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## Aiding and Abetting the Breach of Fiduciary Duty: Will the Greenmailer be Held Liable ?

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## NOTES

### ADING AND ABETTING THE BREACH OF FIDUCIARY DUTY: WILL THE GREENMAILER BE HELD LIABLE?\*

IN the arena of corporate takeovers, it is not unusual for a corporation to repurchase shares accumulated by a prospective tender offeror at a premium over market price. The non-prorata repurchase targets only the shares of the tender offeror. This strategic repurchase of targeted stock to stop the tender offeror from taking over the company, commonly referred to as greenmail, has been highly controversial.<sup>1</sup> Increasingly, the shareholders of the target

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1. The flurry of legislative proposals addressing the subject of greenmail over the last few years reflects this controversy. In 1984, the Securities and Exchange Commission released the results of a study of the stock price movements of 89 firms implementing targeted stock repurchases. *See* The Impact of Targeted Share Repurchases (Greenmail) on Stock Prices, [1984-1985 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,713 (Sept. 11, 1984) [hereinafter Impact of Greenmail]. The study concluded that the overall effect of greenmail on the wealth of non-participating target shareholders is negative. The purpose of the study was to lend support to an SEC proposal which would have restricted the repurchase of more than three percent of the outstanding securities from any individual holder at a price above the market price, unless the shareholders approve the purchase.

While several bills were submitted to Congress for consideration after the SEC proposal, none were enacted. *See, e.g.*, S. 2782, 98th Cong., 2d Sess. (1984); S. 2777, 98th Cong., 2d Sess. (1984); S. 2754, 98th Cong., 2d Sess. (1984); H.R. 5693, 98th Cong., 2d Sess. (1984). Attempts to restrict the payment of greenmail continue. *See, e.g.*, S. 1323, 100th Cong., 1st Sess. § 8, 133 Cong. Rec. 7601-02 (1987); H.R. 2172, 100th Cong., 1st Sess. (1987).

One statute specifically addressing the payment of greenmail has been enacted. The Internal Revenue Service has subjected any person who receives greenmail to a non-deductible 50% excise tax on any gain realized. I.R.C. § 5881 (West Supp. 1988). The provision, which went into effect after December 15, 1987, defines greenmail as any consideration paid by a corporation in redemption of its stock if such stock has been held by the shareholder for less than two years, and the shareholder (or any related person or person acting in concert with the shareholder) made or threatened a public tender offer for stock in the corporation during that period. While this statute makes greenmail a less profitable undertaking by giving the IRS a piece of the pie, it does not prohibit the payment of

corporation are calling the recipients of greenmail, the greenmailers, into court and seeking to hold the greenmailers liable for the receipt of the premium paid.<sup>2</sup> Will these claims succeed? As this Note demonstrates, whether the greenmailer will be held liable is a function of the willingness of the courts to recognize the presence of conflicts of interest in corporate directors.

In attempts to establish liability for greenmailers, shareholders allege that the corporate directors breached their fiduciary duty to shareholders by paying the price of a targeted stock repurchase and that the greenmailer aided and abetted that breach by paying a premium over the market price. Part one of this Note examines the requirements for establishing a claim of aiding and abetting the breach of fiduciary duty. One of the elements of such a claim is knowledge of the breach of the principal wrongdoer, who in this case is the director acting as agent for the shareholders. If the greenmailer is to be held liable for simply knowing the fact that greenmail is paid, it must be assumed that harm flows directly or indirectly to the shareholders from the payment of greenmail out of the corporate assets. However, as part two demonstrates, the theorists and scholars support such divergent views on the effects of greenmail that there is no consensus on the harm or benefits of greenmail, and thus no standard by which to measure the behavior of the greenmailer. The greenmailer in most instances cannot "know" that harm will flow to the shareholders when there is so much ambiguity in the theory regarding the effects of greenmail.

If knowledge of the payment of greenmail alone is not enough, what type of knowledge will result in liability for the greenmailer? The answer, set out in part three, is that the greenmailer must have knowledge of the conflict of interest of the directors before liability can be imposed. When directors are conflicted, they are faced with an overriding motivation that might (1) keep them from closely analyzing the effect of the greenmail payment, or (2) cause them to ignore the results of their analysis. Only

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greenmail.

2. Some find it unpalatable to hold the greenmailer liable when he is simply pursuing his own interests in a business transaction executed between two parties. See SENATE COMM. ON BANKING, HOUSING AND URBAN AFFAIRS, TENDER OFFER DISCLOSURE AND FAIRNESS ACT OF 1987, S. REP. NO. 265, 100th Cong., 1st Sess. 155 (1987) [hereinafter SENATE REPORT] (proposals by Sen. D'Amato to amend the bill as reported out of committee by imposing liability on the issuers of the shares (the managers) as well as on the greenmailers).

when the managers are conflicted can a greenmailer "know" that harm is likely to flow to the shareholders.

In the end, the determination of liability for a greenmailer hinges not on establishing the greenmailer's knowledge of actual harm flowing to the shareholders, but on the court's willingness or unwillingness to acknowledge the presence of conflicts of interest influencing the decisionmaking of directors. Part four of this Note presents a survey of judicial willingness to recognize managerial conflict in three different jurisdictions and the corresponding willingness or unwillingness to recognize a cause of action against the greenmailer.

### I. THE COMMON LAW BASIS FOR AIDING AND ABETTING THE BREACH OF FIDUCIARY DUTY

A claim of aiding and abetting the breach of fiduciary duty may be found in the common law of several jurisdictions. Courts recognize that "directors of a corporation stand in a fiduciary relationship to the corporation's shareholders."<sup>3</sup> If the duties created by that fiduciary relationship are breached, a third party may be held liable for aiding and abetting the breach of the principal.<sup>4</sup> As a federal district court in New York explained:

[I]t is not essential that one occupy a direct fiduciary relationship as a predicate to the imposition of liability based upon a claim of breach of duty. One who knowingly participates in or joins in an enterprise whereby a violation of a fiduciary obligation is effected is liable jointly and severally with the recreant fiduciary. Even assuming [the defendant] himself did not stand in a direct fiduciary relation to the plaintiffs, he is charged with having conspired knowingly with those who were their fiduciaries. The charge having been made, suit to enforce the claimed liability may properly be maintained in this court.<sup>5</sup>

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3. *Penn Mart Realty Co. v. Becker*, 298 A.2d 349, 351 (Del. Ch. 1972). *See also* *Laventhol, Krekstein, Horwath & Horwath v. Tuckman*, 372 A.2d 168, 170 (Del. 1976)(comparing the fiduciary duty of corporate officers and directors to the duty of a trustee). For a discussion of the fiduciary duties owed to shareholders, see *infra* notes 95-102, 115-18 and accompanying text.

4. Examination of those cases in which the third party is held liable for breach of a separate fiduciary duty owed directly to the shareholders is beyond the scope of this Note. A dominant shareholder and a titular director or officer (or even an agent of the firm) would probably be held liable for a direct breach of duty rather than for aiding and abetting.

5. *Oil & Gas Ventures-First 1958 Fund, Ltd. v. Kung*, 250 F. Supp. 744, 749 (S.D.N.Y. 1966) (footnotes omitted).

Therefore, those who knowingly participate in the breach by corporate officials may be held jointly and severally liable.<sup>6</sup>

The wording of the elements necessary to establish liability for aiding and abetting vary from jurisdiction to jurisdiction. The "well settled" law of New York sets forth three elements.<sup>7</sup> "The claimant must prove (1) a breach by a fiduciary of obligations to another, (2) that the defendant knowingly induced or participated in the breach, and (3) that the plaintiff suffered damages as a result of the breach."<sup>8</sup> An alternate formulation of the elements requires the plaintiff to demonstrate (1) a breach of fiduciary duty by the principal, (2) knowledge of this wrongdoing by the alleged aider and abettor, and (3) substantial assistance or encouragement provided by the alleged aider and abettor to the principal.<sup>9</sup> Although phrased differently, both formulations require some type of action and some type of knowledge of the breach.

In recognizing a cause of action against the alleged aider and abettor, courts may refer to trust law. According to the Restatement (Second) of Trusts, a third party transferee who takes trust property knowing of a breach of trust by the trustee cannot claim the property free of the trust.<sup>10</sup> The requirement that the third party know of the breach of trust is consistent with the knowledge requirement imposed on the alleged aider and abettor in the breach of fiduciary duty. Like the test for aiding and abetting, the Restatement has an implicit requirement that the third party take

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6. See *Jackson v. Smith*, 254 U.S. 586, 589 (1921); *Laventhol, Krekstein, Horwath & Horwath v. Tuckman*, 372 A.2d 168, 170 (Del. 1976).

7. *S & K Sales Co. v. Nike, Inc.*, 816 F.2d 843, 847-48 (2d Cir. 1987).

8. *Id.* (quoting *Whitney v. Citibank, N.A.*, 782 F.2d 1106, 1115 (2d Cir. 1986)). This formulation is similar to that found in Delaware which requires the plaintiff to "allege (1) the existence of a fiduciary relationship, (2) a breach of the fiduciary's duty, and (3) knowing participation in that breach by the defendants." *Penn Mart Realty Co. v. Becker*, 298 A.2d 349, 351 (Del. Ch. 1972). The allegation of damages is also required as a fourth element. *Gilbert v. El Paso Co.*, 490 A.2d 1050, 1057 (Del. Ch. 1984).

9. *Terrydale Liquidating Trust v. Barness*, 611 F. Supp. 1006, 1016 (S.D.N.Y. 1984) (applying Missouri law). This formulation is roughly the same as that applied to aiding and abetting federal securities law violations. See *IIT, An Intern. Inv. Trust v. Cornfield*, 619 F.2d 909, 922 (2d Cir. 1980); *Rolf V. Blyth, Eastman Dillon & Co.*, 570 F.2d 38, 47-48 (2d Cir.), *cert. denied*, 439 U.S. 1039 (1978). However, it is noteworthy that the subject of the alleged aider and abettor's awareness in the case of securities law violations is typically fraud or concealment. The analysis of the elements required to establish aiding and abetting fraud is quite different from the analysis of aiding and abetting the breach of fiduciary duty. For an examination of aiding and abetting in the field of securities law, see Note, *Liability for Aiding and Abetting Violations of Rule 10b-5: The Recklessness Standard in Civil Damage Actions*, 62 TEX. L. REV. 1087 (1984).

10. RESTATEMENT (SECOND) OF TRUSTS §§ 296-297 (1957).

action. This portion of the Restatement addresses only situations in which the third party takes receipt of or in some way lays claim to the trust property. The aiding and abetting requirements of action and knowledge may therefore be based on the law of trusts.

In addition to drawing on the law of trusts, several jurisdictions have turned to tort law as support for the liability of the aider and abettor.<sup>11</sup> A comment to the Restatement (Second) of Torts provides that when a fiduciary relationship is breached, a person acting in concert with the fiduciary can be held liable for the harm done.<sup>12</sup> Subsection (b) of section 876 would require that the person acting in concert with the fiduciary know of the fiduciary's breach and give him "substantial assistance or encouragement."<sup>13</sup> These requirements strongly support both formulations of the test for establishing a claim of aiding and abetting the breach of fiduciary duty.

Given these theories on which the greenmailer *may* be held liable, what is the likelihood that liability will be established? To establish the "action" requirement, courts examine whether a defendant "induced or participated in the breach" or provided "substantial assistance or encouragement." The level of participation need not rise to the level of fraud or collusion; the plaintiff need not establish that the directors and the greenmailer failed to conduct arms-length negotiations.<sup>14</sup> Even if the greenmailer can meticulously document the adversarial nature of the negotiations,

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11. See, e.g., *S & K Sales Co. v. Nike, Inc.*, 816 F.2d 843, 849 (2d Cir. 1987); *Terrydale Liquidating Trust v. Barnes*, 611 F. Supp. 1006, 1015 (S.D.N.Y. 1984); *Marine Midland Bank v. Smith*, 482 F. Supp. 1279, 1290 (S.D.N.Y. 1979), *aff'd*, 636 F.2d 1202 (2d Cir. 1980).

12. RESTATEMENT (SECOND) OF TORTS § 874, comment c (1976). The comment provides that "[a] person who knowingly assists a fiduciary in committing a breach of trust is himself guilty of tortious conduct and is subject to liability for the harm caused thereby." *Id.*

13. *Id.* § 876. The elements required to establish liability for assisting in the breach are set out in section 876:

Persons Acting in Concert

For harm resulting to a third person from the tortious conduct of another, one is subject to liability if he

(a) does a tortious act in concert with the other or pursuant to a common design with him, or

(b) knows that the other's conduct constitutes a breach of duty and gives substantial assistance or encouragement to the other so to conduct himself, or

(c) gives substantial assistance to the other in accomplishing a tortious result and his own conduct, separately considered, constitutes a breach of duty to the third person.

