (The Hague: Kluwer Law International, 2005) at 18.

as fully as technological constraints permit. Consumer welfare, in this sense, is merely another term for the wealth of the nation."[272]

We see that by consumer welfare, Bork means the welfare of the nation as a whole, in other words, the wealth of all people. It follows that consumer welfare is a broad concept, providing that society's wealth should be maximized as a whole. The same view is shared by the Chicago School that used the term consumer welfare to describe the welfare of all consumers in society.[273]

However, as suggested by some commentators, the word "consumers" may in fact refer to different types of consumers. For example, both a corporation that purchases intermediate products and an ultimate consumer at the end of the distribution chain are deemed consumers.[274] According to Kirkwood and Lande, Bork makes no distinction between end consumers and manufacturers that can also be consumers. Kirkwood and Lande have criticized Judge Bork's broad definition, stating that it displays no concern for real consumers, those who

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[272] Bork, The Antitrust Paradox: A Policy at War with Itself (Basic Books, 1978) p.90.

[273] Rosch, *supra* note 270, at 354-355.

The Chicago School introduced a legal and economic approach to antitrust policy, establishing that the economic efficiency should be the aim for the national legal system. *See* Cseres, *supra* note 271, at 22-30.

"The basic view and the fundamental understanding of the Chicago School can be characterized as follows:

- The market process is seen as the free play of economic moves and responses without public intervention and as the "survival of the fittest" (Stigler – so-called Economic Darwinism. (citation omitted)
- Governmental or public influence has to be repelled and restricted to the setting of a minimum legal framework.
- The self-image of the Chicago School as liberal-conservative is interpreted as a pro big-business and anti-union by its critics."

Ingo Schmidt & Jan B. Rittaler, A Critical Evaluation of the Chicago School of Antitrust Analysis xiii (2nd ed., Springer 1989).

[274] Gregory J. Werden, *Competition, Consumer Welfare, & The Sherman Act*, 9 Sedona Conf. J. 87, 91 (2008).

purchase goods and services.[275] The authors reason that under the Bork concept, consumer welfare is maximized when economic efficiency is improved even if the end consumers are harmed.[276] In their words, the primary beneficiaries under Bork's regime would be monopolists and cartels, or firms possessing market power and extracting consumer welfare through high prices.[277] However, an overall increase in the wealth of a nation means wealth increase for all consumers, including those consumers who actually buy products and services. Additionally, the increase in wealth means there must be no evidence that ultimate consumers would necessarily be worse off. Furthermore, the increased efficiency of firms possessing market power does not mean that consumer prices will rise. Therefore the assertion that ultimate consumers would be worse off while monopolists would be better off under Bork's concept is not exactly relevant.

The economic concepts employed that form the basis of antitrust laws cannot be regarded as purely black and white. Economic efficiency might harm ultimate consumers as dramatically as consumer protection in the long run. Protecting consumers from paying high prices might provide them with immediate benefits while at the same time, making free competition between firms difficult and perhaps impossible. Solely following the antitrust goal of increasing consumer welfare by preventing unfair wealth transfers from consumers to producers may not be the ideal regime in the antitrust jurisprudence. Pursuing only one goal may create leaks in the system of consumer welfare protection. Several major goals should be followed instead.

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[275] Kirkwood & Lande, *supra* note 268, at 199.
[276] *Id*. at 200.
[277] *Id*.

According to Brodley, antitrust policies should focus both on consumer welfare and economic efficiency.[278] There could be, however, certain disadvantages while pursuing both goals. Producers may be motivated to increase output, and therefore increase allocative efficiency, but instead of reducing consumer prices, they may adopt a discriminatory pricing policy that would allow them to capture additional consumer surplus.[279] Producers may lack incentives to lower their prices after they have achieved production efficiencies due to collaboration with competitors, enabling them to keep their prices at the same level or higher.[280] Therefore, achieving production efficiency may still result in profit maximization for producers and reduced consumer welfare.[281]

One should note that consumer welfare is achieved not only through low prices but also by innovations and overall technological progress. Should antitrust policy care only about consumer welfare, meaning low prices, consumers might be deprived of the possibility to enjoy all the benefits provided by technological progress. Producers may well be charging consumers an acceptable price, receiving normal profits without putting any efforts into new developments. Under these circumstances, consumers would value products they have been buying for a long period of time less and product consumption would reduce over the time, causing a decline in economic development. Therefore, antitrust policy allows producers to charge prices that are higher than consumers would originally prefer:

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[278] Brodley, *supra* note 271, at 1041.
[279] *Id*. at 1033.
[280] *Id*. at 1033-1034.
[281] *Id*. at 1034.

> Antitrust law has always permitted to some degree conduct that is not in the immediate interest of consumers in order to sustain innovation and production efficiencies. .... Antitrust law has accepted and accommodated that tension, recognizing from the origin of the Sherman Act that there could be a lawful monopoly – a monopoly obtained by superior skill, foresight, or effort - even though consumers might, for a sustained period, have to pay high prices.[282]

In order to benefit from innovation and production efficiencies over the long run, most consumers would agree to pay more in the short run. Antitrust policy makers should work hard in order to ensure that consumers only suffer from higher prices temporarily and are able to enjoy all the benefits from an inconvenient overcharging in the long run.[283]

Unfair transfers of consumers' surplus to monopolists, making consumers poorer and monopolists richer, constitute a major concern of antitrust. Therefore, many commentators argue that the primary goal of antitrust should be consumer protection rather than economic efficiency as suggested by Judge Bork.[284] Discussing the original goals of Congress when passing the Sherman Act, Robert Lande mentions Congress' condemnation of monopolistic overcharges and unequal distribution of wealth as a consequence of such overcharges.[285] Another argument in favor of the consumer protection notion as the primary goal of

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[282] *Id*. at 1036.

