Summer 1991

Greenmail, the Control Premium and Shareholder Duty

Roberta S. Karmel
Brooklyn Law School, roberta.karmel@brooklaw.edu

Recommended Citation
48 Wash. & Lee L. Rev. 937 (1991)

GREENMAIL, THE CONTROL PREMIUM AND SHAREHOLDER DUTY

ROBERTA S. KARMEL*

I. INTRODUCTION

Although greenmail[1] has some defenders,[2] it generally is condemned by business persons,[3] government officials[4] and academics.[5] Typically, a green-

* Roberta S. Karmel, B.A. Radcliffe 1959, LL.B. New York University 1962, is a Professor of Law and Co-Director of the Center for the Study of International Business Law, Brooklyn Law School. She is also a Partner of Kelley Drye & Warren and was a Commissioner of the Securities and Exchange Commission from 1977-80. A research stipend from Brooklyn Law School was helpful in the preparation of this article. The research assistance of Brooklyn Law School students John H. Moore, Ana Maria Valverde and Albertine Renee van Buuren and the comments of Professor Ronald J. Gilson, Philip E. Karmel and Professor Arthur Pinto are gratefully acknowledged.

1. "Greenmail—named after blackmail—is the repurchase of stock from an unwanted suitor at a higher-than-market price. Companies pay greenmail to end the threat of a takeover." Leefeldt, *"Greenmail," Far From Disappearing, Is Doing Quite Well in Disguised Forms*, Wall St. J., Dec. 4, 1984, at 10, col. 1. Whether the increase in price caused by the unwanted acquiring party's purchases should be discounted is a subject of debate. *See* BLOCK, BARTON & RADIN, THE BUSINESS JUDGMENT RULE 414, n.1 (3d ed. 1989). Under the U.S. tax laws, "greenmail" is defined to mean "any consideration transferred by a corporation (or any person acting in concert with such corporation) to directly or indirectly acquire stock of such corporation from any shareholder if—

(1) such shareholder held such stock . . . for less than 2 years before entering into the agreement to make the transfer,
(2) at some time during the 2-year period ending on the date of such acquisition—
    (A) such shareholder,
    (B) any person acting in concert with such shareholder, or
    (C) any person who is related to such shareholder or person described in subparagraph (B), made or threatened to make a public tender offer for stock of such corporation, and
(3) such acquisition is pursuant to an offer which was not made on the same terms to all shareholders.

26 U.S.C. § 5881(b) (1988).

2. *See, e.g.*, Macy & McChesney, *A Theoretical Analysis of Corporate Greenmail*, 95 YALE L.J. 13 (1985). *See also* Forman, *Greenmail Isn't Always Blackmail*, Wall St. J., May 7, 1987, at 30, col. 3. *Cf.* note 42, *infra*.

3. *See* Sandler, *"Pale Green Greenmail" Is Spreading as Firms Buy Out Raiders as Part of Broader Purchases*, Wall St. J., Nov. 10, 1986, at 59, col. 3; Williams, *Businessmen to Seek End to "Greenmail," "Golden Parachutes"*, Wall St. J., Jan. 23, 1985, at 53, col. 3. Both the Business Roundtable and the Securities Industry Association have taken positions against greenmail. The Business Roundtable, *Statement of Principles on Hostile Takeover Abuses*, Mar. 26, 1985; *Report by the Trading Practices Committee to the Chairman of the SIA*, Mar. 24, 1987, at 13-14, approved by the SIA Board on Mar. 24, 1987.

4. *See* Simon, *Needed: A "Generic Remedy"*, FORBES, Nov. 5, 1984, at 40. Legislative efforts to curb greenmail are discussed *infra* at notes 32-48 and accompanying text.

5. *See, e.g.*, Gilson, *Drafting on Effective Greenmail Prohibition*, 88 COLUM. L. REV. 329 (1988); Gordon & Kornhauser, *Takeover Defense Tactics: A Comment on Two Models*, 96 YALE L.J. 295 (1986).

mailer takes a large position in a company's stock, threatens a takeover, and then sells the stock to the company at above market prices. The very term "greenmail" is pejorative and even those who have engaged in greenmail have argued that it is contrary to good business conduct.[6] Nevertheless, most cases attacking greenmail have failed,[7] and those that have succeeded generally have been based on a breach of duty by the directors paying greenmail.[8] Greenmailers have been held liable only rarely, and then for aiding and abetting such a breach of fiduciary duty rather than for their own misconduct.[9] Federal legislative proposals to prohibit or regulate greenmail have not been adopted,[10] although greenmail profits have become subject to confiscatory tax rates.[11]

This article will discuss the reasons why greenmail has not been prohibited by statute or found wrongful in many court cases and suggest various theories of liability for greenmail. Judicial resistance to making greenmail tortious is strong for at least two reasons: first, minority shareholders generally have no duty to other shareholders;[12] second, control is generally regarded as freely saleable,[13] and courts intuitively recognize that greenmailers are dabbling in the control premium. Yet, these principles are contradictory. If the greenmailer is not a controlling shareholder, then he does not own any part of the control premium and is not entitled to sell it. What then is the greenmailer selling? Either he is defrauding the corporation by purporting to sell control when he does not have any, and thereby causing corporate waste, or he is trafficking in the sale of corporate offices. That is, the officers and directors paying greenmail are paying to remain in office. This is one situation where the sale of control is not legal.[14] Conversely, if the greenmailer in fact has control, then it may be consistent with traditional corporate law principles to impose a duty to other shareholders on the greenmailer,[15] and inquire whether he is breaching that duty by making the corporation purchase control with corporate funds.

6. *See* Samuel M. Feinberg Testamentary Trust v. Carter, 652 F. Supp. 1066 (S.D.N.Y. 1987); Exchange Act Release No. 22792 (Jan. 15, 1986), 34 SEC Docket 1263. Even Carl Icahn agreed that greenmail should be ended so long as some defensive tactics are also stopped. *Commission Seeks Legislation to Limit Golden Parachutes, Tender Offer Abuses,* 16 Sec. Reg. & L. Rep. (BNA) 573, 574 (Mar. 30, 1984).

7. *See infra* notes 101-02, 105-06 and 123.

8. *See infra* notes 103 and 107.

9. *See infra* notes 108-09.

10. *See infra* notes 32-52 and accompanying text.

11. 26 U.S.C. § 5881 (1988).

12. Controlling shareholders may owe a fiduciary duty to minority shareholders. *See infra* note 133.

13. R. Clark, Corporate Law 478-98 (1986).

14. Caplan v. Lionel Corp., 14 N.Y.2d 679, 249 N.Y.S.2d 877, 198 N.E.2d 908 (1964). *See infra* notes 152-66.

15. *See, e.g.,* Zahn v. Transamerica, 162 F.2d 36, 41-42 (3d Cir. 1947). *See also infra* notes 125-33.

In any event, even a minority shareholder should not be allowed to intentionally inflict injury upon a corporation or its other shareholders. Finally, greenmail involves manipulative stock trading which is destructive of investor confidence in the markets.

II. Criticisms of Greenmail

There are three major policy criticisms of greenmail. First, it is a management entrenchment device. Second, the payment of greenmail discriminates unfairly among shareholders. Third, greenmail is coercive.

By its very nature, greenmail is an antitakeover device because target management is paying a would-be acquiring party to leave management alone by cashing out the greenmailer at a premium over market.[16] Indeed, a standstill agreement in which the greenmailer promises not to purchase any more shares generally accompanies a greenmail payment.[17] The management entrenchment explanation for greenmail recognizes that there is an inherent conflict of interest between management and the corporation in control transactions. Accordingly, management is tempted to act in its own interests, but to the detriment of the corporation, in paying greenmail.[18]

Greenmail is intrinsically unfair because it denies everyone else the right to participate in the premium that is paid for the greenmailer's shares.[19] This type of discrimination among shareholders has been specifically prohibited in tender offers,[20] but is consistent with the general rule that a premium may be paid for a control block.[21] Because greenmail is a privately negotiated transaction, it does not fall within the definition of a tender offer,[22] and, therefore, the prohibitions against discriminatory treatment of shareholders in tender offers is inapplicable. Whether the cases permitting the payment of a premium for control justify greenmail is one of the issues this article will address. However, it generally is presumed that the greenmailer does not have control, but rather threatens to acquire it.[23]

Opprobrium has been heaped upon greenmailers because their conduct is viewed as extortion.[24] In the words of one commentator, some believe

---

16. Gilson, *supra* note 5, at 329-30.

17. *See* Comment, *Greenmail: Can the Abuses Be Stopped?*, 80 Nw. U.L. Rev. 1271, 1274 n.18 (1987); Macy & McChesney, *supra* note 2, at 35-37.

18. Note, *Greenmail: Targeted Stock Repurchases and the Management—Entrenchment Hypothesis*, 98 Harv. L. Rev. 1045, 1047 (1985).

19. Comment, *supra* note 17, at 1285.

20. 17 C.F.R. § 240.14d-10(a)(2) (1990).

21. *See* American Law Institute, Principles of Corporate Governance: Analysis and Recommendations § 5.16 (Tent. Draft No. 10, 1990) [hereinafter ALI Tentative Draft No. 10].