14. *Penn Mart Realty Co. v. Becker*, 298 A.2d 349, 351 (Del. Ch. 1972).

aiding and abetting the breach of fiduciary duty could be established. A court could well conclude that receipt of the greenmail payment, without more, constitutes sufficient participation to satisfy the element of "substantial assistance."

The minimal level of participation required suggests that the real issues will be whether the corporate directors, the principal wrongdoers, will be held liable and whether the greenmailer "knew" of their breach. In examining the element of knowledge of the breach, it is necessary to determine the level of scienter required. At least one jurisdiction has held that proof of intent to harm is not necessary to establish aiding and abetting the breach of fiduciary duty.<sup>15</sup> On the other hand, "mere suspicion or even recklessness as to the existence of a breach is insufficient."<sup>16</sup> The greenmailer will only be held liable if actual knowledge of the breach is established.<sup>17</sup>

A focus on the actual knowledge of the alleged aider and abettor rather than on what the defendant "should have known" is supported by two different considerations. First, unlike the principal wrongdoers who are the directors of the corporation, the alleged aider and abettor has no direct fiduciary duty to the shareholders of the corporation.<sup>18</sup> When the alleged aider and abettor is a corporation, the defendant will owe no fiduciary duty to the plaintiff shareholders and may owe an affirmative duty to its own shareholders. The lack of a direct fiduciary duty to the target corporation shareholders justifies requiring a higher level of awareness of the breach on the part of the aider and abettor before imposing liability than would be required of the principal wrongdoer who owed a direct duty.

A second consideration supporting an actual knowledge requirement is related to the concern that the imposition of aider and abettor liability not "disrupt commercial activity in a manner

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15. *S & K Sales Co. v. Nike, Inc.*, 816 F.2d 843, 848-49 (2d Cir. 1987). In *S & K Sales*, Nike entered into an agreement with an employee of *S & K Sales*. *Id.* at 845. The corporation allegedly participated in the breach of the employee's fiduciary duty. *Id.* at 847. In its defense, Nike relied on agency law to argue that it could not be liable unless the court found that it intended to harm *S & K Sales*. The Restatement (Second) of Agency supports this view, stating that a third party who "intentionally causes or assists an agent to violate a duty to his principal, would be held liable." RESTATEMENT (SECOND) OF AGENCY § 312 (1957). The court rejected this argument.

16. *Terrydale Liquidating Trust v. Barnes*, 611 F. Supp. 1006, 1027 (S.D.N.Y. 1984).

17. *Id.*

18. *Id.* at 1030.

wholly inconsistent with the purposes of aider and abettor liability."<sup>19</sup> Third parties must be able to conclude corporate transactions with confidence that they will not be drawn into disputes between managers and their shareholders. Furthermore, parties to arms-length negotiations are not expected to disclose to each other the details of their respective positions.<sup>20</sup> It would be unreasonable to impose on the alleged aider and abettor a duty to uncover all that goes on in the "inner councils."<sup>21</sup> To encourage the certainty of commercial transactions and to facilitate arms-length negotiations between parties, the courts establish liability for the alleged aider and abettor only upon a showing of actual knowledge of the breach of fiduciary duty.

Having established that evidence of actual knowledge of the breach is required, the next question in the analysis of aider and abettor liability entails analyzing the subject matter of the actual awareness that will result in liability.

## II. THE PAYMENT OF GREENMAIL: HARM OR BENEFIT TO THE SHAREHOLDERS?

The greenmailer clearly has knowledge of the fact that greenmail, which by definition includes a premium over market price, is paid. Is the knowledge of the payment alone sufficient to satisfy the element of knowledge of the breach? To answer this question, it is necessary to examine the conflicting views regarding greenmail.

### A. The Conflicting Views of Greenmail

In recent years greenmail has been the subject of much debate and little agreement among legal scholars. At one end of the spectrum are those who propose a ban on all greenmail.<sup>22</sup> At the other end of the spectrum are those who argue that greenmail

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19. *Id.* (citing *Woodward v. Metro Bank of Dallas*, 522 F.2d 84, 97 (5th Cir. 1985)).

20. *Solash v. Kurlander*, Fed. Sec. L. Rep. (CCH) ¶ 93,608 (1988).

21. *Terrydale Liquidating Trust v. Barness*, 642 F. Supp. 917, 929 (S.D.N.Y. 1986), *aff'd*, 846 F.2d 845 (2d Cir. 1988).

22. See Note, *Greenmail: Targeted Stock Repurchases and the Management-Entrenchment Hypothesis*, 98 HARV. L. REV. 1045, 1046, 1064 (1985) (proposing a federal ban on greenmail to protect shareholders from the misappropriation of corporate assets by directors for their own benefit). See also Gordon & Kornhauser, *Takeover Defense Tactics: A Comment on Two Models*, 96 YALE L.J. 295, 320 (1986) (favoring a rule which would proscribe greenmail entirely except, perhaps, in a specific transaction approved by a majority of disinterested shareholders).



serves a useful function in the corporate arena.<sup>23</sup> Taking the middle ground are others who suggest that there are some occasions when the payment of greenmail may be appropriate.<sup>24</sup>

### 1. The Case Against Greenmail

A debate over the relative harm or benefit to the shareholders underlies the theoretical debate regarding the role of greenmail. Some scholars see only the harm flowing from the payment of greenmail. Even if the directors believe they are acting to further the best interests of the corporation, there are at least two ways in which shareholders may be harmed. First, the firm may have paid more than the market value of the shares, thereby reducing the value of the remaining shares. Second, the repurchase of a significant number of shares may have reduced the likelihood of a subsequent take-over bid. In addition to the harm that may flow from a poor business decision to pay greenmail, directors may be faced with a conflict of interest and may choose to pay greenmail in order to retain control. Many scholars who criticize greenmail view it as a misappropriation of corporate assets.<sup>25</sup> Under this view, the directors and officers are criticized for making payments to preserve their positions of power<sup>26</sup> and for paying a premium to just one shareholder rather than to all shareholders.<sup>27</sup>

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23. See Dennis, *Two-Tiered Tender Offers and Greenmail: Is New Legislation Needed?*, 19 GA. L. REV. 281, 341 (1985)(suggesting that legislative and other proposals limiting greenmail should be rejected since greenmail benefits the market for corporate control and does not harm shareholders as a class).

24. See Impact of Greenmail, *supra* note 1 (proposing the requirement of a shareholder vote to approve greenmail rather than outright prohibition, since any other rule would hinder beneficial repurchases for the purposes of eliminating dissident minorities and of signaling the market that shares are undervalued); Macey & McChesney, *A Theoretical Analysis of Corporate Greenmail*, 95 YALE L.J. 13, 61 (1985)(concluding that courts should allow the payment of greenmail when the payment enhances the welfare of shareholders); Shleifer & Vishny, *Greenmail, White Knights, and Shareholders' Interest*, 17 RAND J. ECON. 293, 307-08 (1986)(suggesting the value of greenmail as a signal to prospective bidders when other signaling mechanisms are not available, but recognizing those situations in which greenmail may be abused); Comment, *Greenmail: Can the Abuses Be Stopped?*, 80 NW. U.L. REV. 1271, 1305, 1308, 1318 (1986)(arguing that the use of greenmail may be justified on an economic basis since it may facilitate takeovers by reducing costs for potential bidders and also recommending that courts adopt an economic analysis in applying the business judgment rule).

25. Note, *supra* note 22, at 1046.

26. See *infra* notes 28-52 and accompanying text.

27. See *infra* notes 53-58 and accompanying text.

### a. The Management-Entrenchment Hypothesis

According to the agency cost theory,<sup>28</sup> the separation of ownership from control in the modern corporation,<sup>29</sup> with shareholders claiming ownership and with control residing in management, results in a conflict of interest for managers. Directors are forced to choose between fulfilling their duty to maximize shareholder value and furthering their own interests within the corporation.<sup>30</sup> As directors promote their interests at the expense of ownership interests, agency costs<sup>31</sup> are incurred by shareholders.

In theory, shareholders are able to monitor management deci-

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28. See T. VAN HORNE, *FINANCIAL MANAGEMENT AND POLICY* 303-05 (7th ed. 1986)(Agency cost theory states that separation of ownership and control creates a need for residual claimants to observe management's activity. These observation costs fall upon the shareholders which, in turn, reduce the overall value of the firm for shareholders.).

29. A. BEARLE & G. MEANS, *THE MODERN CORPORATION AND PRIVATE PROPERTY* 119-26 (1932).

30. Note, *supra* note 22, at 1048. This conflict of interest is evident not only as managers seek compensation and perquisites, but also as they enter new businesses or diversify activities to stabilize earnings, assuming that these actions are contrary to shareholder interests.

31. Professors (now Judge) Easterbrook and Fischel have explored the subject of agency costs in the takeover context. Easterbrook & Fischel, *The Proper Role of a Target's Management in Responding to a Tender Offer*, 94 HARV. L. REV. 1161, 1168-74 (1981). While acknowledging specific advantages which flow from the separation of ownership and control, they also recognize the agency costs which exist:

Corporate managers (which include both officers and members of the board), like all other people, work harder if they can enjoy all of the benefits of their efforts. In a corporation, however, much of the benefit of each manager's performance inures to someone else, whether it be shareholders, bondholders, or other managers. The investors must be given a substantial share of the gains to induce them to put up their money. Because no single manager receives the full benefit of his work, he may find that, at the margin, developing new ventures and supervising old ones takes too much effort to be worthwhile; each manager may reason that someone else is apt to do the work if he does not or to take the rewards even if he does well. No manager will be completely vigilant. So some managers will find it advantageous to shirk responsibilities, consume perquisites, or otherwise take more than the corporation promised to give them. One especially important way in which managers' performance falls short of the ideal is in choosing the firm's other agents. Because no manager can obtain all of the benefits available to the firm from making good decisions, no one takes all cost-justified steps to recruit and train those employees best suited for their jobs. As a result, many firms will have some employees . . . who, although fully dedicated, ought not to be in the positions they hold. These agency costs of less than optimal management cause the firm's shares to trade for less than the price they would achieve if agency costs were zero.

*Id.* at 1169-70. Therefore, agency costs may be a factor under either inefficient or incompetent management.

sions, but the costs of monitoring may be substantial.<sup>32</sup> Similar obstacles deter managers from monitoring themselves and their colleagues.<sup>33</sup> This dilemma has prompted several scholars to suggest that tender offers provide the best method of monitoring managers and reducing agency costs.<sup>34</sup> Prospective bidders search for firms in which the value of the firm can be increased by replacing inefficient management.<sup>35</sup> A market for corporate control is thereby created.<sup>36</sup> Without the threat of acquisition, managers would be free to take actions which increase agency costs and harm shareholders.

The most common criticism of greenmail, contained in the management-entrenchment hypothesis, flows from an application

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32. Easterbrook and Fischel provide several explanations for the unlikelihood of effective monitoring by shareholders. *Id.* at 1170-71. At the outset, they note that shareholders typically are "passive investors seeking liquid holdings. They have little interest in managing the firm and less incentive to learn the details of management." *Id.* at 1171. Second, any benefit gained from monitoring the managers must be shared with all shareholders as the management of the firm improves. The possibility of other shareholders free-riding on the benefits found in effective monitoring encourages passivity. Finally, effective monitoring by any one shareholder is to no avail if the shareholder is without power to compel the managers to improve their performance. *Id.*

33. Like shareholders, managers are concerned with free-riding in their efforts to monitor the firm. In addition, managers working in teams may find it difficult to determine individual contribution and may be unwilling to discipline those they view as their colleagues. *Id.* at 1172-73.

34. Dennis, *supra* note 23, at 309 n.143.

35. According to Easterbrook and Fischel, monitoring by prospective bidders provides benefits to a firm even when there is no apparent problem with inefficient or incompetent management and increased agency costs:

More significantly for our purposes, shareholders benefit even if their corporation never is the subject of a tender offer. The process of monitoring by outsiders poses a continuous threat of takeover if performance lags. Managers will attempt to reduce agency costs in order to reduce the chance of takeover, and the process of reducing agency costs leads to higher prices for shares.

Easterbrook & Fischel, *supra* note 31, at 1174.