[283] Antitrust laws have to secure that overcharges are justified by gained efficiencies and are accommodated for the sake of production and innovation efficiencies that result in total social wealth increase. In addition, antitrust must verify that activity, directed at total social wealth increase, although impairing the immediate consumer surplus, must be least harmful for consumers among other available alternatives. Finally, the task of antitrust policy is to make certain that activity, causing subordination of immediate consumer interest, is temporary and that it does not suppress interfirm competition permanently. *See Id*. at 1037-39.

[284] *See* generally John B. Kirkwood & Robert H. Lande, *The Fundamental Goal of Antitrust: Protecting Consumers, not Increasing Efficiency*, 84 Notre Dame L. Rev. 191 (2008); Lande, *supra* note 231, at 65.

[285] Lande, *supra* note 231, at 94.

antitrust is that the concept of allocative inefficiency was not familiar to legislators at the time when the Sherman Act was passed. In other words, there is no evidence that this notion influenced the passage of the Sherman Act in any manner.[286]

3.2 Minor goals of antitrust laws

3.2.1 Excessive corporate political influence

Some commentators discuss the problem of excessive corporate political influence resulting from high market concentration or accumulation of wealth.[287] Professor Pitofsky suggests that a single firm possessing market power is likely to have more political influence than a trade association of small firms.[288] Each small firm is governed by a different management team with unique objectives and strategies. These firms are therefore unlikely to have common opinions and a united voice on all problems and issues. Incompatible goals might generate controversies between the firms regarding the direction a trade association should follow, resulting in a decrease of economical strength and political influence.

While there are many possible reasons for pursuing a merger, one should note that a desire to gain greater political influence can serve as a key motivator. Elzinga notes that a conglomerate may increase the legal representation of an

[286] Kirkwood & Lande, *supra* note 268, at 204.
[287] David W. Barnes, *Nonefficiency Goals in the Antitrust Law of Mergers*, 30 Wm. & Mary L. Rev. 787, 813-815 (1989).
[288] *Id*.

acquired firm in Washington, D.C., therefore gaining economic advantage over smaller competitors.[289]

The problem of excessive power certainly exists and deserves the special attention of government enforcement agencies. However, the extent of this power should not be overestimated. Rather, the issue should be examined from the perspective of how aggressively excessive corporate political influence should be prevented. Considering the body of laws that has been enacted to rectify the problems of excessive market power and accumulation of wealth, it appears that legislators in fact adopted legislation that is in many ways redundant and somewhat excessive. The Sherman and Clayton Acts have been adopted to prevent the accumulation of excessive power and corporate influence in the marketplace, but how do antitakeover statutes address the problem of excessive corporate political influence? One can say that antitakeover statutes, by protecting smaller companies from the takeover attempts of more powerful rivals, also protect society by preventing large corporations from accumulating power and lobbying their interests. At first sight, the argument appears to have merit, but is it not the Sherman and Clayton Acts that perform this function? If they do and are still being fully enforced, why consider antitakeover statutes as legislation

[289] *Id*. *See also* Kenneth G. Elzinga, *Free Enterprise vs. The Entrepreneur: Redefining the Entities Subject to the Antitrust Laws*, 125 U. Pa. L. Rev. 1191, 1197-1198 (1977). Elzinga refers to acquisitions of independent firms by conglomerates in order to gain better Washington representation. As an example, Elzinga mentions the acquisition of O.M. Scott grass seed company by ITT. The latter had no business in the grass seed industry before the acquisition, hence the merger did not appear to increase ITT or Scott's market shares or provide apparent economic advantages. However, using ITT's connections, Scott could now find itself capable of reaching the federal government. Such relationships may be used in order to "gain favors regarding taxes, import competition, government contracts, and other amenities which will give it an advantage over its rivals…".

guarding the aforementioned goals? It follows that antitakeover statutes are not necessary in order to prevent the accumulation of corporate political power. Therefore, antitakeover statutes turn out to be irrelevant and perhaps excessive in terms of furthering antitrust goals, as the goal of eliminating excessive corporate political power is already being pursuit by antitrust laws. Preventing the accumulation of this excessive influence remains the task of antitrust policy and should not interfere with the matters of antitakeover statutes.

3.2.2 Excessive governmental regulation of corporations

One of the concerns expressed by some scholars regarding mergers is the excessive government control of corporations.[290] Since large companies typically possess substantial market power and some degree of political influence, many would say that it is in the best interest of society to subject such companies to more extensive governmental oversight. The reasoning behind this assertion centers on the need for a more thorough review of large companies' activities to impede possible abuses of corporate power. In order to supervise corporations' activities, the government needs to establish special governmental bodies, requiring the investment of substantial resources. Governmental supervision does not seem to be optimal for either party, the corporations themselves or the governmental bodies that regulate them. Corporations are forced to file extensive reports to the supervising bodies while the government, and by extension society, incurs the extra cost of hiring and training special personnel to keep the whole system running. The costs of filing various reports to government institutions

[290] Barnes, *supra* note 287, at 816.

appear to be prohibitively high at the moment, and an added obligation to report more activities would only worsen the situation. Consumers will be forced to bear the burden of these elevated filing costs through price increases in the goods and services they purchase from the regulated corporations. In fact, consumers will ultimately pay a double price for the heightened regulation, because in addition to the increased filing costs reflected in product prices, a heavier tax burden will be required to keep governmental institutions functioning. It follows that the development of a system that works with minimal governmental intrusion is preferable by society.