22. *See* Hanson Trust PLC v. SCM Corp., 774 F.2d 47 (2d Cir. 1985).

23. *See* Booth, *Management Buyouts, Shareholder Welfare, and the Limits of Fiduciary Duty*, 60 N.Y.U. L. Rev. 630, 662 (1985); Lipton, *Corporate Governance in the Age of Finance Corporatism*, 136 U. Pa. L. Rev. 1, 31-32 (1987).

24. *See* Macey & McChesney, *supra* note 2, at 38. This epithet was used by Charles L.

that "greenmailers are the worst example of exploitive, opportunistic players in the market for corporate control, threatening an acquisition that has no efficiency justification (and may impose significant costs) simply to garner short term gains."[25]

Defenders of greenmail claim that the payment of greenmail is a signal that a company is undervalued, which should generate an auction for the corporation which ultimately will benefit all shareholders.[26] Pursuant to this analysis, greenmail is viewed as a payment for the information that management is misusing or underutilizing corporate assets.[27] However, these arguments fly in the face of the power struggle that realistically occurs between management and greenmailers.[28] Further, empirical studies suggest that greenmail is destructive of shareholder values because after greenmail is paid there is a decline in share price, and a subsequent tender offer is problematic.[29]

Another rationalization for greenmail is that it may be necessary to protect a corporation from an abusive tender offer or dissident shareholder.[30] Directors therefore are justified in defending the corporation against the threat of a greenmailer by purchasing his shares. This theory is simply a respectable version of the management entrenchment hypothesis, in that directors are viewed as protecting the corporation, instead of their own positions, against the greenmailer. It is the basis for most of the court decisions upholding greenmail.[31]

III. Legislative and Charter Initiatives to Outlaw Greenmail

A. *Federal Securities Laws*

Efforts to prohibit greenmail through federal legislation date back to the July 1983 report of the blue-ribbon advisory committee on tender offers (the Advisory Committee) created by the Securities and Exchange Commis-

---

Marinaccio when he was SEC Commissioner. Williams, *supra* note 3. Some critics have argued all defensive open market purchases are coercive. Bradley & Rosenzweig, *Defensive Stock Repurchases and the Appraisal Remedy*, 96 Yale L.J. 322, 324-26 (1986). Greenmail also has been called legal blackmail. Lipton, *'Greenmail' is a Corporate Disgrace*, N.Y. Times, Apr. 15, 1984, § 3, at 2, col. 3.

25. Gilson, *supra* note 5, at 331.

26. *See* Macey & McChesney, *supra* note 2, at 24-25.

27. *Id.* at 29-31. *See also* Barron's, Jan. 14, 1985, at 28.

28. *See, e.g.*, Matsuura, *Boone-San, Either Put Up or Shut Up*, Wall St. J., Apr. 18, 1990, at A22, col. 3.

29. *See* Office of the Chief Economist, Securities and Exchange Commission, The Impact of Targeted Share Repurchases (Greenmail) on Stock Prices (Sept. 11, 1984). *See also* Gilson, *supra* note 5, at 330, n.3.

30. Lipton, *supra* note 23. The author is not endorsing this theory. Better techniques than greenmail, for example fair price amendments, exist for dealing with abusive tender offers.

31. *See infra* notes 86-87 and accompanying text.

sion (SEC).[32] The report did not use the term "greenmail," but rather the more neutral description of "block purchases at a premium," and stated that:

> The Committee is particularly concerned with a target company's repurchase of its stock at a premium to market from a dissident shareholder. Under current law, the ability of a company to repurchase shares from dissident shareholders at a premium has created incentives for investors to accumulate blocks with the intention to sell them back to the issuer at a profit. Not only does such a transaction generally serve little business purpose outside the takeover context but also it constitutes a practice whereby a control premium may be distributed selectively and not shared equally by all shareholders. Moreover, the Committee is concerned about the doubt that such a transaction casts on the integrity of the takeover process. The Committee recommends prohibiting the repurchase at a premium of a block of stock held for less than two years without shareholder approval.[33]

Accordingly, the Advisory Committee recommended that repurchase of a company's shares at a premium over market from a particular holder or group that has held such shares for less than two years should require shareholder approval, unless such an offer is made to all holders of a class of securities.[34]

When the SEC came up with its own legislative package on tender offers in 1984, shareholder approval of greenmail arrangements were included. The SEC's tender offer reform proposals included as an amendment to section 14 of the Securities Exchange Act of 1934 (Exchange Act)[35] a provision that would make it unlawful

> . . . for an issuer to purchase, directly or indirectly, any of its securities at a price above the market from any person who holds more that 3% of the class of the securities to be purchased and has held such securities for less than two years, *unless* such purchase has been approved by the affirmative vote of a majority of the aggregate voting securities of the issuer, *or* the issuer makes an offer to acquire, of at least equal value, to all holders of securities

32. Advisory Committee on Tender Offers, Securities and Exchange Commission, Report of Recommendations (July 8, 1983), *reprinted in* [1983-84 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,511 (July 15, 1983).

33. *Report of Recommendations, supra* note 32, at 46.

34. *Id.*

35. 15 U.S.C. § 78n (1988). The Williams Act, which regulates tender offers, is contained in §§ 13(d) and (e) and 14(d), (e) and (f) of the Exchange Act, 15 U.S.C. §§ 78m(d) and (e) and 78n(d), (e) and (f) (1988) and the regulations thereunder, 17 C.F.R. 240.13d-1 to 13e-101, 240.14a-1 to 14f-1 (1990).

of such class and to all holders of any class into which such securities may be converted.[36]

This and other SEC tender offer reform recommendations became the basis for the Tender Offer Reform Act of 1984, a bill approved by the House Energy and Commerce Committee in August, 1984.[37] This bill had an antigreenmail provision identical to the SEC's above-quoted recommendation.[38]

The Tender Offer Reform Act of 1984 never became law for reasons not directly related to the antigreenmail provision. Very generally, the SEC's proposals were designed to facilitate tender offers and protect shareholders, whereas Congress began to develop an animus against takeovers. The House bill contained a number of controversial antitakeover provisions, including an increase in the minimum period for keeping a tender offer open from 20 business days to 40 calendar days, a community impact statement provision, and a broad restriction on golden parachutes.[39] Because of these provisions, which had not originated from the SEC, the SEC opposed the bill.[40] The Reagan administration also opposed the bill, charging that the legislation would be an unwarranted step toward a federal corporation law.[41] Accordingly, the legislation died.

A 1985 tender offer reform bill never emerged from committee because the SEC reversed itself. Adopting the views of the Reagan Administration, the SEC opposed almost all of its own 1984 legislative proposals, including a federal prohibition against greenmail.[42] Such opposition was based on the view that corporations were adopting antigreenmail charter amendments and Congress was discouraging greenmail through tax legislation.[43]

---

36. Letter from SEC Chairman John S. R. Shad to Congressman Timothy E. Wirth, [1984 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,630 at 86,880 (May 21, 1984) (emphasis in original).

37. H.R. 5693, 98th Cong., 2d Sess. (1984).

38. *Id.* at § 204(a)(5). The subcommittee had eliminated the two year limitation and prohibited all but routine issuer repurchases without a shareholder vote, but after strong SEC objection, the two-year limitation was restored. Memorandum of the SEC Regarding H.R. 5693, as Amended and Ordered Reported by the House Committee on Energy and Commerce, H.R. 1028, 98th Cong., 2d Sess. (1984) [hereinafter SEC Memorandum].

39. SEC Memorandum, *supra* note 38, at 35-36.

40. *Id.* at 36-39.

41. *The Battle Over Tender Offer Reform: From the States and the Courts to Congress*, 20 Sec. Reg. & L. Rep. (BNA) 60, 61 (Jan. 15, 1988) [hereinafter *Battle Over Reform*].

42. Leefeldt, *A Sweet Way to Foil Takeover Bids*, Wall St. J., Sept. 4, 1985, at 24, col. 4. In testimony before Congress, SEC Chairman Shad went so far as to defend greenmail as a way station to the launch of a full takeover. *Commission Will Not Reintroduce Takeover Legislative Package, Shad Says*, 17 Sec. Reg. & L. Rep. (BNA) 573, 574 (Apr. 5, 1985).

43. *Battle Over Reform*, *supra* note 41, at 61. At that time, Congress had passed tax legislation to limit the deductibility to the corporation of greenmail payments. 17 Sec. Reg. & L. Rep. (BNA) 573 (Apr. 5, 1985). An excise tax on greenmail profits was not passed until 1987. *See infra* notes 54-55.