This view of the value of monitoring all firms is not without its critics. As noted by Senators Sasser, Sanford, and Chafee, "[e]conomic evidence of which we are aware demonstrates that corporate takeovers, especially hostile ones, have usually been directed instead at *efficient* management, have not generally resulted in more competitive corporations, and have caused significant hardship to many corporate constituencies." SENATE REPORT, *supra* note 2, at 70.

36. The concept of a market for corporate control is generally attributed to Henry Manne. Manne, *Mergers and the Market for Corporate Control*, 73 J. POL. ECON. 110, 117-18 (1965). By encouraging the replacement of inefficient managers, creating synergies between firms, and bridging the gap between the divergent interests of shareholders and managers, the market for corporate control helps to ensure that society's resources are used to their fullest potential. Dennis, *supra* note 23, at 283.

of the increased agency costs analysis to the takeover context.<sup>37</sup> When exposed to a hostile takeover, managers are faced with more intense conflicts of interests, forcing them to choose between shareholder interests and preserving their own positions within the corporation. The use of corporate assets in the payment of greenmail, under this analysis, represents management's decision to retain power at shareholders' expense.<sup>38</sup> Several empirical studies appear to support the view that the payment of greenmail is made to the detriment of the shareholder.<sup>39</sup>

The assumptions underlying the management-entrenchment hypothesis have, however, come under attack. The theory assumes that without the payment of greenmail, the bidder would have taken control and incumbent management would have been replaced.<sup>40</sup> As Professor Roger Dennis points out, however, a bidder

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37. For a more detailed discussion of agency costs and greenmail, see Macey & McChesney, *supra* note 24, at 38-43; Note, *supra* note 22, at 1048-49.

38. Easterbrook and Fischel argue that the only proper response to a tender offer is complete managerial passivity. At most, management should offer resistance to takeover attempts only to the extent that they may issue a press release urging shareholders to reject the offer. Easterbrook & Fischel, *supra* note 31, at 1164, 1201.

By contrast, other scholars, who also endorse a general prohibition against takeover defense tactics, believe that there are benefits derived from requiring management to facilitate an auction for tender offer bids. Bebchuck, *The Case for Facilitating Competing Tender Offers*, 95 HARV. L. REV. 1028, 1029-30, 1054 (1982) (arguing that target shareholder welfare and social welfare are enhanced when management is required, as part of its fiduciary duty, to seek a higher offer); Gilson, *A Structural Approach to Corporations: The Case Against Defensive Tactics in Tender Offers*, 33 STAN. L. REV. 819, 848, 867 (1981) [hereinafter Gilson, *A Structural Approach*] (rejecting defensive tactics in general but recommending active negotiations by target management in order to produce tender offer information which facilitates shareholder comparison of the value of the target with the value of the offer). See also Bebchuck, *The Case for Facilitating Tender Offers: A Reply and Extension*, 35 STAN. L. REV. 23, 24-25, 45-46 (1982) (providing further support for an "auctioneering rule" and emphasizing the need for a regulatory delay period to secure the time that is necessary for competing bids); Gilson, *Seeking Competitive Bids Versus Pure Passivity in Tender Offer Defense*, 35 STAN. L. REV. 51, 62-64, 66 (1982) (arguing that allowing management to solicit competing bids may increase the return to the bidder on the costs of the search and will more efficiently allocate assets to their most productive users). But see Easterbrook & Fischel, *Auctions and Sunk Costs in Tender Offers*, 35 STAN. L. REV. 1, 21 (1982) (responding to the proponents of facilitating auctions and emphasizing the possibility of decreased returns to potential bidders, resulting in decreased monitoring in general).

39. Two studies which compared the stock prices of firms paying greenmail before and after the payment found significant declines in share prices when firms paid greenmail. See Dann & DeAngelo, *Standstill Agreements, Privately Negotiated Stock Repurchases, and the Market for Corporate Control*, 11 J. FIN. ECON 301, 307 (1983). It is posited that a decline in the value of the firm as measured by the price of a share is not in the best interests of the firm's shareholders. Macey & McChesney, *supra* note 24, at 43.

40. Dennis, *supra* note 23, at 333.

might be deterred by other defensive measures and, even if the takeover is successful, incumbent management may be retained.<sup>41</sup>

Even if greenmail is paid, those in management may not be successful in preserving their positions.<sup>42</sup> The greenmail may signal<sup>43</sup> other prospective bidders that opportunities for takeover gains exist.<sup>44</sup> Therefore, Professors Jonathan Macey and Fred McChesney argue that if managers pay greenmail in order to preserve their jobs, they must be prepared to repeat the process with other bidders in the future.<sup>45</sup> A pattern of greenmail payment would eventually result in the removal of management by shareholders or by a successful bidder.<sup>46</sup> In this sense greenmail is "firm-specific."<sup>47</sup> Unlike other defensive tactics which are intended to protect against both present and future takeover attempts, greenmail eliminates only one bidder — the greenmailer. Since other takeover attempts are likely to follow, management cannot logically expect to preserve its position. Therefore, Macey and McChesney conclude that the hypothesis that greenmail is paid to entrench management is flawed.<sup>48</sup>

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41. *Id.*

42. Professor Dennis notes that the ability of management to maintain tenure following greenmail payment may be a function of the number of shares which they directly control. If management controls a "significant" proportion of total outstanding shares, the repurchase may decrease the number of shares available to the other bidders and thereby decrease the likelihood of additional takeover attempts. If management holds a limited number of outstanding shares, the chances for further takeover attempts are not diminished. *Id.* at 333-34.

43. *See infra* notes 61-74 and accompanying text.

44. The payment of greenmail informs the market that one bidder identified potential takeover gains. This evaluation may gain credibility in the market place if the original bidder has made public the specific source of those gains by disclosing future plans for the target. Dennis, *supra* note 23, at 334.

45. Macey & McChesney, *supra* note 24, at 41.

46. Professors Macey and McChesney see this result as inevitable since the repeated payment of greenmail decreases firm assets:

The more greenmail a firm pays, the greater the diminution of its assets, and so the greater the drop in the price of its shares. This drop in share price alerts shareholders to management's pursuit of job tenure rather than firm profits, thereby increasing the likelihood of management being ousted. Moreover, this drop may facilitate takeover by yet another outsider, whose first act will be dismissal of the management that has dissipated firm assets so fruitlessly. Thus, even if one believes that agency costs are a formidable problem in larger corporations, greenmail seems a self-defeating tactic for managers concerned about job tenure.

*Id.*

47. *Id.* at 42.

48. Macey and McChesney may be overestimating the role of logic in the managerial response. It is not difficult to imagine a "short-sighted" response, based on a perceived

Agency cost problems may also be overstated. Managers who pursue their own interests at the expense of shareholder interests may be disciplined by the "market for managers."<sup>49</sup> This force serves to monitor agency costs independently of the market for corporate control. Further, if agency costs pose particular problems in the greenmail context, shareholders could choose to draft charter amendments which prohibit greenmail outright or which require approval by a majority of disinterested shareholders.<sup>50</sup> The costs for drafting such a provision would be minimal in a newly-formed corporation. The fact that few corporations, including those newly-formed, have pursued this option is inconsistent with the basic premises of the agency-cost theory.

Even if the management-entrenchment hypothesis correctly predicts management behavior, there may be no valid reason to prohibit greenmail payments.<sup>51</sup> Shareholders who expect a higher takeover bid may prefer to eliminate the original bidder and may endorse the payment of greenmail, even if it is made to entrench management.<sup>52</sup>

#### b. The Unfairness Objection

Another objection to the payment of greenmail focuses on the premium paid to the bidder for the repurchase of shares. Fairness seems to dictate that the appropriate price to pay for outstanding shares held by a minority shareholder posing a threat of takeover is the price at which all other shares are sold on the open market.<sup>53</sup> However, the minority shareholder is viewed as possessing *de facto* control over the corporation.<sup>54</sup> To regain that control, a

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immediate need for self-preservation.

49. Macey and McChesney, *supra* note 24, at 40-41 n.91.

50. *Id.*

51. *Id.* at 42.

52. "[S]uccessful firms are precisely those that align shareholder and manager incentives. Managers may do the right things (from the shareholders' perspective) for the wrong reasons." *Id.*

53. Arguably a large block of shares offered for sale at one time might disrupt the market. The result would be a discounted price, or "blockage penalty" for the block of shares. Dennis, *supra* note 23, at 339.

54. If the bidder has established actual control, the repurchase of shares at a premium would constitute self-dealing and would no longer be considered greenmail. Macey & McChesney, *supra* note 24, at 48 n.121. See also Nathan & Sobel, *Corporate Stock Repurchases in the Context of Unsolicited Takeover Bids*, 35 BUS. LAW. 1545, 1554 (1980) (arguing that the "fairness doctrine" and special kinds of fiduciary duty should be applicable only when the bidder selling the block of shares is in a control position).

premium over market price is typically paid to the minority shareholder. Only one shareholder receives a premium for the repurchase of control. This unequal treatment of shareholders is viewed as unfair.<sup>55</sup>

Critics of this reasoning emphasize that unequal treatment of shareholders may not be unfair if the equality among shareholders is superficial and if significant differences exist which justify differentiated treatment.<sup>56</sup> If a repurchase of control is viewed as the real basis for the premium, an argument against the unfairness objection can be made. The value of control has been increased by the minority shareholder who reasonably expects to keep the gain produced.<sup>57</sup> Other shareholders who expect to share in the premium are actually trying to free-ride on a gain produced by only one shareholder. An equal opportunity for all shareholders to sell their shares at a premium would actually be unfair to the minority shareholder.

The payment of greenmail may also be defended if the premium is viewed as a payment for information rather than for repurchase of control.<sup>58</sup> If a higher takeover bid is likely, the shareholders may be willing to pay the greenmail, including the premium, to obtain information developed by the greenmailer. The minority shareholder who has identified a means for increasing the value of the firm is not equal to all other shareholders. Payment of a premium for information is, therefore, not unfair.

## 2. The Case in Favor of Greenmail

The economic theories which support greenmail emphasize the role of information in the market for corporate control. Managers who possess non-public information may use greenmail to signal the market and facilitate an auction for competing bids.<sup>59</sup>

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55. The critics of greenmail maintain that the minority shareholder's stock should be acquired through a tender offer made to all shareholders. Macey & McChesney, *supra* note 24, at 48.

56. For example, to counter the argument that a large block of shares be sold at market value just as small blocks of shares, it is possible to justify a premium based on several advantages to the corporation. The corporation would have to pay a premium to accumulate a significant number of its securities on the open market. This premium is simply paid to the minority shareholder who has already accumulated the block and thereby removed price and timing uncertainties in the repurchase plan. Nathan & Sobel, *supra* note 54, at 1554.

57. Macey & McChesney, *supra* note 24, at 48-49.

58. *Id.*

59. See *infra* notes 61-74 and accompanying text.

Alternately, bidders may be encouraged to seek out and act on information regarding undervalued firms if greenmail is available to reduce the risk involved for the bidder.<sup>60</sup>

a. The Shareholder Welfare Hypothesis

The agency cost theory<sup>61</sup> is based on the theory of efficient capital markets which maintains that all relevant and ascertainable information is immediately incorporated into the market price of shares.<sup>62</sup> Without debating this widely accepted hypothesis, the proponents of greenmail build a theory based on the limits of the efficient capital markets theory. While all *public* information may be reflected in share price, the theory does not suggest that *privately* held information is also incorporated.<sup>63</sup> Directors may possess inside information which leads them to believe that their corporation's shares are undervalued on the market.<sup>64</sup> If the information loses its value when revealed,<sup>65</sup> the directors cannot align the correct value of the firm with market share price simply by making public the information.

Directors may recognize that their firm offers gains which can be realized by a potential acquiror. However, they may choose to reject an initial tender offer if the bid is too low or if there is a strong likelihood that a higher bid can be obtained.<sup>66</sup> Relying on private information, management may selectively reject one bidder, thereby signalling to other prospective bidders the existence

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60. See *infra* notes 75-91 and accompanying text.

61. See *supra* notes 28-36 and accompanying text.

62. The Efficient Capital Market Hypothesis (ECMH) assumes that the prevailing stock price immediately assimilates new information provided to the market. See generally Fama, *Efficient Capital Markets: A Review of Theory and Empirical Work*, 25 J. FIN. 383 (1970); Fischel, *Efficient Capital Market Theory, the Market for Corporate Control, and the Regulation of Cash Tender Offers*, 57 TEX. L. REV. 1 (1978); Gilson & Kraakman, *The Mechanisms of Market Efficiency*, 70 VA. L. REV. 549 (1984); Gordon & Kornhauser, *Efficient Markets, Costly Information, and Securities Research*, 60 N.Y.U. L. REV. 761, 770 (1985).