The law and economics literature discussing excessive governmental control provides two suggestions that help avoid the development of extensive supervisory machinery. They include the promotion of competition and the prohibition of mergers.

Competition, according to Professors Blake and Jones, polices the market allowing the government to decrease its direct supervision: "The great virtue of the competitive process is that it makes possible the attainment of a viable economy with a minimum of political interference."[291]

The limitation or prohibition of mergers and the promotion of competition among firms that would otherwise merge prevents overregulation of corporations by the government and partially decreases the need for a large regulatory apparatus.

[291] Harlan M. Blake, William K. Jones, *In Defense of Antitrust*, 65 Colum. L. Rev. 377, 382 (1965).

Although Blake and Jones' argument seems reasonable, additional factors must be considered before it is fully accepted. It may be tempting to simply create legislation to forbid a practice that presents regulatory difficulties, but this may not always be the best option. In an economy that aims to maximize consumer welfare, policy makers would surely prefer to subject mergers to a detailed investigation in order to prevent any price discrimination or abuse of power resulting from substantial market influence. That being said, prohibiting mergers altogether would provide a simpler alternative, releasing government bodies from an extensive and thorough research of each potential merger. However, does the prohibition of mergers serve the best interest of consumers? Is it good for the economy?

Protecting small businesses from acquisition does not always mean lower prices for consumers. On the contrary, small businesses typically cannot achieve economies of scale and economies of scope, therefore, establishing higher prices for the end consumer. Suppose a certain amount of hair salons operate in town X. To provide their services, they purchase professional cosmetics from different suppliers. The cost of the cosmetics constitutes part of the net cost of their services. Suppose that a producer of professional cosmetics is willing to merge or acquire one of the hair salons. Such a transaction would allow both companies to achieve greater efficiency by cutting the net costs. The cosmetics producer would have a guaranteed product market and may in turn cut marketing costs and reduce its sales force, while the hair salon would pay lower prices for the cosmetics. This hypothetical merger would not only benefit the specified firms by cutting the net

costs but would also force other firms to compete more vigorously, provided that the efficiency achieved in the merger is used to lower consumer price.

The example above by no means suggests that small business is unnecessary for the economy, or that small business should not be protected. It should. Still, while protection may be necessary, small businesses should not be thoughtlessly overprotected at the expense of consumers.

Prohibiting mergers and acquisitions would substantially restrict investment freedom. Business leaders are well aware of the phenomenon called "business for sale". This situation is consistent with other sectors of the economy in that demand creates supply and vice versa. Every day investors are seeking to invest in new and promising business opportunities. Large corporations, possessing substantial free cash flows and wishing to expand their service offerings or product line, may seize the opportunity to invest in other companies, including start-ups. On the other side, bright and talented people offer new ideas, new technologies and new business plans. Young companies with modest development funding may possess excellent business skills and establish an effective strategy for a business to grow and succeed. In these circumstances, mergers and acquisitions represent a valuable instrument for both investors and investees. Besides serving as an extremely important mechanism for matching excess funds with promising growth opportunities, mergers stimulate progress and development in relevant sectors of economy.

Mergers and acquisitions create many distinct advantages including, but not limited to: economic efficiencies, better quality of goods, ability to perform

extensive research and development, and better personnel training. Prohibiting mergers simply to eliminate the need for a large regulatory structure implies extensive costs to the market that are clearly not justified by the associated benefits.

3.2.3 Protection of communities

One concern expressed regarding mergers is the protection of local communities that lose a degree of control and independence when a local firm is merged with a larger, external firm. Decentralized decision-making is believed to bring benefits to local communities.[292] As mentioned by David Barnes, decisions made by outside management typically do not favor local interests and may lead to deteriorating effects on local economy.[293]

Mergers and acquisition may harm local communities in several ways. Economies of small towns consist of small enterprises that offer a diverse array of goods and services. Acquisition of these companies may lead to substitution of such goods and services by other products that local customers do not favor. Consequently, companies may lose customers and suffer financial losses. In addition, small companies provide the local community with jobs. Following an acquisition, it is typical for a structural reorganization to take place according to new standards and policies imposed by the acquirer. These may include changes that affect personnel, such as staff reductions or salary decreases. All of these measures have the potential to negatively impact the local economy.

[292] Barnes, *supra* note 287, at 829.
[293] *Id.*

However, one should not underestimate the potential for positive changes as a result of a merger. One of the most appealing advantages concerns the quality and price of products and services. Medium and large companies typically have more efficient production and operation processes than smaller companies do. Thus, consumers gain consumer surplus by paying less for goods and services sold at a lower price by more efficient companies. Besides, stringent competition and a more dynamic environment experienced by enterprises in large cities typically force them to offer customers a vast array of products as well as goods and services of higher quality. Sometimes companies offer extra services in addition to their core products in order to provide customers with a more pleasing purchasing experience.