The impetus for antigreenmail federal legislation and other tender offer reform continued into the 100th Congress, but as the session went on, a Supreme Court decision changed everyone's politics. In early 1987, the business community pushed for tender offer reform, and a number of bills aimed at restricting bidder strategies were introduced.[44] Several of these bills contained antigreenmail provisions. The most important were a comprehensive Senate bill introduced by Senator William Proxmire, Chairman of the Senate Banking Committee, which contained a requirement for a shareholder vote to authorize greenmail, similar to the provisions of the 1984 House bill,[45] and a comprehensive House bill introduced by Representative John Dingell, Chairman of the House Committee on Energy and Commerce, which also contained a provision similar to that of the 1984 House bill.[46] Also noteworthy was a bill introduced by Representative Norman Lent, ranking minority member of the House Committee on Energy and Commerce, which, in addition to making it unlawful for an issuer to pay greenmail, provided that any greenmail profit could be recovered by the payor corporation in a suit by the corporation or a derivative shareholder's suit.[47] This solution to the problem of greenmail was similar to the corporate recovery of short-swing insider profits in section 16(b) of the Exchange Act.[48]

The cause of federal tender offer reform was then dealt a severe blow by the decision of the United States Supreme Court in *CTS Corp. v. Dynamics Corp. of America*,[49] which held that an antitakeover statute of the state of Indiana was constitutional. As a result of this case, the states immediately began enacting antitakeover statutes, and federal takeover reform became mired in debates over federal pre-emption.[50] The SEC continued to argue that "it would be an intrusion into matters traditionally governed by state law to enact a federal prohibition again [greenmail] purchases."[51] In addition, antitakeover business interest became less enthusiastic about federal legislation as the prospects became bright for a Delaware

44. *Battle Over Reform*, *supra* note 41, at 65. *See also* A. Lajoux, *Corporate Governance on Capitol Hill: Business Judgment at a Crossroads*, DIRECTOR'S MONTHLY, July-Aug. 1987, at 1.

45. S. 1323, 100th Cong., 1st Sess. § 8 (June 4, 1987). A refinement on the definition of market price was added. A bill introduced by Senator D'Amato, S. 227, 100th Cong., 1st Sess. (Jan. 6, 1987), defined greenmail as the purchase at a premium above the average market price during the 30 trading days preceding the purchase from any 5% holder who had purchased within 6 months.

46. H.R. 2172, 100th Cong., 1st Sess. § 2 (Aug. 27, 1987). A provision for SEC rulemaking was added.

47. H.R. 2668, 100th Cong., 1st Sess. § 108 (June 11, 1987).

48. 15 U.S.C. § 78p(b) (1988).

49. 481 U.S. 69 (1987).

50. *Battle Over Reform*, *supra* note 41, at 65, 75-76.

51. Statement of David S. Ruder, Chairman of the SEC, before the Committee on Telecommunications and Finance of the House Committee on Energy and Commerce at 36 (Sept. 17, 1987).

takeover statute.[52] The political shift wrought by the *CTS* case can be seen in what happened to the antigreenmail provision in Senator Proxmire's comprehensive reform bill. Although the antigreenmail provision in the bill as initially proposed was in language similar to the SEC's 1984 proposal,[53] during the mark-up on this bill the language was amended to make greenmail profits recoverable by the corporation or in a derivative suit, thus making it illegal to accept greenmail, but not illegal to offer it.[54]

B. Federal Tax Laws

The 100th Congress concluded without enacting any takeover legislation. However, in 1987 Congress did pass a 50% federal tax on greenmail profits.[55] Some have criticized this tax as an effort to regulate non-tax economic and social behavior which properly should be dealt with by other laws, in this case the federal securities laws.[56] Moreover, it is anomalous that the same Congress which was unable to pass takeover reform legislation because of concerns over pre-emption of state law could pass a tax which intrudes upon internal corporate affairs and negates the effect of some state statutes.[57]

The tax law approach to prohibiting greenmail differs from the Advisory Committee's and SEC's 1984 proposals in that it emphasizes the coercive and improper conduct of the greenmailer and makes his conduct subject to penalty rather than emphasizing the unfairness to shareholders who are unable to take advantage of the greenmailer's premium and making the issuer's greenmail payment unlawful.

C. State AntiGreenmail Legislation

The SEC's withdrawal as an advocate for tender offer reform legislation, Congressional inability to form a consensus as to what such legislation should accomplish, and the *CTS* case effectively left takeover legislation to the states. The states eagerly accepted this task, enacting a wide variety of

52. *Id.* at 75. Delaware did pass a takeover statute. DEL. GEN. CORP. L. § 203 (1988) became effective July 1, 1987. Shareholder activists then began to push for federal takeover reform. *See Congress Must Define States' Role in Regulating Takeovers, Panel Told*, 19 Sec. Reg. & L. Rep. (BNA) 1085 (July 24, 1987).

53. *Supra* note 45.

54. S. REP. No. 265, 100th Cong., 1st Sess. 1323, § 8 (Dec. 17, 1987); *Battle Over Reform*, *supra* note 41, at 71. In addition, the SEC was given exemptive authority.

55. 26 U.S.C. § 5881(a) (1988). The definition of greenmail for this purpose is set forth in note 1, *supra*. Congress also passed legislation limiting the deductibility by a corporation of greenmail payments. Tax Reform Act of 1986, Pub. L. No. 99-514, § 613, 100 Stat. 2251 (codified at 26 I.R.C. § 162(k) (1988)). *See generally* Lustig, *The Emerging Role of the Federal Tax Law in Regulating Hostile Corporate Takeover Defenses: The New Section 5881 Excise Tax on Greenmail*, 40 U. FLA. L. REV. 789 (1988).

56. Lustig, *supra* note 55, at 818-27.

57. *Id.* at 827.

essentially antitakeover statutes.[58] Most of the provisions of these laws are beyond the scope of this article, which will discuss only greenmail provisions.

It should first be noted, however, that traditional state corporation law statutes have been generally either silent or specifically permissive on the question of corporate stock repurchases.[59] Therefore, any statute making the payment of greenmail unlawful is an exception to the general rule permitting repurchases. In addition, shareholders generally are free to obtain the highest possible price when selling their shares. Accordingly, any greenmail prohibitions aimed at the greenmailer are also exceptional.

The formulation of state antigreenmail statutes is generally similar, and prohibits a corporate repurchase of a significant block of stock (in some cases 3%, in some 5%, and, in New York, as high as 10%) that has been held for a short period of time (ranging from 6 months to 3 years) without a majority shareholder vote or an equal offer to all shareholders.[60] A new Pennsylvania statute goes beyond outlawing greenmail and requires anyone who declares an intent to buy more than a 20% stake in a company to disgorge profits on recently purchased shares sold within 18 months after the announcement.[61]

These statutes are premised on the unfairness of permitting the greenmailer to enjoy a premium, rather than on the greenmailer's coercive conduct. The question of whether greenmail is a tort for which the greenmailer can be held accountable has been left to judicial decision-making.[62]

D. *Private Ordering and the ALI Corporate Governance Project*

A popular academic theory of the past decade has been that corporations are a nexus of contracts, and private ordering should replace government-

---

58. *See* Johnson & Millon, *Missing the Point About State Takeover Statutes*, 87 MICH. L. REV. 846 (1989); Millon, *State Takeover Laws: A Rebirth of Corporation Law?*, 45 WASH. & LEE L. REV. 903 (1988); Romano, *The Political Economy of Takeover Statutes*, 73 VA. L. REV. 111 (1987); *De Facto Federal Anti-Bidder Stance Exists Through State Laws, IRRC Says*, 21 Sec. Reg. & L. Rep. (BNA) 1501 (Oct. 6, 1989).

59. *See* Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985). The Ohio statute, for example, provides that a corporation may purchase shares "when the articles authorize the redemption of such shares and do not prohibit such purchase." OHIO REV. CODE ANN. § 1701.35 (A)(1) (Page 1985). Open market repurchases by a public company may be regulated by the Williams Act and SEC rules thereunder. *See* Bradley & Rosenzweig, *Defensive Stock Repurchases*, 99 HARV. L. REV. 1377 (1986).

60. 1990 Ariz. Legis. Serv. Ch. 85 § 10-1204 (West); Mich. Bus. Corp. Act § 340.368 (1990); MINN. STAT. ANN. § 302A.553 (West 1989); N.Y. BUS. CORP. L. §§ 513(e), 912(aa) (Consol. 1990); TENN. CODE ANN. § 48-35-501 to 505 (1988); WISC. STAT. ANN. § 180.725(5) (West 1989). An Indiana statute authorizing certain issuer stock redemptions was passed with the caution that such authorization should prevent sellers from asking for greenmail. IND. CODE ANN. § 23-1-42-10 (Burns 1989).

61. 1990 Pa. Act 36, SB 1310 (April 17, 1990) (to be codified at PA. STAT. ANN. tit. 15, § 25-74 (Purdon 1990)). *See* Klein & Greenbaum, *Many Pa. Companies Opt Out*, Nat'l L.J., Sept. 10, 1990, at 15.