63. Note, *supra* note 22, at 1049.

64. Introduction of a new product or the value of a particular asset are examples of the type of information which may be non-public. Comment, *supra* note 24, at 1304.

65. For example, trade secrets must be kept proprietary or they will lose their value. Note, *supra* note 22, at 1050.

66. Professors Macey and McChesney have developed in detail a theoretical framework in which greenmail may improve the price shareholders receive by facilitating an auction for bids. Macey & McChesney, *supra* note 24, at 16-27. Earlier arguments favoring an auction for tender offer bids did not contemplate the use of greenmail in such a manner. All defensive tactics were considered indefensible. See *supra* note 38.



of unidentified gains worthy of investigation.<sup>67</sup> This signal may facilitate an auction for control of the firm to the highest bidder. The payment of greenmail thereby maximizes shareholder welfare.

Several assumptions underlying this theory have been attacked.<sup>68</sup> The analysis seems to require differentiation between "conscientious" and "self-interested" management. In cases of conscientious management, greenmail is paid when management believes that the bid offered is too low and that a higher bid is possible. If the greenmailer were to agree with management's valuation of the firm and saw the potential for another bidder, he would offer a higher bid and pursue acquisition rather than accept the greenmail. To objectively justify the payment of greenmail, management's beliefs regarding the likelihood of a higher bid must be more accurate than the beliefs held by the original bidder.<sup>69</sup> However, in some instances the beliefs of the original bidder may be more accurate.<sup>70</sup>

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67. For a thorough analysis of the use of greenmail as a signal to other potential bidders, see Shleifer & Vishny, *supra* note 24. The authors argue that the payment of greenmail signals the market that the target corporation has not yet identified a "white knight." *Id.* at 294-95. A "white knight" is a "potential acquirer invited by the target management to top an initial offer opposed by that management." *Id.* at 294. The existence of a white knight would ordinarily deter prospective bidders from seeking additional information about the target corporation. The signal that there is no white knight can encourage the acquisition of information and facilitate an auction. In this way, greenmail may benefit shareholders. *Id.* at 307.

68. See Gordon & Kornhauser, *supra* note 22, at 313-19 (criticizing the framework established by Macey and McChesney). For a vigorous defense of their original work, see Macey, *Takeover Defense Tactics and Legal Scholarship: Market Forces Versus the Policymaker's Dilemma*, 96 YALE L.J. 342 (1986) and McChesney, *Assumptions, Empirical Evidence and Social Science Method*, 96 YALE L.J. 339 (1986).

69. Gordon & Kornhauser, *supra* note 22, at 315.

70. The question of who is more accurate may depend on the anticipated source of gains:

In cases of synergistic undervaluation, target management might reasonably be unaware of potential synergies with other assets, while the acquiror more probably would understand the manner in which the target's assets would enhance operations like its own . . . .

If the undervaluation results from management inefficiency, target management arguably should have more accurate beliefs, since it has the most comprehensive knowledge about the target's current operations. But why would conscientious management be subject to undervaluation due to management inefficiencies? Perhaps management is well-meaning but incompetent. Incompetence suggests that management requires a takeover to cure its own deficiencies; yet management's incompetence must not prevent its accurate valuation of the target's assets. This combination of incompetent management and accurate valuation is implausible.

Yet another assumption underlies the justification of greenmail in cases of conscientious management. Before management can facilitate an auction, several bidders must be available. If only one other bidder exists, the final bidder would not be motivated to offer a higher bid once the greenmailer was removed from competition.<sup>71</sup>

If directors are self-interested, they will pay greenmail only when they believe that another bid is unlikely. If management were aware of another, higher bidder, the payment of greenmail would be self-defeating.<sup>72</sup> For greenmail to be justified as benefiting shareholders in this context, management's beliefs must be inaccurate and other bidders must be available for auction.<sup>73</sup> The argument here is not that the assumptions themselves defeat the shareholder welfare theory, but that it is unlikely that the assumptions are valid.<sup>74</sup>

#### b. The Free-Rider Problem

As noted earlier, many scholars assert that high agency costs are a primary cause of undervaluation of a firm.<sup>75</sup> Shareholders and managers are unable to effectively monitor management and reduce these costs. A major obstacle hindering shareholders is the free-rider problem. Shareholders are unwilling to monitor management because gains resulting from their efforts, specifically the improved performance of the firm, will be distributed among all shareholders.<sup>76</sup> Similarly, managers might be unwilling to monitor management when other managers and shareholders can free-ride on the information produced.<sup>77</sup>

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*Id.* at 315-16.

71. *Id.* at 316.

72. See *supra* notes 42-46 and accompanying text.

73. Gordon & Kornhauser, *supra* note 22, at 317-18.

74. Gordon and Kornhauser have summarized their conclusions regarding the only possible circumstances in which shareholders would want to pay greenmail:

Shareholders would want management to pay greenmail only (1) when conscientious management has more accurate and more favorable beliefs about the prospects of a third party bid, or (2) when self-interested management has more accurate and more favorable beliefs about the true value of the firm than the acquiror but less accurate and less favorable beliefs about the prospects of a successful third party bid. These circumstances are highly unlikely.

*Id.* at 319.

75. See *supra* notes 29-36 and accompanying text.

76. See *supra* note 32.

77. See *supra* note 31.

Prospective bidders must also contend with the free-riding problem.<sup>78</sup> To identify targets for takeover, potential acquirors seek information on unrecognized sources of gains. The gains may flow from identifying potential synergies or from identifying inefficient or incompetent management. However, the cost of acquiring this information may be substantial. While these costs may be recouped by the gains realized in a successful acquisition,<sup>79</sup> an attempt at takeover may not succeed.

By acting on the information, the prospective bidder signals<sup>80</sup> others in the marketplace that the target is the source of previously unrecognized gains. Other bidders, with no information costs to recover, are free to enter a bidding contest with the original bidder.<sup>81</sup> The result of this free-riding is that each bidder must face a substantial risk in initiating a bid for a target.<sup>82</sup> The effect on the market for corporate control is that the overall number of initial bids is reduced.<sup>83</sup> Potential bidders are likely to reduce or terminate the search for information.<sup>84</sup>

Greenmail may be viewed as a solution to this problem. Since all other defensive measures increase the likelihood of failure of takeover attempts, they serve to decrease the number of initial bids and the search for information.<sup>85</sup> Availability of greenmail payments, on the other hand, may increase the number of initial bids by decreasing the bidder's risk of incurring unrecovered search costs and by simultaneously mitigating the free-rider problem.<sup>86</sup> The possibility of a greenmail payment may persuade the bidder that the risks of offering the initial bid are sufficiently reduced to justify initiating an information search. Therefore, greenmail may represent a payment to the offeror for the market price of the shares held plus a premium to reimburse the offeror for the

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78. See Note, *supra* note 22, at 1055-56.

79. The total cost to be recouped includes not only the search costs for the targeted corporation, but also the costs for unsuccessful searches. *Id.* at 1055.

80. *Id.* at 1049.

81. Bids entered by subsequent contenders can be higher than the original bid since only the original bidder must expend resources to cover search costs. The original bidder must raise the offer or admit defeat. Macey & McChesney, *supra* note 24, at 29.

82. See Comment, *supra* note 24, at 1303-04.

83. Macey & McChesney, *supra* note 24, at 29.

84. Just as all shareholders benefit when tender offerors monitor the market, all shareholders are harmed when the risk of uncompensated costs decreases the search for information. See *supra* note 35.

85. Macey & McChesney, *supra* note 24, at 30.

86. *Id.*

costs incurred in the acquisition of information. Shareholders benefit from increased monitoring of the market by potential bidders<sup>87</sup> and specifically from the information produced which results in an auction for a higher bid.<sup>88</sup> Greenmail is distinct from all other forms of defensive tactics in that it appears to benefit the shareholder.

The scholars who criticize the payment of greenmail as a partial solution to the free-rider problem rely on empirical studies which indicate that share prices decline immediately after the greenmail payment.<sup>89</sup> Managers are under a duty to protect the interests of shareholders who, empirically, are harmed by greenmail.<sup>90</sup> The risks and costs to potential bidders should be of no concern to managers.<sup>91</sup> The critics conclude that greenmail should not be paid.

### 3. The Consequences of Ambiguity in the Theory

The disagreements among scholars concerning the harm or value of greenmail make it clear that this is a subject on which reasonable minds can differ. Regarding the payment of greenmail, Macey and McChesney have observed that "greenmail is [not] an unmitigated good, but . . . it is not an unmitigated bad, either. No unambiguous inference can be made from the mere fact that greenmail is paid . . . ."<sup>92</sup>

Since the payment of greenmail is an ambiguous act, it cannot *automatically* be assumed to be a breach of fiduciary duty. The fact that the greenmailer knows the payment of greenmail includes a premium does not mean that the greenmailer knows *a priori* that harm will outweigh the benefits to shareholders or that the directors have breached their fiduciary duties. The ambiguity and uncertainty of the theories surrounding greenmail indicate that a greenmailer should not be held liable for aiding and abetting the breach of fiduciary duty merely on the basis of the knowledge that greenmail was paid and received.

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87. Dennis, *supra* note 23, at 332.

88. Macey & McChesney, *supra* note 24, at 32.

89. See *supra* note 39.

90. Note, *supra* note 22, at 1056.

91. *Id.*

92. Macey & McChesney, *supra* note 24, at 50.

## B. Implications for the Liability of Managers

While bills proposing regulation of greenmail still exist,<sup>93</sup> the ambiguity of the theory may explain why legislators have been unwilling to set out hard and fast rules governing the payment of greenmail. Presently, as long as there is full disclosure to shareholders of the greenmail payment, it is unlikely that corporate directors will be held liable for a violation of federal law.<sup>94</sup>

When it is alleged that directors have breached their fiduciary duty under state law, the ambiguity of the theory alone affords some protection for the directors. In addition, managers are protected by the judicial application of the business judgment rule.

Under state law, directors typically are given the authority to manage the business and affairs of the corporation and to delegate their power of management to others,<sup>95</sup> such as corporate officers. However, for the protection of the shareholders, the managers are also charged with the fiduciary duty of care.<sup>96</sup>

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93. See *supra* note 1. Consideration of existing and proposed federal and state regulatory statutes is outside the scope of this Note. For an analysis of state legislative actions and federal securities law regarding greenmail, see Comment, *supra* note 24, at 1292-1301. For a critical assessment of legislative initiatives against greenmail, see Macey & McChesney, *supra* note 24, at 51-53. For a criticism of current legislative proposals which "legalize" greenmail by creating a safe harbor and for an alternate proposal for evaluating greenmail in terms of its effect on stock prices after the repurchase, see Gilson, *Drafting an Effective Greenmail Prohibition*, 88 COLUM. L. REV. 329, 331, 352-53 (1988).

94. Dennis, *supra* note 23, at 283.

95. The Model Business Corporation Act provides that "[a]ll corporate powers shall be exercised by or under the authority of, and the business and affairs of the corporation managed under the direction of, its board of directors, subject to any limitation set forth in the articles of incorporation." MODEL BUSINESS CORP. ACT § 8.01 (b) (1984). The official comment indicates that the wording is intended to provide leeway for those corporations in which direct management by directors is impractical. In such cases, the board may delegate to appropriate officers those powers which the board is not required by law to exercise itself. MODEL BUSINESS CORP. ACT § 8.01 (b), official comment (1984). State statutes contain similar provisions. See, e.g., CAL. CORP. CODE § 300(a) (West Supp. 1988); DEL. CODE ANN. tit. 8, § 141(a) (Supp. 1988).

96. The duty of care is identified in section 8.30(a) of the Model Business Corporation Act:

### General Standards for Directors

(a) A director shall discharge his duties as a director, including his duties as a member of a committee:

(1) in good faith;

(2) with the care an ordinarily prudent person in a like position would exercise under similar circumstances; and

(3) in a manner he reasonably believes to be in the best interest of the corporation.

MODEL BUSINESS CORP. ACT § 8.30(a) (1984). Subsection (2) sets out the standard for the

The duty of care is the standard to which managers are held. Directors must demonstrate that they prepared adequately for the decisionmaking process by showing that their judgment was *informed*.<sup>97</sup> However, courts are reluctant to second guess the quality of the analysis and the actual judgment that led to a particular decision. If the decision is informed, the courts will give deference to "honest business judgment"<sup>98</sup> and will not hold managers "liable for mistakes of judgment in actions arguably taken for the benefit of the corporation."<sup>99</sup> Therefore, "even though hindsight indicates the decision was not the wisest course,"<sup>100</sup> managers will be afforded some protection by the courts. This protection, referred to as the business judgment rule,<sup>101</sup> means that courts, while still requiring informed judgment, will be unwilling to scrutinize the actual analysis undertaken and the judgment made as long as "any rational business purpose can be attributed to [a] decision."<sup>102</sup>

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duty of care. Similar standards are established by state common law or statute. *See, e.g., CAL. CORP. CODE* § 309(a) (West Supp. 1988).