Small companies would not cease to exist if their goods and services were still valued. Small stores, providing unique services and selling exclusive goods, successfully operate both in small towns and large cities. If there is a demand, the selling proposition will remain in place. Customers do not buy the exact same clothes or accessories because people value diversity and distinction. Therefore, even though some enterprises in small communities are acquired by larger companies that manage their business externally, a certain percentage of customers would still appreciate unique goods or personalized service. It may cost them more compared to the goods and services sold by firms operating nationwide, but these consumers are willing to pay the premium. Personalized products sold by small firms are still in demand in the present economy, where mergers are not forbidden. These companies have established a market niche and

operate in a competitive market regardless of the possibility of a merger. Therefore, there is no reason to adopt legislation that would prohibit mergers altogether.

The manner in which business is conducted in small towns is also of importance to the argument. Small towns are less likely to be influenced by new business practices immediately after they are introduced. Sometimes, managers of small local enterprises prefer to maintain the status quo, disregarding new and more efficient business practices. Mergers, in addition to fostering economic efficiency, help generate new trends of development and modify a company's direction according to new business developments.

Aside from stimulating operational and economic efficiency, mergers may contribute to professional and cultural well-being through enhancing employee education. Acquiring companies often offer training programs for professionals, instructional seminars for office personnel and other educational workshops. Large companies typically can afford to direct some of their funds towards employee training, whereas small companies may be unable to offer similar programs on account of their limited resources.

Corporate charity contributions are another aspect to consider concerning the protection of local communities. Various empirical studies cited by David Barnes suggest that there may be a lower rate of corporate charitable contributions and a decrease in the reinvestment of locally generated profits following a merger.[294] These reduced community contributions are attributed to the shift in

[294] *Id. at* 832.

the locus of control caused by a more centralized management structure.[295] As a general trend, percentage of net pre-tax income or sales directed to charity appears to decline as the firm size grows.[296] Therefore, preventing firms from expanding in size may increase the total amount of funds earmarked for charitable contributions.[297] Professors McElroy and Siegfried's survey revealed that "seventy percent of contributions by large firms are made to the headquarter's city and that executives in the headquarter's city controlled ninety percent of funds expended on contributions."[298] In addition, the average charitable contribution per employee amounted to $214 for the headquarters' cities, while cities where plants were located obtained only $43 per employee.[299]

The fact that the share of contributions in the headquarters' cities is almost 5 times larger than that in smaller locations does not mean that the amount contributed to small towns is not justifiable. Traditionally, the cost of living and the overall prices in large cities are notably higher than those in small towns, requiring more charitable proceeds to fund events and initiatives. To put it simply, catering services in large cities would cost charitable organizations a pretty penny. Besides, small communities can solve or prevent some social problems through a system of continuous monitoring that is performed by society autonomously, while large cities are unable to perform the monitoring function due to their size. For example, unlike large cities, small towns would inhibit less

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[295] *Id.*
[296] *Id.* (citing P. Blumberg, *The Megacorporation in American Society* 58 (1975)).
[297] *Id.* (citing McElroy & Siegfried, *The Effect of Firm Size and Mergers on Corporate Philanthropy, in the Impact of the Modern Corporation*, 99-138 (B. Bock ed. 1984)).
[298] *Id.*
[299] *Id. at* 833.

homeless children that need attention and help. Minor social problems are sooner detected and solved in small towns.

Hypothetically speaking, it cannot be assumed that small business would be able to contribute to local community more than $43 contributed by larger firms, provided these firms were protected from acquisitions through policy.

These concerns surrounding charitable contributions may be taken into account in terms of merger policy. However, the possibility of adverse affects on corporate charitable contributions as a result of a merger should be weighed against the numerous potential benefits. Efficiency gains from a merger would likely have a significant positive impact on the local economy that would prevail over social costs in the long run.

The fear of losing corporate control is reasonable if considered independently. Taking into consideration all of the benefits and gains that mergers may generate, there is no reason to prohibit or significantly restrict mergers. Appropriate compensation for loss of corporate control, however, may be sufficient enough to cancel out the social costs resulting from mergers. Such compensation may include, for example, the increased charity donations or the augmented contributions to fund social advertising.

3.2.4 Entrepreneurial freedom

Commentators cite the protection of small business as one of Congress' many intentions when passing the Sherman Act. As Robert Lande states, the ability of small businesses to operate and compete effectively in the market was of

particular concern to Congress.[300] Notably, the discussion suggests that the issue of small business protection was established as a self-goal and was not based on efficiency considerations.[301] According to Lande, the protection of small businesses was in fact a rather supplemental concern. The major congressional concern was the protection of consumers.[302] Should this goal contradict to the desire to protect small businesses, the former would surely receive preference.[303] The author states:

> It can fairly be said that one of Congress' goals was to assist small businesses; although consumers' interests were meant to be paramount, and conflicts between the welfare of consumers and small businesses were generally to be resolved in favor of consumers, Congress' desire to help small businesses certainly extended to those circumstances in which small businesses would be helped but consumers would not significantly suffer.[304]

The intention of Congress to protect small businesses was not a primary objective. Moreover, it faded into obscurity once it became evident that this goal might negatively impact the welfare of end consumers. Measures intended to protect small businesses can often create a form of overprotection. Therefore, the issue with small businesses should be termed as assistance, not protection. There are many alternative ways the government can encourage and support small enterprises without enlisting the provisions of merger law.