62. *See* Note, *Liability for Greenmailers: A Tort Is Born*, 19 IND. L. REV. 761 (1986).

mandated standards of fiduciary duty.[63] In its extreme form, this theory argues that markets effectively discipline all corporate charter provisions. Therefore, all corporate rules of fiduciary duty should be the product of private ordering, not government regulation.[64] A more moderate view is that private ordering should be permitted within a general framework of government-mandated fiduciary duties as set forth in statutes or as interpreted by the judiciary.[65]

An interesting example of this more moderate contractarian view that corporations can elect to "opt out" of fiduciary duties within certain public policy limits can be found in several advisory and council drafts of the Corporate Governance Project (Project) of the American Law Institute (ALI), concerning greenmail in the context of transactions in control. This Project is not a traditional restatement, but rather a "prestatement" of what good corporate law should be, and its recommendations are designed to be implemented either by statute or by judicial decision making. Part VI of the Project, addressed to "Actions Affecting Fundamental Shareholder Rights (Including Transactions in Control)," initially envisioned (in Advisory Draft No. 7) the use of shareholder action to respond to transactions in control.[66] A central focus of corporate governance therefore set forth was the freedom to adopt special charter or by-law provisions to alter standard corporate structures.[67]

The freedom which shareholders were given in Advisory Draft No. 7 to change charter documents, however, was limited by public policy as expressed in cases and corporation statutes.[68] In addition, certain defensive strategies in takeovers, including greenmail, were prohibited, as follows:

> A corporation may repurchase its voting equity securities on a non-pro rata basis and at a premium price only if such repurchase:
> (1) Is intended to reduce or eliminate holders of a small number of shares;
> (2) Involves an amount of securities that is not significant and is repurchased from shareholders who have held the securities for a significant period of time;
> (3) Has been approved by disinterested shareholders, and does not constitute a waste of corporate assets . . . or
> (4) Is necessary to prevent immediate and substantial injury to the corporation.[69]

---

63. *See Contractual Freedom in Corporate Law*, 89 COLUM. L. REV. No. 7 (Nov. 1989), (symposium issue devoted to discussion of this theory).

64. *E.g.*, Butler & Ribstein, *Opting Out of Fiduciary Duties; A Response to the Anti-Contractarians*, 65 WASH. L. REV. 1 (1990).

65. Coffee, *No Exit?: Opting Out, The Contractual Theory of the Corporation, and the Special Case of Remedies*, 53 BROOKLYN L. REV. 919 (1988).

66. AMERICAN LAW INSTITUTE, PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS 34 (Advisory Group Draft No. 7, 1986).

67. *Id.* at 36.

68. *Id.* at § 6.01(b).

69. *Id.* at § 6.16(b).

Because shareholders can vote to pay greenmail, this section is consistent with contractarian theory. Indeed, the argument can be made that such a prohibition against greenmail facilitates rather than displaces private ordering, because decisions concerning greenmail payments are put directly to the shareholders.

The Comment on this section states that the section could be implemented by judicial decision,[70] which is curious because it reads like a statute and indeed follows the pattern of the federal securities law proposals outlawing greenmail that were never adopted. The Comment explains that the section differs from existing case law, which inquires into director motivation or principal purpose to determine the legitimacy of corporate repurchases, and instead adopts a functional standard.[71]

Part VI of the ALI Project proved too controversial to survive as envisioned, and the antigreenmail provision was successively watered down before being completely dropped.[72] As of the date of this Article, Part VI has been transformed into a general and platitudinous injunction against management entrenchment.[73] The legality of any greenmail payments presumably could be tested under current Delaware and other relevant case law.

Although the philosophy of the ALI Reporters as set forth in the initial drafts of Part VI did not prevail in the Project, numerous corporations have adopted antigreenmail charter provisions consistent with the ALI Advisory Draft No. 7 language set forth above. One of the first to do so, in 1984, was International Minerals & Chemical Corp. (IMC).[74] Over the next three years, about 70 publicly traded corporations adopted similar amendments.[75] In addition, in 1988 an antigreenmail shareholder proposal by the California Public Employees Retirement System (CalPERS) won 55% of the vote of a public corporation.[76] Antigreenmail charter provisions typically require an affirmative shareholder vote before the purchase of

70. *Id.* at 248.

71. *Id.*

72. *See* AMERICAN LAW INSTITUTE, PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS § 6.04 (Advisory Group Draft No. 8, 1987); (Council Draft No. 10, Jan. 26, 1988); (Council Draft No. 11, April 20, 1988); (Council Draft No. 12, Sept. 8, 1988); ALI Tentative Draft No. 10, *supra* note 21.

73. Section 6.02(a) of ALI Tentative Draft No. 10, *supra* note 21, provides: "The board of directors may take any action that has the foreseeable effect of blocking an unsolicited tender offer . . . unless the action would materially disfavor the long term interests of the shareholders." At the May, 1990 meeting of the ALI a floor amendment to add "corporation and its" immediately before "shareholders" to this provision passed. *See Departing From Draft, ALI Supports Broader Takeover Defense Authority*, 22 Sec. Reg. & L. Rep. (BNA) 843-44 (June 1, 1990).

74. This corporation has since changed its name to IMCERA Group, Inc. The author has been a director of the company since 1980. *See generally* Siegel, *How to Foil Greenmail*, FORTUNE, Jan. 21, 1985, at 157, 158.

75. Gilson, *supra* note 5, at 331 n.6.

76. Remarks of Securities and Exchange Commission Chairman David S. Ruder, "The Impact of Institutional Investors on Large Corporations" (Oct. 11, 1988).

shares at a premium above market price from a short term shareholder unless an offer on the same terms is made to all shareholders.[77]

E. Summary of Solutions

The various legislative and private ordering initiatives to outlaw greenmail appear to acknowledge that the payment of greenmail would be best judged under the fiduciary duty standard of directors to the company and its shareholders.[78] Nevertheless, the latitude given to directors under the business judgment rule to resist hostile takeovers has placed egregious greenmail payments beyond shareholder scrutiny, and a regulatory response may therefore be necessary.

Two basic solutions for greenmail have been proposed. The most popular, which originated with the Advisory Committee and the SEC and has been adopted in state laws and corporate charter provisions concerning greenmail, has been to require a shareholders' vote before greenmail can be paid, or in the alternative, to require the issuer to make a tender offer to all shareholders. Another solution has been to squeeze the profit out of greenmail and therefore penalize the greenmailer. Congress did so through its 50% tax on greenmail profits. In addition, proposed federal legislation developed the idea that greenmail profits should be reclaimed by the corporation, or its shareholders in a derivative action, similar to the recapture of short swing insider trading profits.[79]

Although this idea was not put into law because federal tender offer reform ran into political opposition and failed, it poses some interesting theoretical questions. Is greenmail, like insider trading, an intentional tort, based on unfair advantage, for which liability could or should be imposed? If so, should such liability be under federal or state law or both? If a duty to the corporation or its shareholders must be found in order to impose liability on the greenmailer what is the nature of that duty?

IV. The Greenmail Cases

A. Breach of Fiduciary Duty

Considering the widespread incidence of greenmail,[80] there are relatively few cases attacking the practice. Most of them have been brought on the

---

77. The IMC charter applied to purchases from a holder of 3% for less than 2 years at a price above the highest closing sale price during the 30 day period preceding the purchase. Interestingly, the antigreenmail amendment provided that it should not be construed to relieve any greenmailer from any fiduciary obligation imposed by law. Gilson, *supra* note 5, discusses the theoretical problems of drafting anti-greenmail charter provisions.

78. "Tender Offer Disclosure and Fairness Act of 1987," Report of the Senate Committee on Banking, Housing, and Urban Affairs to Accompany S. 1323, 100th Cong., 1st Sess. (Dec. 17, 1987) at 33.

79. *Id.* at 33-34.

80. According to an SEC staff study, from January 1979 to March 1984 approximately $5.5 billion was paid by issuers to repurchase blocks of stock from individual shareholders, at an aggregate premium of more than $1.0 billion. Much of this premium was greenmail. *Id.* at 32-33.

theory that the payment of greenmail was a breach of fiduciary duty by the directors who authorized the payment. Generally, such directors have been able to claim the benefits of the business judgment rule.[81] Very generally, the cases fall into the Delaware mode of affording directors the shield of the business judgment rule for greenmail payments; the California mode of screening conflicts of interest; and the New York and federal cases which try to find a middle ground between permitting control sales and outlawing greenmail.

1. Delaware

The Delaware courts have been generous in affording directors the protection of the business judgment rule in greenmail payment cases. The basic proposition that directors may forestall a takeover bid by way of a selective stock repurchase, provided the transaction is free from fraud or unfairness, unless they have acted solely or primarily out of a desire to perpetuate themselves in office,[82] was established in a series of cases in the early 1960s before the term "greenmail" became well known.

The first case was *Kors v. Carey*,[83] in which the chancery court exonerated the directors of Lehn & Fink Products Corporation (Lehn), a drug and cosmetics manufacturer. The directors had authorized the purchase at a premium through a broker of a 16% block of its stock owned by United Whelan Corporation (United), a drugstore chain that was a major customer of Lehn. Ownership of Lehn by United would have affected Lehn's relationship and reputation with other customers. Lehn and United had fundamentally different business strategies and policies. United stressed liquidity, aggressive advertising, and quick profits. United dealt directly with manufacturers, which posed antitrust problems. The court found no evidence that management was seeking to retain control of the corporation, although some directors were Lehn executives. The court also found that United posed a serious threat to the welfare of the corporation and its shareholders. In any event, the court was unable to see how the plaintiff was damaged, and the case was complicated by a cross-claim by United, also named as a defendant, to rescind the purchase by Lehn.