97. "The judgment of the directors must be an 'informed' one, with the inquiry directed to the material or advice the board had available to it and whether it had sufficient opportunity to acquire knowledge concerning the problem before acting." *Moran v. Household Int'l, Inc.*, 490 A.2d 1059, 1075 (Del. Ch.), *aff'd*, 500 A.2d 1346 (Del. 1985). However, the courts may give wide latitude to the managers in fulfilling this duty. For example, when B.F. Goodrich was faced with a possible takeover attempt, it consummated an acquisition for which it had unsuccessfully negotiated earlier. The court accepted the officers' reliance on studies and financial analyses completed four years earlier with only a brief, handwritten memorandum of valuation for the acquisition and a sheet of paper containing longhand calculations to provide updated information. *Northwest Indus. v. B.F. Goodrich Co.*, 301 F. Supp. 706, 709 nn.3 & 6 (N.D. Ill. 1969)(applying New York law).

98. *Northwest Indus.*, 301 F. Supp. at 711. The court defined "honest business judgment" as "the exercise of that care which businessmen of ordinary prudence use in managing their own affairs." *Id.* The requirement of ordinary prudence echoes the standards set forth in section 8.30(a)(2) of the Model Business Corporation Act. *See supra* note 96.

99. *Moran v. Household Int'l, Inc.*, 490 A.2d 1059, 1074 (Del. Ch.), *aff'd*, 500 A.2d 1346 (Del. 1985).

100. *Cheff v. Mathes*, 41 Del. Ch. 494, 505, 199 A.2d 548, 554 (1964).

101. Jurisdictions vary in their wording of the rule. The following is typical of the language used by Delaware courts:

The business judgment rule is an acknowledgment of the managerial prerogatives of Delaware directors . . . . It is a presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company.

*Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984) (citations omitted).

102. *Kaplan v. Goldsamt*, 380 A.2d 556, 568 (Del. Ch. 1977)(involving the repurchase of stock from a dissident director/shareholder).

The directors of the corporation are afforded protection by both the ambiguity of the theory regarding greenmail and the business judgment rule. The act of payment is ambiguous, and the decision to pay will not be judicially reviewed with strict scrutiny.

### C. Implications for the Liability of Greenmailers

The act of payment of greenmail is, without more, insufficient to establish the liability of the greenmailer. First, the ambiguity of the theory makes it difficult to determine at the time of payment whether the harm will exceed the benefit. Second, even if the harm does outweigh the benefit, the protection provided by the business judgment rule makes it unlikely that the courts will conclude that the directors breached their fiduciary duty of care. Therefore, awareness of the payment alone does not satisfy the knowledge requirement for aiding and abetting the breach of fiduciary duty by the directors.

However, it is important to recognize the limits of this conclusion. If the greenmailer has knowledge of *actual harm* to the shareholders, in addition to knowledge that the greenmail was paid, the additional knowledge may satisfy the element of knowledge of the breach. In *Heckmann v. Ahmanson*,<sup>103</sup> Saul Steinberg and associates acquired more than two million shares of Walt Disney Productions.<sup>104</sup> Interpreting this action as an initial step in a takeover action, the Disney directors countered by acquiring the Arvida Corporation and thereby assuming \$190 million in debt.<sup>105</sup> Three months later the Disney directors repurchased all of the Steinberg shares for approximately \$77 a share, which included a premium over the market price.<sup>106</sup> This repurchase, which the court categorized as greenmail, was financed through increased borrowing.<sup>107</sup> With the debt assumed following the acquisition of

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103. 168 Cal. App. 3d 119, 214 Cal. Rptr. 177 (1985). For a discussion of the role that *Heckmann* played in establishing tort liability for the greenmailer, see Note, *Liability for Greenmailers: A Tort is Born*, 19 IND. L. REV. 761 (1986).

104. *Heckmann v. Ahmanson*, 168 Cal. App. 3d 119, 124, 214 Cal. Rptr. 177, 180 (1985).

105. *Id.*

106. *Id.* at 124-25, 214 Cal. Rptr. at 180-81. The exact market price at the time of repurchase is not stated. However, Steinberg was prepared to pay \$67.50 a share in a tender offer at that time. Assuming that this figure approximates market price, Steinberg received a premium of \$9.50 a share, or fourteen percent of market price. According to the repurchase agreement, part of the repurchase price was a reimbursement of the costs Steinberg incurred in preparing the tender offer. *Id.*

107. *Id.* at 124, 126, 214 Cal. Rptr. at 180-81.

Arvida and the repurchase of the Steinberg shares, corporate debt rose to two-thirds of equity.<sup>108</sup> This action harmed the shareholders because it negatively affected the corporation's credit rating and stock prices.

In reviewing a lower court decision to issue an injunction which, in effect, imposed a constructive trust on the profits of the repurchase,<sup>109</sup> the court of appeals concluded that at the trial on the merits, Steinberg could be held liable as an aider and abettor in the breach of fiduciary duty.<sup>110</sup> Steinberg "knew or should have known Disney was borrowing the \$325 million purchase price. From its previous dealings with Disney, including the Arvida transaction, it knew the increased debt load would adversely affect Disney's credit rating and the price of its stock."<sup>111</sup> The argument that Steinberg had *actual* knowledge of harm flowing to the Disney shareholders is strengthened by the fact that Steinberg, while still a shareholder, attempted to block the acquisition of Arvida and the assumption of the \$190 million debt with a derivative suit.<sup>112</sup> If Steinberg had argued in court that the assumption of Arvida's debt would lower shareholder value, then the increase in debt to finance the repurchase could only further harm the shareholders. These facts suggest that the greenmailer knew that the actual harm to shareholders exceeded the benefits.<sup>113</sup>

Therefore, when the greenmailer possesses actual knowledge of harm to the shareholders, there is a possibility<sup>114</sup> that the requirement of knowledge of the breach will be satisfied. However, if the greenmailer knows only that the shares are being repurchased at a premium, the ambiguity of the theory regarding greenmail and the protections of the business judgment rule preclude the possibility of concluding *a priori* that the shareholders will be harmed and that a fiduciary duty will be breached.

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108. *Id.*

109. *Id.* at 123, 214 Cal. Rptr. at 180.

110. *Id.* at 127, 214 Cal. Rptr. at 182-83.

111. *Id.*

112. *Id.* at 124, 214 Cal. Rptr. at 180.

113. See *supra* text accompanying notes 103-12.

114. It is not clear that the court would have concluded that knowledge of actual harm would be sufficient in and of itself to establish the element of knowledge of the breach. The court also stated that Steinberg and associates "knew it was reselling its stock at a price considerably above market value to enable the Disney directors to retain control of the corporation." Heckmann, 168 Cal. App. 3d at 127, 214 Cal. Rptr. at 182 (emphasis added). For the significance of this additional information, see *infra* notes 115-84 and accompanying text.



### III. THE PREREQUISITE KNOWLEDGE: THE FIDUCIARY'S CONFLICT OF INTEREST

If knowledge of the payment of greenmail, without actual knowledge of specific harm flowing to the shareholders, is insufficient to establish knowledge of a breach of fiduciary duty, what knowledge is required? Three cases involving takeovers and mergers suggest an answer, although they do not involve greenmail. In each case the knowledge required to establish knowledge of the breach of fiduciary duty is the *actual* knowledge of the managers' conflict of interest.

#### A. Conflict and the Business Judgment Rule

As noted earlier, state law gives managers the authority to manage the business and affairs of the corporation, but simultaneously imposes on them duties of care and loyalty to protect the shareholders.<sup>115</sup> To meet the duty of care, the managers' decision must be an informed one, but great deference is given to the analysis and judgment stages of the decision making process. This deference, the business judgment rule, means that the courts will use a lower level of scrutiny when examining the analysis and judgment aspects of a business decision.

The duty of loyalty requires directors to subordinate their own interests and to single-mindedly pursue the best interests of the corporation.<sup>116</sup> If the directors are faced with a conflict of interest, the decision may be self-serving and, therefore, a breach of the fiduciary duty of loyalty. When there is evidence of a conflict of interest and breach of the duty of loyalty, the protection afforded by the business judgment rule is removed. While managerial decisions which reflect poor judgment or incompetence are shielded by the business judgment rule, decisions which are conflicted are not similarly protected. The courts raise the level of judicial scrutiny and require the defendants to show that the deci-

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115. See *supra* notes 95-102 and accompanying text. For an argument that the duty of care and duty of loyalty analysis cannot resolve the conflict of interests concern presented by defensive tactics, see Gilson, *A Structural Approach*, *supra* note 38, at 821-31.

116. The Model Business Corporation Act requires a director to discharge his duties "in a manner he reasonably believes to be in the best interests of the corporation." MODEL BUSINESS CORP. ACT § 8.30(a)(3). See *supra* note 96. If the directors pursue the best interests of the corporation, the value of the firm will be maximized, which is in the best interests of the shareholders.

sion made was fair to shareholders.<sup>117</sup> The closer scrutiny will typically be triggered by a showing of fraud or bad faith.<sup>118</sup>

### B. Consequences of Conflict in the Managers

Once a court determines that managers are conflicted in their decisionmaking, the court will look more closely at the decision reached. Directors then must establish that in spite of the possibility of conflict, they did not breach their duty of loyalty.

During a takeover attempt, the offeror may or may not know that the directors have actually succumbed to the conflict of interest. If the greenmailer in a takeover attempt has actual awareness of the existence of a managerial conflict of interest, however, the courts will let stand a claim of aiding and abetting the breach of fiduciary duty. The courts seem to conclude that once the offeror has knowledge of a conflict, the ambiguity of the results of the payment dissipates. Where there is knowledge of the presence of conflict, the offeror has imputed knowledge of the harm to shareholders and of the breach of fiduciary duty.

There are two cases from the Delaware courts addressing the aider and abettor claim. In *Gilbert v. El Paso Co.*,<sup>119</sup> the chancery court denied the defendants' motion for summary judgment on a claim of aiding and abetting the breach of fiduciary duties.<sup>120</sup> Burlington Industries (Burlington) had initiated a hostile takeover of El Paso Company (El Paso) by making a tender offer for fifty-one percent of El Paso's shares.<sup>121</sup> The tender offer was made, how-

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117. See, e.g., *Terrydale Liquidating Trust v. Barness*, 611 F. Supp. 1006, 1018 (S.D.N.Y. 1984), *aff'd*, 846 F.2d 845 (2d Cir. 1988)(the court held that transferring trustees breached no fiduciary duty in selling trust assets and liquidating the trust to thwart a tender offer, and that imposition of a constructive trust was unwarranted).

118. See, e.g., *Klaus v. Hi-Shear Corp.*, 528 F.2d 225, 233 (9th Cir. 1975)(requiring "fraud or breach of trust" to entertain a challenge to the business judgment of the directors under California law); *Northwest Indus. v. B.F. Goodrich Co.*, 301 F. Supp. 706, 712 (N.D. Ill. 1969)(requiring "proof of fraud or manifestly oppressive conduct to set aside an action of the directors" under New York law); *Moran v. Household Int'l*, 490 A.2d 1059, 1074 (Del. Ch.), *aff'd*, 500 A.2d 1346 (Del. 1985)(requiring "fraud or bad faith" to hold directors liable for mistakes of judgment under Delaware law).

119. 490 A.2d 1050 (Del. Ch. 1984).

120. *Id.* at 1058. However, the court did dismiss charges based on infringement of contractual rights and on a direct fiduciary duty. *Id.* at 1051. While the chancery court upheld the availability of a claim of aiding and abetting the breach of fiduciary duty, at the trial on the merits the court held that the directors did not breach their fiduciary duties, and therefore, rejected the aiding and abetting claim. *Gilbert v. El Paso*, No. 7075, slip op. (Del. Ch. Nov. 21, 1988).