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[300] Lande, *supra* note 231, at 102.
[301] *Id.* at 104.
[302] *Id.* at 103.
[303] *Id.* at 103.
[304] *Id.* at 105.

In Lande's view, one of Congress' original purposes when passing the antitrust laws was to stimulate efficient behavior in firms.[305] It is difficult to disagree that a healthy business environment is the right option for a market-based economy. Businesspeople must have incentives to compete and improve the efficiency of their operation. In order to create a healthy competitive market, one of the government's tasks is to ensure that business is conducted on fair terms. Efficient behavior is rarely possible when there are weak links in the system, allowing businesses to employ dishonest practices. Apart from the goals being discussed herein, antitrust law also strives to eliminate predatory practices and business dishonesty, essentially forcing players into a co-operative Nash equilibrium.

Considering the implications of this goal on merger law, one should note that the desire to create a healthy business environment does not imply that mergers should be forbidden or severely restricted. Congress' aim was to condemn trusts that possessed enough market power to raise prices artificially, thus harming end consumers and preventing the formation of a competitive market.[306] Congress was concerned with unfair transfers of wealth from consumers to trusts, rather than with the issue of keeping the business small.[307] The unreasonable prevention of the firm growth is unlikely to have been the goal established by Congress. After all, one can imagine a hypothetical situation where a lack of mergers might seriously harm consumers. An example is when

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[305] *Id.*
[306] Robert H. Lande, *Wealth Transfers as the Original and Primary Concern of Antitrust: The Efficiency Interpretation Challenged*, 50 Hastings L.J. 871, 888 (1999).
[307] *Id.*

mergers do not occur because of prohibitive laws, leaving mostly small businesses in place with the net effect of decreased efficiency and elevated prices. In this hypothetical situation, prohibiting or limiting mergers would have adversely affected the whole economy, as firms would not put resources to their most efficient uses. The situation illustrates the value of mergers in today's economy.

Judicial decisions and commentary refer to entrepreneurial freedom as the reason for small business protection.[308] Firstly, small businesses should be protected in order to give individuals the freedom to be self-employed as big business raises barriers for entry; and secondly, small businesses should be preserved because through their unique offerings, they are often better able to satisfy consumer demands.[309] The opportunity to be self-employed, according to some interpretations of Jeffersonian economic and political ideology, constitutes a guarantee of economic and political freedom.[310] Entrepreneurial freedom is undoubtedly important for a free market economy. However, Jeffersonian-type goals diminished in importance due to the theory's inability to guarantee competitive prices for consumers, causing it to be eventually supplanted by efficiency goals.[311] One should keep in mind that a main goal of U.S. antitrust

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[308] Barnes, *supra* note 287, at 841.
[309] *Id.*
[310] *Id.* at 842, (1989). (citing Mueller, *Small Business and Big Monopoly: The Galbraithian 'Socialist Imperative*,' 10 Antitrust L. & Econ. Rev., No. 1, at 17, 23 (1978)).
[311] Debra A. Valentine, The Goals of Competition Law, prepared remarks for the Pacific Economic Cooperation Council (PECC), Conference on Trade and Competition Policy, Montreal, Canada. May 13-14, 1997, at http://www.ftc.gov/speeches/other/dvspeech.shtm. Explaining why efficiency goals have taken an important place in antitrust policy, Valentine states: "Why has the first set of Jeffersonian-type goals receded in importance and the second set of consumer welfare and efficiency goals taken precedence? First of all, there is a tension, if not an inconsistency, between the two sets of goals. By focusing solely on deconcentrating markets and protecting small, inefficient competitors for numbers' sake, a competition official cannot insure that consumers have access to goods at a competitive price, quantity and quality and that society benefits from efficiencies and the best possible allocation of resources. Courts have had to choose

law is to ensure competition and not necessarily to protect small businesses: "The idea of antitrust laws is to protect the framework, not the individual participants. I have a legal right to compete. That doesn't mean I have a legal right to win. Antitrust laws protect competition, not competitors."[312]

Antitrust laws emerged to prevent the creation of a monopolistic market that can result from the existence of powerful and wide-reaching corporate entities. Large corporations may dominate the market through their ability to make impactful decisions that would otherwise be made by many independent entrepreneurs.[313] In terms of concentration, antitrust laws primarily focus on market power, not on entrepreneurial opportunity.[314]

Furthermore, what kind of entrepreneurial freedom can mergers negatively affect, if an independent entrepreneur is unlikely to merge with another firm against his own will? Moreover, referring to takeovers, how can an independent firm be the target of a takeover, if it is privately held?

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between competition and the amelioration of economic distress of individual firms and workers, and between efficiency and the retention of large numbers of small, locally owned competitors. They have increasingly chosen competition, consumer welfare and efficiency over the alternative social and political goals."

[312] M. Ray Perryman, Antitrust laws need to be modernized, not abolished, The Victoria Advocate, July 26, 1998, at 12. *See also* Brown Shoe Co. v. U.S., 370 U.S. 294, 311-323 (1962) (referring to the legislative history of antitrust laws).

[313] Gray Dorsey, *Free Enterprise vs. The Entrepreneur: Redefining the Entities Subject to the Antitrust Laws*, 125 U. Pa. L. Rev. 1244, 1247 (1977).