In *Bennett v. Propp*[84] the Delaware Supreme Court approved *Kors v. Carey* but nevertheless affirmed liability as to the chairman of the board

81. The business judgment rule shields directors from liability for disinterested business decisions made with due care, in good faith, and without an abuse of discretion. BLOCK, BARTON & RADIN, *supra* note 1, at 12. In order for the business judgment rule to apply to antitakeover measures, the board must demonstrate good faith and a reasonable investigation to prove that protection of the corporate enterprise and shareholders is necessary, and the defensive measures must be reasonable in the face of the threat posed. Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 954-55 (Del. 1985).

82. *See* Polk v. Good, 507 A.2d 531, 536-37 (Del. 1986); Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 955 (Del. 1985).

83. 39 Del. Ch. 47, 158 A.2d 136 (Del. Ch. 1960). *See also* Martin v. American Potash & Chemical Corp., 92 A.2d 295 (Del. 1952).

84. 41 Del. Ch. 14, 187 A.2d 405 (1962).

of Noma Lites, Inc. (Noma), who purchased over 22% of Noma's stock in the open market in order to defeat an anticipated takeover by Textron, Inc. The chairman did not notify the board of these repurchases until after they had been made and the corporation was required to borrow money from a factor against its accounts receivable to close the transactions. Testimony showed that retaining control of the corporation was the chairman's motivation behind the share repurchase. The president of Noma, who had been informed of the purchases, was held jointly and severally liable for what the court labelled "the tort of using corporate funds to maintain control."[85] The directors who approved the purchase in a resolution were exonerated on the grounds that they acted reasonably when confronted with this emergency, and that they avoided the potential liability to Noma if the trades were not closed. While *Bennett* is not a greenmail case, it is important because it established the principle that if board members act solely or primarily because of the desire to perpetuate themselves in office, the use of corporate funds for a repurchase of shares is improper.

This principle was tested in *Cheff v. Mathes*,[86] which is considered the leading case in Delaware on greenmail. *Cheff* was a derivative action by common stockholders of Holland Furnace Co. (Holland), seeking to set aside a purchase by Holland of its own stock at a premium over market from Motor Products Corp. (Motor), which was controlled by Arnold H. Maremont (Maremont), and to obtain damages from Holland's directors. Holland was engaged in the manufacture of hot air furnaces and air conditioners, and was unique in the industry because it used its own retail sales force. However, its sales techniques were of questionable legality, and involved the company and its president in litigation with the Federal Trade Commission. In early 1957, Holland went through a reorganization to stem declining sales. In June 1957 exchange trading in Holland's stock doubled. Maremont met with P.T. Cheff, director and CEO of Holland, and proposed a Holland-Motor merger. When this offer was declined, Maremont disclaimed further interest. However, in July, Maremont told another director that he owned 55,000 Holland shares and in August he demanded a seat on Holland's board. According to the defendants, Maremont threatened to break up Holland's sales staff, which led to employee unrest. The board then authorized market purchases of Holland stock for use in a stock option plan (which never materialized). After consulting with independent legal counsel, investigating Maremont and discovering that he had a reputation as someone who made quick profits by selling or liquidating companies and that Motor was in questionable financial condition, Holland determined to purchase Maremont's shares. In October, a total of 155,000 shares were purchased from Motor at a premium over market. Katherine N. Cheff, as a director or through a company under her control, had been prepared to buy Maremont's stock if Holland had not done so.

85. Bennett v. Propp, 41 Del. Ch. 14, 187 A.2d 405, 411 (1962).
86. 41 Del. Ch. 494, 199 A.2d 548 (Del. 1964).

The Delaware court struggled with the basic issues that have been at the heart of all subsequent takeover cases. On the one hand, there was evidence of management entrenchment at shareholder expense. The Vice Chancellor had found that the actual purpose behind the purchase from Motor was the desire to perpetuate control. However, not all the directors knew of the alternative possibility that Mrs. Cheff could have bought Maremont's stock, and they were exonerated. On the other hand, the Delaware Supreme Court viewed Maremont as a threat to the continued existence of the corporation, a threat that the directors could use corporate funds to counteract. The court viewed its decision as turning on burden of proof questions and held that, except for the directors who had a personal pecuniary interest in the transaction (Mr. Cheff and Holland's attorney), there was no self-dealing. Accordingly, in order to enjoy the benefit of the business judgment rule, the defendants merely had to show reasonable grounds to believe a danger to corporate policy and effectiveness existed by the presence of the Maremont stock ownership. Although the Vice Chancellor found there was no substantial evidence of a liquidation posed by Maremont, the Court held that the defendants' fear that Maremont would change the sales policies Holland believed vital to its future success was sufficient.

There were two aspects of the transaction in *Cheff* that the court scrutinized. One was the use of corporate funds to purchase Maremont's stock. The court held that because it was not improper for the corporation to use its funds to purchase Maremont's stock, the existence of an alternative purchaser was irrelevant. The other aspect of the purchase under attack was the premium price paid. The parties to the case conceded that a substantial block will command a control premium. However, the plaintiff argued that it was inappropriate for the corporation to pay a control premium, because control is meaningless to an acquisition by a corporation of its own shares. The court held that because the holder of a substantial block would expect to receive a premium for control, it was not unreasonable for the corporation to pay that premium.

Cheff has been followed in subsequent cases upholding greenmail payments as a valid exercise of directors' discretion under the business judgment rule.[87] Moreover, the rationale of *Cheff* is strikingly similar to the Delaware Supreme Court's recent business judgment rule decisions upholding antitakeover strategies in addition to greenmail.[88] Nevertheless, the tolerance for greenmail by the Delaware courts is not unlimited. *Good v. Texaco, Inc.*[89]

---

87. *See* Polk v. Good, 507 A.2d 531 (Del. 1986); Grobow v. Perot, 526 A.2d 914 (Del. Ch. 1987), *aff'd*, 539 A.2d 180 (Del. 1988); Kaplan v. Goldsamt, 380 A.2d 556 (Del. Ch. 1977). *Cf.* Crane v. Harsco Corp., 511 F. Supp. 294 (D. Del. 1981). *See also* BLOCK, BARTON & RADIN, *supra* note 1, at 417.

88. *E.g.*, Paramount Communications, Inc. v. Time, Inc., 571 A.2d 1140 (Del. 1989); Ivanhoe Partners v. Newmont Mining Co., 535 A.2d 1334 (Del. 1987); Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985).

89. Civ. Action No. 7501 (Del. Ch. May 14, 1984) *reprinted in* 9 DEL. J. CORP. L. 461. *Accord*, Seibert v. Harper & Row, Civ. Action No. 6639 (Del. Ch. Dec. 5, 1984).

involved the purchase by Texaco, Inc. (Texaco), of a 9.9% common stock interest owned by the Bass Brothers at a premium over market, for $650 million cash and 12.6 million shares of newly issued voting preferred stock. The voting rights were equal to the voting rights of the common stock, and constituted approximately 5% of the total voting power of all of Texaco's outstanding shares. The Bass Brothers agreed to acquire no more shares for a period of ten years and to vote their Texaco preferred stock in accordance with the recommendation of Texaco's board of directors. A motion to dismiss for failure to make demand was denied on the ground that the purchase of 5% of the voting stock by Texaco's board made the directors "interested" and supported allegations of an illegal vote buying scheme. Three days later, Texaco and the Bass Brothers entered into a modification of the agreement to provide that the 12.6 million preferred shares would be voted not by the directors, but rather proportionately to all other votes cast by Texaco shareholders, and thereafter the case was settled.[90]

In *Polk v. Good*[91] the plaintiffs argued that *Kors*, *Cheff* and *Bennett* should not be interpreted to permit greenmail to those who threaten proxy fights and tender offers, but should be limited to those instances where dissident shareholders threaten to interfere with the day-to-day business operations of a company. The court gave short shrift to this plea to prevent the corruption of corporate democracy, and suggested that fraud or unfairness was required for liability.[92] If there is any premise underlying the Delaware cases it is that the stockholders to whom greenmail is paid pose serious threats to proper business values because they are looking for short-term profits through the trading and liquidation of stock and business assets. Therefore, directors are justified in using corporate funds to assure corporate survival by eliminating such dangerous shareholders.[93]

An interesting interpretation of Delaware law by a federal court is contained in *Fry v. Trump*,[94] which, in addition to claims under the federal securities laws, alleged breach of fiduciary duty, waste of corporate assets and an illegal payment of greenmail by Bally Manufacturing Company (Bally) to its former shareholder Donald J. Trump (Trump). In addition, Trump was charged with aiding and abetting the directors' breach of fiduciary duty and also with independently breaching his duty to Bally as a shareholder. The greenmail payment at issue was at a premium far in excess of market value. Also, it involved the dropping of a counterclaim by Trump in litigation brought against Trump by Bally and a 10-year standstill agreement. Trump never owned more than 9.9% of Bally stock.

---

90. Civ. Action No. 7501 (Del. Ch. Feb. 19, 1985), *reprinted in* 10 DEL. J. CORP. L. 854.

91. 507 A.2d 531 (Del. 1986).

92. Polk v. Good, 507 A.2d 531, 536-37 (Del. 1986). This circumlocution begs the issue: when is greenmail fraudulent or unfair?

93. *Cf.* Gilson, *Just Say No To Whom?*, 25 WAKE FOREST L. REV. 121 (1990).

94. 681 F. Supp. 252 (D.N.J. 1988).