121. *Gilbert v. El Paso Co.*, 490 A.2d 1050, 1053 (Del. Ch. 1984).

ever, subject to certain "conditions" which anticipated common defensive tactics.<sup>122</sup> If these events occurred, Burlington had a right to terminate the offer.<sup>123</sup> Over the following three weeks, although several of the conditions occurred, Burlington did not withdraw the tender offer.<sup>124</sup> At the end of that three week period, when it was clear that a sufficient number of shares had been tendered and that Burlington would obtain a fifty-one percent interest in El Paso, Burlington and the El Paso board of directors reached a "friendly" agreement.<sup>125</sup> The agreement terminated the first tender offer and commenced a second offer.<sup>126</sup> A key difference between the two offers was the number of shares for which Burlington tendered.<sup>127</sup> In the first tender, Burlington offered for 25.1 million shares at a twenty-five percent premium over market price. In the second tender, Burlington offered the same price for only 21 million shares.<sup>128</sup> The remaining shares it needed in order to acquire fifty-one percent of El Paso were obtained by purchasing treasury shares and shares owned by certain El Paso directors who had not tendered in the first offer.<sup>129</sup>

In a class action, El Paso shareholders who had tendered in the first offer claimed that they were harmed by the agreement with Burlington.<sup>130</sup> Not only was the second tender offer for fewer shares, but it was oversubscribed with more than 40 million shares tendered.<sup>131</sup> Even though the tender price remained unchanged, the shareholders who had tendered in the first offer were denied the opportunity to obtain the premium on all of their shares, since shares were purchased on a pro rata basis.<sup>132</sup> The plaintiffs argued

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122. *Id.* The "conditions" included "(1) litigation challenging the tender offer, (2) a change, or proposed change, in the business, assets, or properties of El Paso, (3) the issuance of, or a proposal to issue, additional shares of El Paso stock, (4) the adoption of, or a proposal to adopt, any amendment to El Paso's charter or by-laws, and (5) a definitive agreement for a merger or other business combination between El Paso and Burlington." *Id.*

123. *Id.*

124. *Id.*

125. *Id.*

126. *Id.*

127. *Id.*

128. *Id.*

129. *Id.*

130. *Id.*

131. *Id.*

132. *Id.* Later, Burlington acquired all the remaining outstanding shares of El Paso at the same premium price. *Id.* at 1054. However, this final offer was not announced when the second tender was made. Not expecting to be able to obtain the same premium, several

that the El Paso directors, recognizing the inevitability of a take-over, "abandoned their resistance in order to fashion a better deal for themselves at the expense of certain of its shareholders."<sup>133</sup> Therefore, the El Paso directors had breached their fiduciary duty to their shareholders.<sup>134</sup> Through its agreement with the El Paso directors, Burlington allegedly aided and abetted the breach.<sup>135</sup>

The court rejected Burlington's argument that it was merely conducting arms-length negotiations and pursuing the best interests of its own shareholders in its negotiations.<sup>136</sup> The court observed:

Clearly, the purchase of approximately 556,000 shares from El Paso's directors, who had disdained tendering into the December offer, falls within the ambit of a claim of civil conspiracy. By agreeing to purchase them from El Paso's directors, Burlington is chargeable with knowledge that El Paso's directors were preferring their interests to certain of its shareholders who had already tendered.<sup>137</sup>

Burlington "presumably was aware that certain terms [of the agreement] would result in certain of El Paso's own shareholders being squeezed out of the second offer."<sup>138</sup> Burlington's awareness of the directors' conflict of interest and its awareness of the harm flowing from that conflict would be sufficient to establish knowledge of the El Paso directors' breach of fiduciary duty.<sup>139</sup>

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shareholders sold their shares on the open market without the benefit of the premium. *Id.*

133. *Id.* at 1056. The concern here is self-dealing rather than entrenchment.

134. *Id.* at 1057. The board was free to attempt to persuade the shareholders not to tender their shares, but it could not "interfere with the alienability of the tendered shares by pursuing its own interests." *Id.*

135. *Id.* at 1056.

136. *Id.* at 1057-58.

137. *Id.* at 1057.

138. *Id.* at 1056.

139. The court distinguished an earlier chancery court case, *Weinberger v. United Financial Corp. of California*, No. 5915, slip op. (Del. Ch. Oct. 13, 1983). *Weinberger* was a derivative action in which the plaintiffs alleged that the price paid for the shares of a target corporation, United Financial, in an acquisition by National Steel Corp. (National) was inadequate, even though the price included a premium of 78% over the market price of the stock on the day before the announcement. *Id.* at 2, 9, 10. In a hearing on the defendants' motion for summary judgment, the court concluded that there was a question of fact as to whether United Financial's board exercised an informed judgment in approving the merger agreement, but that there was no evidence of conflict of interest. *Id.* at 13, 16-17, 20. "The decision, in retrospect, may not have been the best decision which could have been made. That, however, is not the test for judicial review." *Id.* at 22.

The plaintiffs also alleged that National was liable for the transaction as an aider and abettor. *Id.* at 29. However, the court concluded that "[e]ven if plaintiff could show liabil-

A subsequent Delaware chancery court decision also briefly addresses aiding and abetting. In *Ivanhoe Partners v. Newmont Mining Corp.*,<sup>140</sup> the tender offeror, Ivanhoe,<sup>141</sup> began to acquire the stock of Newmont Mining.<sup>142</sup> After investigating a number of defensive moves,<sup>143</sup> Newmont reached an agreement with its largest shareholder, Gold Fields,<sup>144</sup> by which Gold Fields would increase its holdings of Newmont stock to 49.9 percent through a "street sweep."<sup>145</sup> Following a successful street sweep, Gold Fields' and Newmont's directors would own a majority of Newmont's outstanding shares.<sup>146</sup> Ivanhoe's tender offer, which was conditioned on Ivanhoe owning fifty-one percent of Newmont stock, would thereby be defeated.<sup>147</sup> Ivanhoe and a class of Newmont shareholders sought injunctive relief<sup>148</sup> against the street sweep, alleging that the Newmont directors had breached four fiduciary duties.<sup>149</sup> Gold Fields allegedly had aided and abet-

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ity on behalf of the board of United Financial, no fact has been adduced to indicate that National aided and abetted the United Financial board in any way." *Id.* There was evidence in the record that National had been advised that the stock was worth at least \$44 a share, although the final price offered was only \$33.60 a share. *Id.* at 5, 9. Therefore, National knew the price was inadequate. The court could have concluded that National knew that the directors' decision was a poor one and that United Financial's shareholders would be harmed. However, the evidence did not support the allegation that National knew of any conflict of interest. Once again, the court seems to have been looking for knowledge of managerial conflict of interest before imposing liability for aiding and abetting.

140. 533 A.2d 585 (Del. Ch.), *aff'd*, 535 A.2d 1334 (Del. 1987).

141. One of the entities controlling Ivanhoe was Mesa Holding Limited Partnership, which is controlled by T. Boone Pickens. *Id.* at 592.

142. *Id.*

143. *Id.* at 592-97.

144. In 1981, Gold Fields announced its intention to acquire 25 to 50 percent of Newmont's stock. After initial resistance by Newmont, the two corporations entered into a standstill agreement in which Gold Fields was prohibited from acquiring more than 33½ percent of Newmont's stock unless a third party acquired 9.9 percent or more of Newmont. *Id.* at 591. Ivanhoe's acquisition of 9.95 percent of the stock entitled Gold Fields to terminate the standstill agreement. *Id.* at 592.

145. *Id.* at 589. A "street sweep" is defined by the court as "a rapid accumulation of a large block of [a] target corporation's stock, through open market or privately negotiated purchases or a combination of both." *Id.*

146. *Id.*

147. *Id.*

148. Injunctive relief was eventually denied. *Id.* at 610.

149. *Id.* at 589, 600. The alleged breaches included: (1) maintaining control in violation of the duty of loyalty to shareholders, (2) effecting a "lock-up" scheme which prevented shareholders from obtaining the highest price through a bidding auction and discriminating among contenders for control, (3) coercing those shareholders selling in the street sweep and using undisclosed material inside information, and (4) pursuing defensive measures that did not correspond to any reasonably perceived threat. *Id.*

ted some of the breaches.<sup>150</sup>

The court rejected all but one of the allegations of breach of fiduciary duty.<sup>151</sup> In the remaining allegation, Newmont was "charged with having adopted defensive measures not responsive to any reasonably perceived threat to corporate policy and which, in all events, were unreasonable in relation to whatever threat may have existed."<sup>152</sup> The court focused on the agreement between Gold Fields and Newmont. To help Gold Fields finance its street sweep, Newmont declared a \$33 per share dividend to all shareholders.<sup>153</sup> In exchange, Gold Fields agreed in a standstill agreement to hold its interest to 49.9 percent of outstanding stock.<sup>154</sup> The problem with the agreement was that it "required Gold Fields to vote its Newmont stock for Newmont's director nominees, and substantially restricted Gold Fields' ability to transfer its Newmont shares to a third party free of the standstill restrictions."<sup>155</sup> The plaintiffs alleged that the restrictions would entrench Newmont's board of directors and preclude any future takeover bid for Newmont.<sup>156</sup>

The court noted that Newmont reasonably perceived a threat from both Gold Fields and Ivanhoe.<sup>157</sup> Furthermore, the standstill agreement itself was a reasonable response to the threat posed by Gold Fields.<sup>158</sup> However, in restricting Gold Fields' right to vote and to dispose of its shares, Newmont "went too far."<sup>159</sup>

By thus 'locking up' Gold Fields' 49.9% stock interest, the standstill agreement guaranteed the incumbency of the Newmont Board (or their designees) and, as a practical matter, assured the defeat of any hostile takeover attempt for possibly ten years. That agreement operated, then, to entrench the Newmont Board.<sup>160</sup>

The restrictions contained in the agreement were an unreasonable

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150. *Id.* at 600.

151. *Id.*

152. *Id.*

153. *Id.* at 597.

154. *Id.* at 597-98.

155. *Id.* at 590.

156. *Id.*

157. *Id.* at 607.

158. *Id.* at 608.

159. *Id.*

160. *Id.* at 608-09. In the opinion of the court, the fact that Newmont and Gold Fields had adopted amendments to remedy these restrictions was relevant to a discussion of the appropriate remedy, and not to the analysis of liability for breach. *Id.* at 609.

response to the threat posed.<sup>161</sup>

The *Ivanhoe* court did not address in detail the role of Gold Fields in aiding and abetting Newmont's breach. The court simply held that the agreement provisions were "a violation of the Newmont directors' duties, . . . in which Gold Fields, as a contracting party that *could not have been unaware of the entrenchment effect of those provisions*, aided and abetted."<sup>162</sup> However, in this statement the court pinpointed the knowledge critical to establish aiding and abetting. If Gold Fields was aware of "the entrenchment effect" of the agreement, then Gold Fields must have realized not only that the Newmont directors were conflicted in their decisionmaking, but also that they acted in their own self-interests.

The most straightforward statement of the knowledge required to establish aiding and abetting the breach of fiduciary duty is found in *Terrydale Liquidating Trust v. Barness*.<sup>163</sup> The court dismissed the allegation of aiding and abetting since the plaintiffs had failed to show actual knowledge of the breach.<sup>164</sup> In *Terrydale*, the plaintiff was a successful but frustrated tender offeror which had attempted to acquire the Terrydale Realty Trust (TRT), a Missouri real estate investment trust,<sup>165</sup> over a period of one year.<sup>166</sup> During that year, the trustees of TRT unsuccessfully sought other tender offer bids, then sold eighty percent of the trust assets and made two different liquidating dividends in a plan to liquidate the trust.<sup>167</sup> Approval of the creation of the Terrydale Liquidating Trust (TLT) and election of offerors' nominees as trustees occurred at the same meeting.<sup>168</sup>

The trust assets were sold to San Francisco Real Estate Investors (SFREI).<sup>169</sup> The Terrydale Liquidating Trust in the hands of the "successful" offeror sought to hold SFREI as an aider and abettor in the alleged breach of fiduciary duties by the trustees of

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161. *Id.*

162. *Id.* (emphasis added).

163. 611 F. Supp. 1006 (S.D.N.Y. 1984).

164. *Id.* at 1012, 1015, 1031 (applying Missouri law).

165. For several reasons the court concluded that the business judgment rule and the conflict of interest analysis applicable in the corporate setting would also be applicable to a real estate investment trust. *Id.* at 1016-17.

166. *Id.* at 1013-14.

167. *Id.*

168. *Id.*

169. *Id.*

TRT.<sup>170</sup> To establish the breach the plaintiffs sought to demonstrate the self-interest of the TRT directors.<sup>171</sup> Since the record before the court suggested potential self-interest by a majority of the TRT trustees, the court could not grant summary judgment based on the presumptions of the business judgment rule.<sup>172</sup> However, summary judgment could still be granted if, as a matter of law, the transactions were fair and reasonable to TRT and its shareholders.<sup>173</sup> After further analysis of the fairness of the transaction, the court concluded that the record did not support the grant of summary judgment.<sup>174</sup> The issue of the breach of fiduciary duty was one for the trier of fact.