[314] *Id.* at 1248-1250 (1977). According to Gray Dorsey: "If a purpose of the Clayton Act were to protect entrepreneurial opportunity- as well as to protect competition-it would contain provisions aimed at limiting concentrations of decisionmaking, doubtless balanced against countervailing economic values. As an example, there might be a provision prohibiting corporate acquisitions of stock or share capital, or the formation of subsidiary corporations, where the effect may be to restrict independent decisionmaking more than is reasonably necessary to achieve economies of scale."

In Barnes' view, antitrust laws cannot serve as a tool for promoting individual liberty through protecting small businesses.[315] The professor maintains that the owner of a small enterprise will sell his business only if he considers such a transaction beneficial.[316] Should the business owner value the independence and entrepreneurial freedom offered by his small business more than the price offered, the transaction would not proceed. The entrepreneur may wish to sell only a part of the shares in his enterprise, therefore, assuming the risk of loosing control over his firm. However, this situation falls under regular business risks that any businessperson bears and it does not prove that mergers and takeovers should be restricted for the sake of individual freedom.

Holding that small firms employ self-protective mechanisms to safeguard entrepreneurial freedom, Barnes maintains that it is the opportunity to compete, not entrepreneurial opportunity, that should be the object of protection.[317]

The aforementioned social and political goals of antitrust law show that there are many aspects that should be taken into consideration when forming antitrust policy. However, the analysis of these goals has not proven that they can be classified as falling under the main purposes of antitrust laws. As opposed to the goals of promoting competition and guarding efficiency considerations, social and political goals do not seem to play a leading role in antitrust policy. Besides, the non-efficiency goals described above have not been clearly defined and appear to be too vague to receive appropriate treatment by antitrust enforcers.[318] In

[315] Barnes, *supra* note 287, at 846.
[316] *Id.*
[317] *Id.* at 846-847.
[318] *Id.* at 865.

addition, when considering the advantages that mergers and takeovers generate, one may be reassured that social and political goals, though important for society, are of diminished importance in shaping antitrust policy.

3.3 Benefits of takeovers and why antitakeover statutes are antithetical to antitrust laws

The main reason a company seeks to merge or acquire another company is to obtain the associated gains available after the deal closes. Upon completion of the M&A transactions, parties attain competitive, financial, operational and other advantages. Various types of these advantages have been discussed in law and economics literature. The most prominent and well-known benefits obtained via mergers and acquisitions are synergy gains, reduction of agency costs, tax benefits, and geographical or other diversification.

Companies expect to realize financial benefits in a merger when both companies are combined and reorganized in a way that allows the new unit to earn profits exceeding the sum of the profits they earned while operating separately.

Explaining the key drivers of mergers and acquisitions, Romano classifies the incentives for takeovers into three categories: value-maximizing efficiency explanations, value-maximizing expropriation, and value-maximizing market inefficiency explanations.[319]

[319] Romano, *supra* note 14, at 125.

Synergy gains

An important source of potential benefits from takeovers that falls under value-maximizing efficiency explanations is synergy gains.[320] Synergy theory occupies an important place in the mergers and acquisitions studies, typically focusing on operational and financial aspects.[321] Operating efficiencies are achieved through economies of scale and economies of scope while financial synergy represents the ability of corporate management to allocate capital more efficiently than capital markets.[322] Operating enhancements also include managerial cost savings where the acquirer's management team may successfully run both the acquired enterprise and the acquiring firm.

If operating separately, low-income firms would need to raise funds to finance their projects externally while the earnings of high-income firms would be subject to taxation. Acquisition, therefore, allows firms to redeploy funds internally, using excess funds from high-income divisions to provide financing for low growth divisions, at the same time avoiding excessive taxation.[323]

In taking over another, sometimes inefficient company, the acquirer expects to achieve synergies that would otherwise be unavailable. Needless to say, the generation of economies of scope and economies of scale, as well as achieving financial synergy, creates extra firm value and enhances consumer well-being. Not only does the acquiring firm experience the potential gains of takeovers, but also the target is able to reap benefits from the acquisition as well

[320] *Id.* at 125.
[321] *Id.* at 126.
[322] *Id.* at 126-128.
[323] *Id.* at 128.

by obtaining vital financing and undergoing a positive structural change. Without a doubt, the prospect of a takeover gives target shareholders the opportunity to sell their shares at a premium. However, the disadvantaged party in this process is the firm's management. Once the target company has been acquired, new managers may wish to replace or completely remove the target's management. Understanding the threat of being ousted, target management may be willing to employ numerous takeover protections. Thus, a target's management may be unable to evaluate benefits from a prospective takeover *bona fide*. The existing premise that acquisitions generate substantial gains for the target shareholders at the expense of the target managers, who driven by self-interest in preserving their jobs have takeover defenses at hand and may raise them, suggests that the wide range of such defenses does not justify itself.

Enacting the legislation that substantially restricts takeovers, state legislatures deprive shareholders of the right to obtain benefits from their investment. Moreover, antitakeover statutes prevent firms from improving their efficiency by enabling managers to resist takeovers, thereby defeating a fundamental goal in business. Reviewing antitrust laws with stated goals of promoting competition and protecting consumers, it appears as though antitakeover statutes are antithetical to the purposes of antitrust policy, aiming to protect managers of potential targets instead of consumers and free competition.