On a motion to dismiss, the allegations that the directors breached their fiduciary duty to shareholders by paying Trump a premium to buy his stock were conceded. The court ruled that the facts alleged supported a claim that Trump participated in the directors' attempts to entrench themselves and therefore aided and abetted their breach of fiduciary duty.

As to any director breach of duty by Trump, the court ruled that only a majority or controlling shareholder owes any fiduciary duty to a corporation. Clearly, Trump was not a majority shareholder, and the plaintiff failed to allege facts that could support claims that Trump directed Bally's day-to-day activities. Therefore, the court held that Trump was not a controlling shareholder and owed no independent duty to Bally.

2. California

In *Heckman v. Ahmanson*[95] a California appellate court sustained both a claim for breach of fiduciary duty against the directors of Walt Disney Productions, Inc. (Disney) and a claim against greenmailers for aiding and abetting the directors' breach of duty. The greenmailers were Saul P. Steinberg and various companies under his control or acting in concert with him (the Steinberg Group), who in March 1984 purchased more than two million shares of Disney stock. Disney countered this opening shot in a probable takeover war by announcing the acquisition of Arvida Corporation (Arvida) for $200 million in newly issued Disney stock and the assumption of $190 million of Arvida debt. The Steinberg Group brought a direct and a derivative action in federal court to block the Arvida acquisition, but the transaction was consummated nonetheless. The Steinberg Group then acquired two million additional shares of Disney stock, so that it then had a 12% ownership position in the company and, on June 8, 1984, advised the Disney directors of its intention to make a tender offer for 49% of the outstanding shares. That evening the Disney directors proposed a repurchase of all stock held by the Steinberg Group, and an agreement to this effect was reached on June 11, 1990. In return, the Steinberg Group agreed not to purchase any Disney stock and to dismiss its individual (but not the derivative) claims in the Arvida litigation. Disney was required to borrow money to effect this repurchase. The Steinberg Group made a profit of about $60 million on this greenmail transaction, which was 50% above market price immediately following the announcement of the repurchase.

On an appeal from the grant of a preliminary injunction by the Steinberg Group, the California Court of Appeal held that the plaintiffs had demonstrated a reasonable probability of success on the merits, entitling them to a constructive trust upon the profits the Steinberg Group received from its sale of Disney stock. The basis for a finding of liability was two-fold. First, the court held that there was insufficient evidence that the Disney directors acted in good faith and inherent fairness or for reasons other than

95. 168 Cal. App. 3d 199, 214 Cal. Rptr. 177 (1985).

the naked desire to retain their positions of power and control over the corporation. It therefore appeared that the Disney directors (who were not parties to the proceedings on the preliminary injunction) breached their fiduciary duty to the shareholders and, consequently, the Steinberg Group could be held jointly liable as an aider and abetter. The second basis of liability was that the Steinberg Group had assumed a fiduciary duty to other Disney shareholders when it sued Disney in a derivative action. Having assumed this fiduciary role, the Steinberg Group could not abandon it for personal aggrandizement.[96]

The plaintiff had also contended that the Steinberg Group violated the fiduciary duty owed by controlling shareholders to other shareholders. In this regard, California has strong precedent to the effect that majority shareholders may not use their power to control corporate activities to benefit themselves alone or in a manner detrimental to the minority by the transfer of controlling shares.[97] However, the court declined to decide this question, holding that the record was inadequate on the issue of whether the Steinberg Group was a controlling shareholder when it sold its stock to Disney. "Although it never owned more than about 12 percent of the outstanding Disney stock this is not determinative of control. The question, a factual one, is what amount of influence it could exert on the corporation by reason of its holdings."[98]

In a case arising out of the same facts the Second Circuit refused to find that the Steinberg Group had engaged in economic duress under New York law.[99] The court held that to establish duress there needed to be a threat that was unlawfully made and caused involuntary acceptance of contract terms because the circumstances permitted no other alternative. According to the court, it was not duress to threaten a tender offer, because a tender offer is lawful.[100]

3. New York

There is sparse case law in the New York courts concerning the legality of greenmail. In *Karfunkel v. USLIFE Corp.*[101] a repurchase of 6% of its

---

96. A similar theory was asserted against Trump in Fry v. Trump, 681 F. Supp. 252 (D.N.J. 1988), as to his counterclaim against Bally, but because the counterclaim was personal and not derivative, this theory of liability was rejected; *see supra* note 94 and accompanying text (discussing *Fry v. Trump*).

97. Jones v. H.F. Ahmanson & Co., 1 Cal. 3d 93, 460 P.2d 464, 81 Cal. Rptr. 592 (1969). This was not a normal sale of control case, but rather involved a scheme in which the majority shareholders set up a holding company in a manner which made the minority shares unmarketable. *See also* Brown v. Halbert, 271 Cal. App. 2d 252, 76 Cal. Rptr. 781 (1969).

98. Heckman v. Ahmanson, 168 Cal. App. 3d 119, 133 n.6, 214 Cal. Rptr. 177, 187 n.6.

99. Kamerman v. Steinberg, 891 F.2d 424 (2d Cir. 1989).

100. *Id.* at 431-32.

101. 116 Misc.2d 841, 455 N.Y.S.2d 937 (Sup. Ct. 1982), *aff'd*, 98 App. Div. 2d 628, 469 N.Y.S.2d 1020 (1st Dept. 1983).

stock by USLIFE Corp. (USLIFE) from American General Corp. (American) at a premium over market triggered shareholder derivative and direct actions. The position had been acquired by American over a period of four years and was sold at $28 per share, which was below book value, but was above the market price of $22.25. American had never sought control of USLIFE. The court found no breach of duty and granted summary judgment.

One of the plaintiff's theories was that when a corporation purchases stock from one shareholder at a premium, it must offer the same terms and conditions to other shareholders on a pro rata basis. In rejecting this claim, the court noted that a New York corporation has a free right to purchase stock, with no limitations except fraud, overreaching, impairment of capital, or harm to creditors. Such a purchase "might be to remove the threat of a corporate raider whose ultimate goal might result in harm to the long-term aims of the corporation."[102] The court also pointed out that the repurchase increased book value and earnings per share for the remaining shareholders.

In *Feinberg Testamentary Trust v. Carter*[103] the court viewed New York law as more restrictive. This derivative action arose out of the purchase by the B.F. Goodrich Company (Goodrich), a New York corporation, from Carl Icahn (Icahn) and affiliated partnerships of a 4.9% block of Goodrich stock. When Icahn had informed the Goodrich directors of his purchase he stated that he planned to acquire as much as 30% of the outstanding shares, and if a takeover failed to materialize, to obtain a seat on Goodrich's board. However, Icahn also simultaneously made a firm offer to sell his initial holdings of over one million shares at $35 a share, which was approximately 25% above the market price of $28. A few weeks later the board accepted Icahn's $35 per share offer and then repurchased the shares with the proceeds of short term loans. Icahn entered into a standstill agreement under which he agreed to abstain from any Goodrich stock purchases for five years. He also agreed not to disclose the repurchase or standstill agreement.[104]

On a motion to dismiss, the court held that the defendants had not made any showing of a justification for the repurchase, which would significantly benefit board members by securing the continued possession of their directorships. The court held that the greenmail payment was a breach of fiduciary duty and waste under New York law. The court distinguished the *Karfunkel* case[105] on its facts and disregarded the only other pertinent New York decision.[106] In the court's view there was no

102. Karfunkel v. USLIFE Corp., 116 Misc. 2d 841, 845, 455 N.Y.S.2d 937, 940 (Sup. Ct. 1982), *aff'd*, 98 App. Div. 2d 628, 469 N.Y.S.2d 1020 (1st Dept. 1983).

103. 652 F. Supp. 1066 (S.D.N.Y. 1987).

104. This nondisclosure by Icahn and Goodrich led to an SEC proceeding against Goodrich. Securities Act Rel. No. 6619, 34 SEC DOCKET 1263 (Jan. 14, 1986).

105. *Karfunkel*, 116 Misc. 2d 841, 445 N.Y.S.2d 937.

106. Lewis v. Kurshan, N.Y.L.J., Dec. 1, 1983, at 6, col. 4 (Sup. Ct. 1983). The court

justification for the purchase, which "resulted in an $8 million loss to Goodrich, with no corresponding benefit to Goodrich shareholders. The only beneficiaries under the repurchase, other than Icahn, were the Goodrich directors, who insured their continued control of the company."[107]

The court then went on to consider Icahn's liability, and was troubled that Icahn's 4.9 percent ownership did not make him a controlling shareholder with a fiduciary duty to minority shareholders. However, the court found that there was ample authority for the proposition that "outsiders, whatever their interest, who attempt to reap benefits through their participation in unconscionable stock transactions may be held liable for aiding and abetting a breach of fiduciary duty."[108]

In *Lou v. Belzberg*,[109] which followed *Feinberg*, a federal district court sustained a claim by a shareholder of Ashland Oil, Inc. (Ashland) against the Belzbergs in connection with a greenmail payment for aiding and abetting a breach of fiduciary duty, even though the claim against the directors was dismissed for failure to make demand. Even though the payment was not above the market, a standstill agreement was executed. The court held there was an adequate allegation that the Belzbergs sought to take advantage of the directors' entrenchment motives. Although Ashland was a Kentucky corporation, in the absence of precedent on point, the court applied *Feinberg*, but distinguished *Feinberg* on the facts.