The *Terrydale* court then turned to the element of knowledge of the breach of fiduciary duty. Only *actual* knowledge of a breach of duty would suffice to establish liability for the aider and abettor.<sup>175</sup> Mere suspicion, recklessness, mere notice, and unreasonable unawareness were all insufficient.<sup>176</sup> Plaintiffs had to establish that the alleged aider and abettor had knowledge of the objective unfairness and unreasonableness of the transaction, and of the "facts and circumstances demonstrating that the trustees acted in furtherance of their own self-interest."<sup>177</sup>

Applying the above standard, the court concluded that SFREI did not have knowledge of the self-interest of a majority of the directors.<sup>178</sup> While the plaintiffs had alleged that the directors who were known to be self-interested had dominated and controlled the others,<sup>179</sup> there was no evidence that SFREI knew of the alleged domination and control.<sup>180</sup> Whether or not SFREI *should* have known of the domination and control was not relevant to an analysis of SFREI's potential liability as an aider and abettor.<sup>181</sup>

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170. *Id.* The plaintiffs alleged that the TRT trustees breached their fiduciary duties by selling and liquidating the trust property for self-interested reasons and at "fire sale" prices. *Id.*

171. *Id.* at 1019.

172. *Id.* at 1023.

173. *Id.*

174. *Id.* at 1026.

175. *Id.* at 1027.

176. *Id.*

177. *Id.* (emphasis added).

178. *Id.* at 1028.

179. *Id.* at 1022-23.

180. *Id.* at 1028.

181. *Id.*



According to the court, absence of knowledge of managerial self-interest defeats the allegation of aiding and abetting. Knowledge of the unfairness of the transaction alone is insufficient to establish liability.<sup>182</sup> Even if SFREI believed that the selling price of the assets was lower than market value and reflected poor business judgment by the TRT trustees which could easily harm TRT shareholders, SFREI would not possess knowledge sufficient to establish knowledge of the breach.<sup>183</sup> Perhaps an exceptionally low price might be relevant to a discussion of whether SFREI should have been aware of unfairness in the transaction. However, even establishing that SFREI should have been aware of unfairness is insufficient, since liability would require a further finding of actual knowledge.<sup>184</sup>

In all three cases addressing liability for aiding and abetting the breach of fiduciary duty, the courts required that the alleged aider and abettor have actual knowledge of conflict of interest in the managerial decision making process. Knowledge of harm to the shareholders of the target corporation was not sufficient.

#### IV. WILL THE GREENMAILER BE HELD LIABLE?

While the preceding analysis makes it clear that knowledge of the presence of a conflict of interest in the directors' decision-making process is the prerequisite knowledge in a claim of aiding and abetting the breach of fiduciary duty, it is still not clear under what circumstances the greenmailer will be held liable. As this part of the Note will demonstrate, the likelihood of establishing the liability of the greenmailer is related to a court's willingness to recognize the self-interest of managers. In the end, a court's assessment of the claims against the greenmailer are a function of the court's recognition of the directors' conflict of interest. In ju-

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182. *Id.*

183. *Id.* at 1028-29

184. *Id.* The court then gave four additional considerations which supported its decision. First, there was no duty of any type between the parties. In fact, SFREI had a duty to its own shareholders to pursue the best price possible. Second, imposing liability with the benefit of hindsight without concrete evidence of knowledge of conflict and of the substantive unfairness of the transaction would "disrupt commercial activity in a manner wholly inconsistent with the purposes of aider and abettor liability." *Id.* at 1029-30. Third, the transaction involved no facially or overtly illicit benefit to the alleged aider and abettor from which the court could infer actual knowledge of a breach of duty. Finally, courts are reluctant to impose liability on managers for defensive tactics in the face of hostile takeover attempts. The same reluctance applied to alleged aiders and abettors. *Id.* at 1030-31.

risdictions in which courts are reluctant to view managerial action as conflicted, courts will also conclude that the greenmailer did not know of the managers' conflict. On the other hand, in jurisdictions in which managerial self-interest is more readily found in the decisionmaking process, the courts will be receptive to claims that the greenmailer knew of the conflict and, therefore, knew of the breach of fiduciary duty.

When courts are willing to view a managerial decision as conflicted, the protection of the business judgment rule is removed and the decision is subjected to a higher level of judicial scrutiny.<sup>185</sup> The clearest case of managerial conflict occurs when directors receive direct financial benefits from a corporate decision, such as a director selling personal property to the corporation. In the takeover context, however, the type of conflict alleged is a less obvious, indirect benefit to the managers through the retention of corporate control. The analysis by the courts in determining whether decisions in the corporate takeover context are conflicted is more difficult not only because the type of conflict is less obvious but also because the courts are faced with certain policy concerns. The courts want to allow corporations the freedom to oppose offers which are detrimental to the corporation and its shareholders.<sup>186</sup> Jurisdictions have balanced the competing concerns in different ways. The following analysis sets forth the approach taken by Delaware, New York, and California. In each case, the court's approach to the possibility of managerial conflict of interest determines the liability of the greenmailer.

### A. Under Delaware Law

Delaware's landmark case, *Cheff v. Mathes*,<sup>187</sup> involved the payment of greenmail to a minority shareholder. In that case, 100,000 shares of stock of the Holland Furnace Company were acquired by an individual who, according to the board, had participated in the liquidation of a number of companies and who was "well known and not highly regarded by any stretch."<sup>188</sup> After

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185. The relationship between conflict of interest and the business judgment rule was set forth in part three of this Note. See *supra* notes 115-18 and accompanying text.

186. *Northwest Indus. v. B.F. Goodrich Co.*, 301 F. Supp. 706, 712 (N.D. Ill. 1969). See also *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 949 (Del. 1985) (recognizing the board's duty to oppose a bid which was perceived to be harmful to the corporation).

187. 41 Del. Ch. 494, 199 A.2d 548 (1964).

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

the payment of greenmail, the shareholders brought a derivative suit alleging that the "true motives behind [the] purchases were improperly centered upon perpetuation of control."<sup>189</sup>

Addressing the issue of management entrenchment in *Cheff*, the court recognized that "directors are of necessity confronted with a conflict of interest" when there is a repurchase of shares in the face of a threat to control.<sup>190</sup> Given this conflict of interest, the burden is on the managers to show "reasonable grounds to believe [that] a danger to corporate policy and effectiveness existed."<sup>191</sup> The directors met this burden by showing that there was a reasonable threat to the continued existence of the corporation, at least a threat to its existing form.<sup>192</sup> In the end, the only way the managers would be liable for the repurchase of shares at a premium would be if the board "acted solely or primarily because of the desire to perpetuate themselves in office."<sup>193</sup>

Since retention of control was not the sole or primary cause for the payment of greenmail, the directors were protected by the business judgment rule. The lower level of scrutiny of the managerial analysis and judgment was easily satisfied.<sup>194</sup> Regarding the allegation that the premium over market price was unfair, the court stated:

[A]s conceded by all parties, a substantial block of stock will normally sell at a higher price than that prevailing on the open market, the increment being attributable to a "control premium." Plaintiffs argue that it is inappropriate to require the defendant corporation to pay a control premium, since control is meaningless to an acquisition by a corporation of its own shares. However, it is elementary that a holder of a substantial number of shares would expect to receive the control premium as part of his selling price, and if the corporation desired to obtain the stock, it is unreasonable to expect that the corporation could

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

190. *Id.* For those outside directors who did not have a pecuniary interest in the firm, there was a conflict of interest amounting to less than self-dealing. Therefore, the burden of proof required of the outside directors would be less than that imposed on inside directors. *Id.* at 505, 199 A.2d at 554-55.

191. *Id.* at 506, 199 A.2d at 555.

192. *Id.* at 508, 199 A.2d at 556. In addition to allegedly posing a threat of liquidation, the prospective bidder had indicated that the type of sales distribution was not "modern" and that a wholesale rather than retail distribution method was appropriate. *Id.* at 500, 199 A.2d at 551. The possibility that the sales force would be reorganized allegedly caused "substantial unrest" among the employees. *Id.* at 500, 199 A.2d at 551-52.

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

194. *Id.* at 506-07, 199 A.2d at 555-56.

avoid paying what any other purchaser would be required to pay for the stock.<sup>195</sup>

In *Cheff*, the groundwork was laid to accept the payment of greenmail and to continue the application of the business judgment rule unless the sole or primary managerial purpose was retention of control.

Since *Cheff*, the Delaware courts have had several occasions to re-examine and refine their analysis of the interplay between conflict, as evidenced by the opportunity for retention of control, and the business judgment rule within the takeover context.<sup>196</sup> In *Moran v. Household International*,<sup>197</sup> the Delaware Supreme Court reviewed its approach to cases involving defensive actions in response to takeover bids:

[I]n *Unocal* we held that when the business judgment rule applies to adoption of a defensive mechanism, the initial burden will lie with the directors. The "directors must show that they had reasonable grounds for believing that a danger to corporate policy and effectiveness existed . . . [T]hey satisfy that burden 'by showing good faith and reasonable investigation . . .'" In addition, the directors must show that the defensive mechanism was "reasonable in relation to the threat posed." Moreover, that

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195. *Id.* at 506, 199 A.2d at 555.

196. For some of the significant cases interpreting Delaware law in this area, see *Johnson v. Trueblood*, 629 F.2d 287, 292 (3d Cir. 1980) (holding that under Delaware law, the business judgment rule is not eliminated by the showing of merely "a" control motive rather than a sole or primary control motive, since "by the very nature of corporate life a director has a certain amount of self-interest in everything he does" and the business judgment rule is designed "to alleviate this problem by validating certain situations that otherwise would involve a conflict of interest for the ordinary fiduciary"), *cert. denied*, 450 U.S. 999 (1981); *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 954-55 (Del. 1985) (calling for an "enhanced duty" of judicial examination at the threshold in cases involving takeover bids and also for a judicial determination of the reasonableness of the defensive measure in relation to the threat posed before the protection of the business judgment rule can be applied); *Moran v. Household Int'l*, 490 A.2d 1059, 1076 (Del. Ch.) (in corporate control cases the managers are afforded the protection of the business judgment rule and, in addition, the burden of persuasion remains with the plaintiff), *aff'd*, 500 A.2d 1346 (Del. 1985).

197. 500 A.2d 1346 (Del. 1985). In *Moran*, the directors had adopted a Rights Plan which would be triggered if a shareholder obtained 20 percent of the outstanding shares or if a prospective bidder announced a tender offer for 30 percent of the shares. *Id.* at 1348. If the Rights Plan were triggered, each common share would be entitled to purchase 1/100 of a share of a newly issued preferred stock. *Id.* at 1349. If the Right to the preferred stock was not exercised and a merger or consolidation later occurred, the shareholder would be entitled to purchase \$200 of the common stock of the *tender offeror* for \$100. *Id.* The concern was that, through this Rights Plan, the stockholders were prevented from receiving tender offers. *Id.* at 1353-54.

proof is material[ly] enhanced . . . where, as here, a majority of the board favoring the proposal consisted of outside independent directors who have acted in accordance with the foregoing standards. Then, the burden shifts back to the plaintiffs who have the ultimate burden of persuasion to show a breach of the directors' fiduciary duties.<sup>198</sup>

While the law appears to impose a heavy burden on managers, in practice the Delaware courts are very tolerant and accept a wide variety of justifications for the payment of greenmail. Managers are given wide latitude, and the courts are reluctant to conclude that the conflict of interest rises to a level that requires withdrawal of the business judgment rule.

The effect of this lenient approach on the analysis of aiding and abetting is illustrated in *Polk v. Good*.<sup>199</sup> In *Polk*, the Supreme Court of Delaware reviewed a lower court decision approving the settlement and dismissal of consolidated shareholder class and derivative actions against Texaco, its board of directors, and the "Bass" investment group.<sup>200</sup> While Texaco was involved in acquiring Getty Oil Company, Texaco's largest shareholder, the Bass group, began increasing their holdings of outstanding common stock from 5 percent to 9.9 percent.<sup>201</sup> The Bass group indicated that it might obtain as much as twenty percent of the outstanding stock, "hinting" at a possible tender offer.<sup>202</sup> However, before any tender offer was made, Texaco repurchased the Bass group's shares<sup>203</sup> for a total of \$1.2 billion, including a premium of \$400 million.<sup>204</sup> The complaint alleged that the Bass group aided and abetted Texaco directors in their breach of fiduciary duty.<sup>205</sup>

In affirming the decision for the defendant, the Supreme Court reiterated the broad protection provided by the business judgment rule.<sup>206</sup> Since ten of the thirteen board members were outside directors, the lower court saw no evidence of self-interest.<sup>207</sup> While some plaintiffs still wanted to press suit, their attor-

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198. *Id.* at 1356 (citations omitted).