Agency costs reduction

The principal-agent relationship has always been an important matter in corporate law. Managers, who are supposed to act in the best interests of shareholders, may occasionally lack the proper incentives for diligent managerial performance. Corporate governance literature shows great concern for the combination of poor management and managerial entrenchment, where the former causes a significant decline in firm value and the latter allows managers to receive unreasonably high compensation at the expense of shareholders.

The advantages generated by takeovers in terms of disciplining inefficient managers should not be overlooked. The mere threat of a takeover can act as an impetus for better managerial performance, eventually leading to an increase in profits. The likelihood of a takeover encourages managers to use corporate employees' working time more efficiently. However, an environment where takeovers are improbable induces managerial slack, shielding managers from immediate scrutiny by capital markets.[324] Romano refers to takeovers as the tool that "reduce[s] managerial slack by replacing inefficient management."[325]

It is interesting to note that even if takeovers fail to encourage better managerial performance in targets, they still appear to be advantageous for all parties, except target managers: "In the hostile takeover context, unsolicited bidders can intervene where management has allowed a serious decline in the corporation's value and take over the corporation, paying shareholders a

[324] Park Mcginty, *The Twilight of Fiduciary Duties: On the Need for Shareholder Self-Help in an Age of Formalistic Proceduralism*, 46 Emory L.J. 163 (1997) (reporting numerous situations where corporate management, insulated from monitoring by courts and capital markets, does act in the best interests of shareholders and arguing that voluntary dissolution would be the optimal mechanism to protect shareholders from opportunistic management).
[325] Romano, *supra* note 14, at 129.

significant premium, while gaining the opportunity to profit from managing the corporation more effectively."[326]

It is observed that the only disadvantaged party in a takeover pursuit resulting from a decrease in the firm's value is management. Target shareholders benefit from such a transaction because they sell their shares at a significant premium and receive adequate returns on their investment. The acquiring firm benefits from obtaining undervalued assets that it can use in its operation more efficiently, achieving synergy gains and earning extra profits.

Enacting antitakeover statutes, states insulate managers from control by capital markets. Takeovers provide capital markets with an effective mechanism for disciplining inefficient managers and forcing them to work in the best interests of shareholders.[327] In capital markets, investors seek the opportunities to allocate their capital as efficiently as possible, therefore seeking for the best agents with whom to entrust their investments. Looking at this situation from a different perspective, one may note that it is the managers who have to compete for the right to manage resources.[328] In order to get a chance to manage the capital that investors are willing to provide, managers have to demonstrate their skills and experience. The more qualified the managers are, the better assets they will get to manage. In other words, allocation of resources by capital markets creates competition between managers. One should bear in mind that competition has always been one of the main antitrust goals. However, antitakeover statutes restrict competition between managers in capital markets, thereby creating

[326] Mcginty, *supra* note 324.
[327] Romano, *supra* note 14, at 129.
[328] Bernard S. Black, *Bidder Overpayment in Takeovers*, 41 Stan. L. Rev. 597, 609 (1989).

inefficiencies. How is the competition in capital markets different from other markets? Why should competition between managers be restricted by state legislation when there is no doubt that competition brings benefits? Is it justified that competition, being a key concept of antitrust policy, has been severely restricted in the market for corporate control? Is it acceptable that a double standard is being applied to the competition between businesses and between managers?

The fact that competition encourages greater performance efficiency does not raise any disputes. Non-competitive markets tend to underperform, comprised of inefficient participants. The same applies to the market for corporate control where inefficient managerial behavior results in decreased firm value. Needless to say, poor management causes a chain of undesired consequences that affect shareholders, employees and most importantly in terms of antitrust policy, consumers.

The ability to use the various available antitakeover defenses to control tender offers provides managers with monopoly power over corporate control.[329] Providing managers with antitakeover defenses, state legislatures substantially reduce the liquidity and hence the efficiency of the market for corporate control.[330] It is maintained that "[antitakeover] legislation harms the national economy by restricting the transfer of control over corporate assets and offends the constitutionally protected principle of open national markets."[331]

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[329] Gilson, *supra* note 133, at 846.
[330] Thomas J. Bamonte, *The Dynamics of State Protectionism: A Short Critique of the CTS Decision*, 8 N. Ill. U. L. Rev. 259, 261 (1988).
[331] *Id*. at 272.

Consequently, the arguments inevitably lead to the conclusion that antitakeover statutes are antithetical to antitrust laws.

Conclusion

This part of the thesis has explored the question of whether antitakeover statutes are antithetical to the goals of antitrust policy. Antitrust laws are known for aiming to promote fair competition in a free market, increase economic efficiency and protect consumers and businesses from anticompetitive practices. Since mergers and acquisitions are governed by antitrust and corporate laws, the legislation of the latter should not conflict with the goals of the former. This section has revealed certain inconsistencies between antitakeover statutes that significantly reduce the monitoring function of capital markets and antitrust laws that seek to promote competition. The importance of the aforementioned major goals of antitrust laws is unquestionable. These goals are of the utmost importance in the present economy and should therefore be further pursued. However, in order to ensure the effective performance of the market, the inconsistencies found in antitakeover legislation should be dealt with in a timely manner.

Research was conducted investigating the minor nonefficiency goals in the antitrust law of mergers. It has revealed that although these goals may play an important role in certain contexts, they should not greatly influence the development of the rules governing mergers and acquisitions. This section has found that mergers and acquisitions often result in a number of social and

economic benefits. Therefore, unless mergers and acquisitions cause anticompetitive consequences that are likely to outweigh their potential benefits, such transactions should be not restricted.