B. *Federal Securities Laws*

Plaintiffs in greenmail cases who have been frustrated in trying to allege a breach of fiduciary duty by directors who paid greenmail, or to find a theory under state law for holding the greenmailer liable for an independent tort, have sued under the federal securities laws. Various theories under the federal securities laws have been attempted with some, but not resounding, success. The cases which have been most successful are those in which greenmail either was not disclosed or was, indeed, denied, thereby allowing the plaintiffs to press a claim for fraudulent misstatements. Cases brought on behalf of a corporation which paid greenmail, alleging antifraud violations but no affirmative misrepresentations, have generally failed, either because the court held that the corporation and its directors were not deceived by the greenmailer, or because the court viewed the complaint as an impermissible effort to charge a breach of fiduciary duty.

In *Feinberg Testamentary Trust v. Carter*[110] Goodrich proposed an anti-greenmail amendment to its charter in its 1985 Proxy Statement. Previously,

---

stated that this case had relied only on a Seventh Circuit precedent interpreting Delaware law, rather than New York law. Instead the court relied on a Second Circuit case applying New York law to a Panamanian corporation.

107. Feinberg Testamentary Trust v. Carter, 652 F. Supp. 1006, 1081 (S.D.N.Y. 1987).

108. *Id.* at 1083.

109. 728 F. Supp. 1010 (S.D.N.Y. 1990).

110. 652 F. Supp. 1066 (S.D.N.Y. 1987).

although Goodrich had disclosed a repurchase of 1,171,700 shares of its stock, it had not disclosed that the purchase was from an individual stockholder, Icahn, who had threatened a tender offer, or that the purchase was at a price significantly above market. The initial 1985 Proxy Statement did not mention the repurchase, but a Supplemental Proxy Statement contained some information about it. However, it failed to name Icahn or describe his threats to purchase 30% of Goodrich or take over the company. The court denied a motion to dismiss holding that the failure to inform shareholders that the Icahn repurchase was a classic greenmail transaction violated the SEC's proxy Rule 14a-9.[111]

Similarly, in *Fry v. Trump*[112] the plaintiffs claimed that Trump made several public statements indicating that he was not a greenmailer, and he was looking out for the welfare of Bally shareholders, when in fact he was negotiating a greenmail transaction. The court found this misrepresentation actionable under SEC Rule 10b-5.[113] Also, in *In re Phillips Petroleum Securities Litigation*[114] the Third Circuit held that a false announcement by T. Boone Pickens Jr. (Pickens) in connection with an announcement of a tender offer for Phillips Petroleum Co. (Phillips) that he would not sell any shares back to Phillips except on an equal basis with all shareholders, could be the basis for a suit under the Racketeer Influenced and Corrupt Organizations Law (RICO).[115]

At one time the SEC took the position that a Rule 10b-5 claim was stated by allegations that a corporation was defrauded when its controlling directors caused it to acquire a large block of its own stock at an excessive price for the purpose of removing the threat to the directors' control represented by the stock.[116] This argument was rejected by the Second Circuit on the ground that there was no deception because the entire board of directors was involved.[117] Subsequently, however, the Second Circuit overruled itself on this issue in a case not involving greenmail, and held that the entire board may defraud the corporation if there is a conflict of interest involved and the directors expect to obtain a personal benefit.[118]

---

111. 17 C.F.R. § 240.14a-9 (1990).

112. 681 F. Supp. 252 (D.N.J. 1988).

113. 17 C.F.R. § 240.10b-5 (1990).

114. 881 F.2d 1236 (3d Cir. 1989).

115. 18 U.S.C. §§ 1961-1968 (1988). Such a claim was dismissed in Lou v. Belzberg, 728 F. Supp. 1010 (S.D.N.Y. 1990). In prior proceedings the RICO claim was dismissed, but the fraud claim was maintained. In re Phillips Petroleum Litigation, 697 F. Supp. 1344, *aff'd in part and vacated in part*, 881 F.2d 1236 (3d Cir. 1988).

116. Brief for the SEC, Amicus Curiae, O'Neill v. Maytag, 339 F.2d 764, 767 (2d Cir. 1964). *See generally* Bayne, *The S.E.C. and the Sale of Control: Ambivalence, Vacillation or Pusillanimity?*, 33 VILL. L. REV. 49 (1988).

117. O'Neill v. Maytag, 339 F.2d 764 (2d Cir. 1964). Another potential problem is that the plaintiff may be neither a purchaser nor seller and therefore lack standing to sue. *See* Birnbaum v. Newport Steel Corp., 193 F.2d 461 (2d Cir.), *cert. denied*, 343 U.S. 956 (1952).

118. Schoenbaum v. Firstbrook, 405 F.2d 215 (2d Cir. 1968), *cert. denied sub nom.* Manley v. Schoenbaum, 395 U.S. 906 (1969).

Nevertheless, in *Kamerman v. Steinberg*[119] the court held that the greenmailing of Disney by the Steinberg Group failed to state a claim under Section 10(b) because Disney was not deceived.

Also of relevance is the holding of the U.S. Supreme Court in *Santa Fe Industries v. Green,*[120] involving a gross undervaluation of shares in a Delaware short form merger, that Congress did not mean to prohibit, in Section 10(b) of the Exchange Act,[121] any conduct not involving manipulation or deception; that is, corporate mismanagement and unfairness are not within the federal anti-fraud provisions. Nevertheless, in *Goldberg v. Meridor*[122] the Second Circuit distinguished *Santa Fe* in a case involving an entire board, but in which there was a fraud on the corporation by the sale of overpriced assets for stock. No disclosure of this breach of fiduciary duty was made to minority shareholders, and the court held that such nondisclosure violated the Exchange Act.

How these somewhat contradictory precedents apply to a case involving greenmail under the federal securities laws in unclear. In *Pin v. Texaco, Inc.,*[123] involving the repurchase of a 9.9% block of stock held by the Bass Brothers at a premium over market after they threatened a takeover of Texaco, the Fifth Circuit held that, under *Santa Fe,* in the absence of any allegation of misrepresentation or failure to disclose a material fact, the Section 10(b) claim failed. The Bass Brothers were not required to disclose in their filings with the SEC that they intended to greenmail Texaco from the outset. "As to Texaco, the complaint alleges nothing more than corporate mismanagement and breaches of fiduciary duty that are traditionally a matter of state regulation."[124]

V. THEORIES OF LIABILITY

A. Pretenders to the Sale of Control

1. Shareholder Fiduciary Duties

The mere ownership of stock does not create a fiduciary relation between shareholders.[125] Nevertheless, when a shareholder assumes the power to

119. 891 F.2d 424 (2d Cir. 1989).

120. 430 U.S. 462 (1977).

121. 15 U.S.C. § 78j(b) (1988).

122. 567 F.2d 209 (2d Cir. 1977), *cert. denied,* 434 U.S. 1069 (1978).

123. 793 F.2d 1448 (5th Cir. 1986). This case grew out of the same facts as the cases discussed in the text accompanying *supra* notes 89-91.

124. Pin v. Texaco, Inc., 793 F.2d 1448, 1452 (5th Cir. 1986).

125. *See* McDaniel v. Painter, 418 F.2d 545, 547 (10th Cir. 1969) (involving sale of control block); Vernon J. Rockler & Co. v. Minneapolis Shareholders Co., 425 F. Supp. 145, 149 (D. Minn. 1977) (denying motion to enjoin company's largest shareholder from proceeding with tender offer). *But see* Wilkes v. Springside Nursing Home, 370 Mass. 842, 353 N.E.2d 657 (1976); Donahue v. Rodd Electrotype Co., 367 Mass. 578, 592-93, 328 N.E.2d 505, 515 (1975) (holding that shareholders in close corporation have same fiduciary relation as partners).

control corporate property or decision making, the shareholder also assumes a fiduciary relation to the corporation and other shareholders with respect to the corporate action taken.[126] Such a controlling or dominant shareholder is considered to have the same duty as directors to deal fairly and with complete candor with minority shareholders.[127] Generally, such a fiduciary relation is imposed only on a controlling shareholder,[128] but where a minority shareholder is in a position to oppress the majority, he can be held liable for a breach of the duty of loyalty.[129]

Shareholder fiduciary duties are grounded upon the power to manage the property of other shareholders. This power usually derives from majority stock ownership, but the duty devolves from the exercise of power, not from formal control.[130] It is "the fact of control of the common property held and exercised, not the particular means by which or manner in which the control is exercised, that creates the fiduciary obligation."[131]

When a shareholder becomes a fiduciary he is under a duty to act for the benefit of the corporation and other shareholders as to the matters with respect to which power is being exercised. As to such matters, he is under a duty not to profit at the expense of the corporation and other shareholders and not to enter into competition with them without their consent.[132] If a greenmailer were made subject to such a fiduciary duty, as this article argues, he would be obligated either to: (1) decline the greenmail payment; (2) share that payment with other shareholders; or (3) receive the payment only after a fully informed shareholder vote.