199. 507 A.2d 531 (Del. 1986).

200. *Id.* at 533.

201. *Id.*

202. *Id.*

203. *Id.* at 534.

204. *Good v. Texaco*, No. 7501, slip op. (Del. Ch. Feb. 19, 1985).

205. *Polk v. Good*, 507 A.2d 531, 534 (Del. 1986).

206. *Id.* at 535.

207. *Id.*

neys concluded "that if the case went to trial, they could not overcome the presumption of the business judgment rule as to the issues remaining."<sup>208</sup> According to the chancery court, the plaintiffs were "completely stymied by the rule of *Cheff v. Mathes* . . . and the similar Delaware case precedents."<sup>209</sup>

The message of *Polk* is that under Delaware law the protections afforded the managers are so great and the burden of proof on the plaintiff is so heavy that it is unlikely that the court will be willing to recognize the presence of conflict of interest in the managers. The decision to acquire Getty is protected by the business judgment rule. The directors can justify their actions to thwart the potential tender offer by pointing to the possible disruption of the plan to acquire Getty. The courts are unwilling to scrutinize either decision to see if conflict of interest is present. This reluctance by the court means that allegations of aiding and abetting will rarely succeed.

#### B. Under New York Law

Applying New York law in *Norlin Corp. v. Rooney, Pace Inc.*,<sup>210</sup> the Court of Appeals of the Second Circuit took a less tolerant approach to the defensive tactics<sup>211</sup> of defendant Norlin Corp. The court reviewed the grant of a preliminary injunction which barred Norlin from voting certain recently issued shares.<sup>212</sup>

The court took a more restrictive approach to the defensive tactics in three ways. First, the court noted that once the plaintiff has made a prima facie case showing that the directors have "a" self-interest in a particular corporate transaction, the burden shifts to the defendants to demonstrate that the transaction is fair and serves the best interests of the corporation and its shareholders.<sup>213</sup> This conclusion conflicts with Delaware law which holds that "a" control motive is insufficient; the control motive must be the primary or sole motive before the burden shifts.<sup>214</sup> Second, the

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208. *Id.*

209. *Good v. Texaco*, No. 7501, slip op. (Del. Ch. Feb. 19, 1985).

210. 744 F.2d 255 (2d Cir. 1984).

211. In its defense, Norlin increased its voting control by issuing new common and voting preferred stock to a wholly owned subsidiary and a newly created employee stock option plan. *Id.* at 258.

212. *Id.*

213. *Id.* at 264. However, the court did not withdraw the protection of the business judgment rule with the showing of "a" self-interest.

214. *See supra* note 196.

court rejected the great weight which Delaware gives to the presence of a majority of outside directors on the board.<sup>215</sup> Finally, the court noted that the duty of loyalty requires the board to demonstrate that any actions it does take are fair and reasonable.<sup>216</sup> While Delaware requires the same showing,<sup>217</sup> the two jurisdictions have very different expectations in this area. Delaware appears to accept almost any justification for the defense tactic. Any threat to the continued existence of the corporation in its present form<sup>218</sup> appears sufficient. The Delaware courts gloss over the "reasonableness" analysis. By contrast, the *Norlin* court specifically "rejected" the view, propounded by Norlin, that once it concludes that an actual or anticipated takeover attempt is not in the best interests of the company, a board of directors may take any action necessary to forestall acquisitive moves.<sup>219</sup> The "reasonableness" of the reaction is a critical element of a valid defense.

The implications for the greenmailer of the more restrictive New York law are illustrated in *Samuel M. Feinberg Testamentary Trust v. Carter*.<sup>220</sup> In that case, Carl Icahn acquired 4.9 percent of Goodrich's common stock. He then announced his plans either to acquire up to a 30 percent interest which he hoped to combine with the interests of others to obtain control, or to obtain a seat on the Goodrich board of directors.<sup>221</sup> However, Icahn also offered to sell his 4.9 percent interest for a sum which included a 25 percent premium above market price.<sup>222</sup> Approximately a week and a half later, the directors accepted Icahn's offer and paid the greenmail. While Icahn's behavior may appear to be reprehensible, it only serves to satisfy the element of substantially assisting the managers' breach. For Icahn to have knowledge of the breach requires that he know of the managers' conflict of interest. This

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215. *Norlin Corp. v. Rooney, Pace Inc.*, 744 F.2d 255, 266-67 n.12 (2d Cir. 1984). The court noted:

We are not persuaded that a different test applies to "independent" as opposed to "inside" directors under the business judgment rule . . . . In any event, once a collective conflict of interest underlying the board's action is shown, any such distinction has no bearing on the fairness and reasonableness of the action taken.

*Id.*

216. *Id.* at 266-67.

217. See *supra* text accompanying note 193.

218. See *Cheff v. Mathes*, 41 Del. Ch. 494, 508, 199 A.2d 548, 556 (1964).

219. *Norlin Corp. v. Rooney, Pace Inc.*, 744 F.2d 255, 265-66 (2d Cir. 1984).

220. 652 F. Supp. 1066 (S.D.N.Y. 1987).

221. *Id.* at 1069.

222. *Id.* at 1069. The premium amounted to \$8 million. *Id.* at 1073.

finding, in turn, is a function of the court's willingness to find conflicts in the managers.

The *Feinberg* court noted that in cases in which management may be faced with a threat to control, the burden of proof shifts to the defendants, thereby denying them "the more extreme protection of the business judgment rule."<sup>223</sup> The court carefully noted the secrecy surrounding the greenmail payment,<sup>224</sup> the directors' failure to give any reason for the greenmail other than the desire to ward off a takeover attempt,<sup>225</sup> and the reasons to attribute self-interest motives to independent directors.<sup>226</sup> The court concluded that the claim against Icahn alleging aiding and abetting could stand.<sup>227</sup> Icahn "may be held to have known that the directors' payment of the premium unquestionably would harm Goodrich and its shareholders, that such a payment would thus constitute a breach of the Goodrich directors' fiduciary duty, and that despite this knowledge he assisted therein for personal gain."<sup>228</sup> Close scrutiny of the directors' conflict facilitates establishing the elements of aiding and abetting.

### C. Under California Law

The Ninth Circuit of the United States Court of Appeals, in *Klaus v. Hi-Shear Corp.*,<sup>229</sup> concluded that management must demonstrate more than that the corporation derived some advantage from its actions.<sup>230</sup> When there is detriment to the minority

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223. *Id.* at 1081 (quoting *Danaher Corp. v. Chicago Pneumatic Tool Co.*, 633 F. Supp. 1066, 1070 (S.D.N.Y. 1986)).

224. *Id.* at 1070. Icahn had specifically agreed not to disclose the greenmail payment unless required by law to do so. *Id.*

225. *Id.* at 1073. There is no indication that Icahn knew the Goodrich managers would be so lacking in imagination that they could not supply any specific reason to justify the greenmail payment.

226. *Id.* at 1070. While a Delaware test for director interest would probably stop at the observation that nine of the twelve directors were independent, the *Feinberg* court went on to detail the specific ways in which the "independent" directors could be deemed self-interested. All directors received a base fee of \$18,000, an additional fee of \$500 for each meeting attended, and stock options. *Id.*

227. *Id.* at 1083-84.

228. *Id.*

229. 528 F.2d 225 (9th Cir. 1975). In *Klaus v. Hi-Shear Corp.*, the target corporation, Hi-Shear, acquired two different corporations by issuing new stock, and also created an Employee Stock Ownership Trust to which Hi-Shear donated treasury shares. The effect of these defensive tactics was to dilute the voting power of Klaus, the offeror. *Id.* at 228-29.

230. *Id.* at 233.



stockholders, the directors must present evidence tending to show either good faith or a *compelling* business purpose which would indicate that their action was fair under the circumstances.<sup>231</sup> To determine if there is a "compelling business purpose," the court suggested balancing "the good to the corporation against the disproportionate advantage to the majority shareholders and incumbent management."<sup>232</sup> Apparently, if the advantage of the transaction is greater for the majority shareholders (and for incumbent management) than it is for the corporation, the business purpose is not "compelling" and fairness is not established. This approach is far more demanding than that of jurisdictions requiring only "a rational business purpose."

The more rigorous approach of California is reflected in the state Supreme Court's analysis of the payment of greenmail. As set forth earlier, in *Heckmann v. Ahmanson*<sup>233</sup> the directors of Walt Disney Productions paid greenmail to Saul Steinberg and others.<sup>234</sup> In addressing the behavior of the directors, the court concluded that it was not necessary for the court to be presented with a "smoking gun."<sup>235</sup> The court believed that the evidence before it was sufficient to demonstrate a probability of success on the merits.<sup>236</sup> The main evidence before the court was that the Disney directors had acquired Arvida Corporation, assumed its debt, and offered to repurchase the Steinberg shares on the same day that the tender offer was revealed.<sup>237</sup> On these facts the court concluded that the directors would probably be liable for a breach of fiduciary duty.

It is clear that the *Heckmann* court viewed defensive tactics as *prima facie* evidence of an attempt by management to retain control. Therefore, in the court's opinion, "[t]he acts of the Disney directors — and particularly their timing — are difficult to understand except as defensive strategies against a hostile takeover."<sup>238</sup> The acquisition of Arvida was characterized as a "well-

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231. *Id.* at 233-34 (quoting *Jones v. H.F. Ahmanson & Co.*, 1 Cal. 3d 93, 114, 460 P.2d 464, 476, 81 Cal. Rptr. 592, 604 (1969)).

232. *Id.* at 234. The court found a "compelling business purpose" existed for the two acquisitions, but not for the employee stock option plan. *Id.*

233. 168 Cal. App. 3d 119, 214 Cal. Rptr. 177 (1985).

234. *See supra* notes 103-08 and accompanying text.

235. *Heckmann*, 168 Cal. App. 3d at 128, 214 Cal. Rptr. at 183.

236. *Id.*

237. *Id.* at 124, 214 Cal. Rptr. at 180.

238. *Id.* at 128, 214 Cal. Rptr. at 183.

recognized defensive tactic by a board seeking to retain control."<sup>239</sup> The California Supreme Court does not recognize the ambiguity of theory surrounding the payment of greenmail. All defensive tactics are viewed as evidence that management has attempted to retain control.

The court noted that the burden shifts to the directors to demonstrate the good faith and inherent fairness of the transaction once it is shown that a director received a personal benefit from the transaction.<sup>240</sup> After observing that there appeared to be a benefit to the directors in this case, the court concluded that Disney's explanation that the corporation and the shareholders would be harmed by the announced tender offer was inadequate.<sup>241</sup>

Under California law, the greenmailer is in a precarious position. The court begins with the assumption that defensive tactics are entrenchment devices. The burden immediately shifts to the defendant managers to show a compelling business purpose and the overall fairness of the transaction. If this is not successfully accomplished, the directors will be liable for breach. The aiding and abetting requirement of knowledge of the breach is satisfied if the greenmailer merely knows that the action taken would be categorized as a defensive measure. From this knowledge alone the greenmailer is assumed to have actual knowledge of the conflict of the directors.<sup>242</sup>

### CONCLUSION

There appears to be a consensus among the courts that the crucial element in establishing the liability of the greenmailer in a claim of aiding and abetting the breach of fiduciary duty is knowledge of the presence of conflict in the decisionmaking of the directors. The relative willingness of the courts to attribute control motives to the directors in the act of paying greenmail will determine the courts' willingness to conclude that the greenmailer knew the directors were conflicted. Those jurisdictions which recognize the

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239. *Id.*

240. *Id.*

241. *Id.*

242. In *Heckmann*, the court stated that "[t]he Steinberg group knew it was reselling its stock at a price considerably above market value to enable the Disney directors to retain control of the corporation." *Id.* at 127, 214 Cal. Rptr. at 182 (emphasis added). The court sees no ambiguity in the payment of greenmail. The self-interest of the managers is assumed.

ambiguity of the theory of greenmail will be unwilling to suspend the business judgment rule protections and carefully scrutinize the directors' behavior. The conclusion likely to be drawn is that the directors were not conflicted and that the greenmailer had no actual knowledge of the conflict. Jurisdictions in which the ambiguity of the theory of greenmail is given little weight will characterize the payment of greenmail as a defensive tactic undertaken primarily for the retention of control. In these jurisdictions, the greenmailer will automatically be attributed with knowledge of the directors' conflict.

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