General conclusion

The current law governing mergers and acquisitions is controversial in its apparent pursuit of contrasting goals. On the one hand, antitrust laws have been designed to promote competition, increase economic efficiency and protect consumers from unfair practices. On the other hand, a complex body of antitakeover statutes tends to reduce efficiency, lessen competition between managers, and perhaps produce deteriorating effects on consumer welfare.

By imposing numerous restrictions on takeovers, antitakeover statutes excessively protect target management from a potential change of control. The improbability of takeovers insulates management from competition, allowing sub-optimal performance. Intentional imposition of constraints that reduce competition contradicts the purposes of antitrust law.

In terms of competition between managers, antitakeover statutes appear to be contentious, and even redundant when referring to competition between businesses in a free market. Antitrust laws, by way of contrast, protect competition in a free market. In particular, the Clayton Act prohibits mergers that may substantially lessen competition. With the Clayton Act properly enforced,

there is no need to enact antitakeover statutes that would allegedly protect competition by restricting takeovers.

Economic efficiency has become a topic of heated debate in both legal and economic circles. The fact that economic efficiency serves the interests of businesses as well as consumers does not leave much room for argument. Economic efficiency drives the development and evolution of business practices and processes while also contributing to matters of consumer well-being. Shielding the incumbent managers from the market for corporate control, antitakeover statutes enable them to shirk their responsibilities without being held accountable to shareholders. Inefficient management teams must be replaced regardless of whether poor managerial performance results from intentional underperformance or from unprofessional actions. Severe restriction of takeovers imposes hazardous consequences on corporate governance. Without the disciplining power of takeovers, managers might have ample incentives to protect their tenure rather than act in the company's best interests. In addition, managers are aware of possible ways to entrench themselves in order to make it costlier for shareholders to remove them.[332] In the absence of takeovers, removal of

[332] Running the company on a day-to-day basis, managers are responsible for making decisions that do not conflict with the interests of the company. However, managerial actions are difficult to control and managers are able to entrench themselves through the control of corporate assets and investment decisions. Manuel Utset indicates that managers often prefer to make decisions that help them to protect and entrench themselves rather than take actions that go along with the interests of the company. Utset illustrates it through the following example: Assume that the managers of C & C, Inc. want to keep their jobs and are faced with two alternative investment opportunities. Investment A has a higher net present value than Investment B. Investment B, however, has certain characteristics that are desirable to managers: (1) if the investment goes awry, the managers can more easily explain the poor performance on the basis of extraneous factors rather than bad managing; and (2) it requires long-term commitments that could be revoked by new managers only at a very high cost, which would make a takeover or any other type of change in managers less attractive. Rational managers will choose Investment B if the benefits of

underperforming managers becomes an arduous task. Poorly managed firms negatively affect overall economic efficiency. Therefore, acquisition and reorganization of such firms should be an option available to potential investors.

The application of antitakeover legislation is overreaching in that it not only impairs economic efficiency in the United States, but it also produces negative effects for foreign companies conducting business with U.S. corporations. Due to a high volume of transactions between the United States and Canada, companies originating in Canada tend to be among the most affected foreign enterprises. Restrictive regimes imposed by the U.S. takeover legislation affects Canadian investors willing to purchase stocks in U.S. corporations. Canadian companies must be aware of the various restrictions U.S. antitakeover legislation imposes on their investments in American corporations. It should be duly noted, however, that Canadian companies will still be forced to conduct business in the United States even in the face of restrictive legislation. The high level of integration between the two economies leaves Canadian firms with little choice even if they suffer financial losses on their investments as a result.

Cross-border mergers and acquisitions are known to attract foreign investment and generate revenues for all participating countries. Examining the particular example of mergers and acquisitions between U.S. and Canadian companies, the former benefit by receiving investment from Canadian businesses resulting in numerous economic efficiencies while the latter benefit by transferring revenues earned in the United States to Canadian shareholders. A

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further entrenchment exceed the costs. Manuel A. Utset, *Towards a Bargaining Theory of the Firm*, 80 Cornell L. Rev. 540, 602 (1995).

significant restriction of hostile takeovers deprives Canadian investors holding stock in the U.S. corporations of a substantial premium that, otherwise, could be reinvested in other businesses in Canada or the United States.

Canada and the United States of America have unique economic relationships that enable them to generate substantial profits and influence global markets. Canadian and American businesses should not be impeded in their efforts to increase economic efficiency by unnecessary antitakeover legislation, especially when considering the aggressive competition that prevails in the global marketplace.

Intended to protect companies from predatory takeovers, antitakeover statutes in fact serve as an instrument to defeat any takeover irrespective of whether or not such a transaction is in the best interest of the corporation and shareholders. If used in bad faith, antitakeover statutes allow managerial slack and reduce economic efficiency. Accordingly, antitakeover statutes conflict with the purpose of antitrust law to increase economic efficiency.

Considering the inconsistencies between antitakeover statutes and antitrust law, it becomes apparent that these two areas of law need to be harmonized. There is no doubt that every area of law should be consistent with the goals it has been designed to achieve. Where many areas of law regulate the same matter but have different goals, conflicting directions make the achievement of these goals unfeasible. This thesis supports the theory that antitakeover statutes are antithetical to antitrust laws and that they should therefore be reconsidered and changed.

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