The policy reason behind imposing a fiduciary duty on a controlling or dominant stockholder is that suppliers of capital must be able to repose

---

126. Swinney v. Keebler Co., 480 F.2d 573, 577 (4th Cir. 1973); Smith v. Atlantic Properties, Inc., 12 Mass. App. Ct. 201, 422 N.E.2d 798 (1981).

127. Weinberger v. UOP, Inc., 457 A.2d 701, 703 (Del. 1983).

128. Osofsky v. J. Ray McDermott & Co., 725 F.2d 1057, 1060 (2d Cir. 1984). *See also infra* note 146.

129. Insuranshares Corp. v. Northern Fiscal Corp., 35 F. Supp. 22, 24-25 (E.D. Pa. 1940); Zimmerman v. Bogoff, 402 Mass. 650, 657-58, 524 N.E.2d 849, 853-54 (1988); Smith v. Atlantic Properties, Inc., 12 Mass. App. Ct. 201, 422 N.E.2d 798 (1981).

130. Harriman v. E.I. duPont de Nemours & Co., 372 F. Supp. 101 (D.C. Del. 1974). *Cf.* Honigman v. Green Giant Co., 309 F.2d 667 (8th Cir. 1962), *cert. denied*, 372 U.S. 941 (1963). The concept of control by a majority shareholder is nebulous in any event and does not require a 51% ownership of the voting common stock. *See* ALI Tentative Draft No. 10, *supra* note 21, at § 1.06a; Berle, *The Price of Power: Sale of Corporate Control*, 50 CORNELL L.Q. 628, 630-31 (1965). *See also* Sherman, *Buyers of Control Get a Lot More Than They Pay For*, Wall St. J., Jan. 24, 1989, at A20, col. 3.

131. Southern Pac. Co. v. Bogert, 250 U.S. 483, 492 (1919). *See also* Meinhard v. Salmon, 249 N.Y. 458, 164 N.E. 545 (1928). In United States v. Margiotta, 688 F.2d 108 (2d Cir. 1982), *cert. denied*, 461 U.S. 913, involving a novel case of breach of fiduciary duty and extortion by a political party chairman, the court suggested that fiduciary duty arises from reliance and/or *de facto* control and dominance. *Id.* at 122, 125. It can be argued that other shareholders rely on the greenmailer to initiate a tender offer, but this reliance is perhaps questionable. However, the greenmailer does exercise *de facto* control over the initiation of a control contest.

132. RESTATEMENT (SECOND) OF TRUSTS § 2 comment b (1959).

trust and confidence in managers of their capital. This rationale was persuasively argued by Harlan Fiske Stone (before he was named to the Supreme Court) in an address he gave in 1934 after a period of securities speculation having many similarities to the bull market of the 1980s.

> I venture to assert that when the history of the financial era which has just drawn to a close comes to be written, most of its mistakes and its major faults will be ascribed to the failure to observe the fiduciary principle, the precept as old as holy writ, that "a man cannot serve two masters." More than a century ago equity gave a hospitable reception to that principle and the common law was not slow to follow in giving it recognition. No thinking man can believe that an economy built upon a business foundation can permanently endure without some loyalty to that principle. The separation of ownership from management, the development of the corporate structure so as to vest in small groups control over the resources of great numbers of small and uninformed investors, make imperative a fresh and active devotion to that principle if the modern world of business is to perform its proper function. Yet those who serve nominally as trustees, but relieved, by clever legal devices, from the obligation to protect those whose interests they purport to represent, corporate officers and directors who award to themselves huge bonuses from corporate funds without the assent or even the knowledge of their stockholders, reorganization committees created to serve interests of others than those whose securities they control, financial institutions which, in the finite variety of their operations, consider only last, if at all, the interests of those whose funds they command, suggest how far we have ignored the necessary implications of that principle. The loss and suffering inflicted on individuals, the harm done to a social order founded upon business and dependent upon its integrity, are incalculable.[133]

2. Sale of Control

There is an extensive body of literature on the question of whether control is an asset belonging to a controlling or dominant shareholder or an asset belonging to the corporation or the shareholders as a body.[134] Stated differently, there is a basic conflict between the view, on the one hand, that shares of stock are property and their owner is free to sell them to anyone for any price and keep the profit, and the view, on the other

---

133. Stone, *The Public Influence of the Bar*, 48 HARV. L. REV. 1, 8-9 (1934).

134. *See* Andrews, *The Stockholder's Right to Equal Opportunity in the Sale of Shares*, 78 HARV. L. REV. 505 (1965); Bayne, *A Philosophy of Corporate Control*, 112 U. PA. L. REV. 22 (1963); Berle, *supra* note 130, at 634-36; Easterbrook & Fischel, *Corporate Control Transactions*, 91 YALE L.J. 698, 716-18 (1982); Javaras, *Equal Opportunity in the Sale of Controlling Shares: A Reply to Professor Andrews*, 32 U. CHI. L. REV. 420, 422-23 (1965).

hand, that a controlling or dominant shareholder must act like a trustee. Discussion and resolution of this controversy are beyond the scope of this article. However, in the author's view, the legality of the control premium has withstood attack in too many cases to claim it is a corporate asset. Nevertheless, a controlling or dominant shareholder does not have an unqualified right to sell corporate offices or assets as incidents of control. Further, a noncontrolling shareholder does not have a right to the control premium.

According to the black letter law, shareholder fiduciary duty does not prevent a controlling shareholder from selling a control block of stock for a premium above market price.[135] However, there are significant exceptions to the principle that control is freely saleable at a premium, which include: a controlling shareholder may not sell control under circumstances that involve the diversion of a corporate opportunity;[136] a controlling shareholder may not sell corporate offices;[137] and a controlling shareholder may not sell control to a looter.[138]

These exceptions appear to be in direct contradiction to the principle that control is freely saleable at a premium. After all, what does the control premium represent if not the price of a majority of board seats? Further, why does anyone seek control except for the purpose of managing corporate assets and taking advantage of corporate perquisites and opportunities? In these days of junk bond takeovers, where corporate control is purchased at a premium with borrowed funds which are then repaid through the proceeds of asset sales, the distinction between the looting and nonlooting cases may be in the eye of the beholder.

The distinction the courts seem to be making, without directly saying so, is that a controlling shareholder is entitled to a fair profit on a control block if the selling controlling shareholder has paid for control by way of financial investment or value added by astute management of corporate assets. As stated in *Zetlin v. Hanson Holdings, Inc.*,[139] ". . . those who invest the capital necessary to acquire a dominant position in the ownership

---

135. Claggett v. Hutchison, 583 F.2d 1259, 1262-63 (4th Cir. 1978); McDaniel v. Painter, 418 F.2d 545, 547 (10th Cir. 1969); Zetline v. Hanson Holdings, Inc., 48 N.Y.2d 684, 685, 421 N.Y.S.2d 877, 878, 397 N.E.2d 387, 388 (1979). *See* ALI Tentative Draft No. 10, *supra* note 21, at § 5.16.

136. Perlman v. Feldmann, 219 F.2d 173, 176-77 (2d Cir.), *cert. denied*, 349 U.S. 952 (1955); Brown v. Halbert, 271 Cal. App. 2d 252, 254, 76 Cal. Rptr. 781, 792-93 (1969); Ferraioli v. Cantor, 281 F. Supp. 354, 356-57 (S.D.N.Y. 1967); Commonwealth Title Ins. & Trust Co. v. Seltzer, 227 Pa. 410, 76 A. 77, 79 (1910).

137. Snyder v. Epstein, 290 F. Supp. 652, 655 (E.D. Wis. 1968); Caplan v. Lionel Corp., 20 A.D.2d 301, 303, 246 N.Y.S.2d 913, 915, *aff'd*, 14 N.Y.2d 679, 249 N.Y.S.2d 877, 198 N.E.2d 908 (1964); Gerdes v. Reynolds, 28 N.Y.S.2d 622 (Sup. Ct. 1941). *But see* Essex Universal Corp. v. Yales, 305 F.2d 572, 573, 575 (2d Cir. 1962).

138. Insuranshares v. Northern Fiscal Corp., 35 F. Supp. 22, 24-25 (E.D. Pa. 1940); DeBaun v. First Western Bank & Trust Co., 46 Cal. App. 3d 686, 120 Cal. Rptr. 354 (1975); Gerdes v. Reynolds, 28 N.Y.S.2d 622, 651 (Sup. Ct. 1941).

139. 48 N.Y.2d 684, 421 N.Y.S.2d 877, 397 N.E.2d 387 (1979).

of a corporation have the right of controlling that corporation. . . . The premium is the added amount an investor is willing to pay for the privilege of directly influencing the corporation's affairs."[140]

Therefore, someone who has not paid the price for control cannot retain the control premium, and the arrogation of a corporate opportunity cannot be disguised as the legitimate sale of a control block.[141] Further, although it is lawful to sell control at a premium to a shareholder who intends to manage the corporation constructively for the benefit of all shareholders, it is unlawful to sell control to a shareholder who intends to destroy the corporation or manage it with a view to selectively extracting profits solely for his own benefit, rather than for the benefit of all shareholders.[142] A corollary to this principle is found in the greenmail cases which permit directors to pay greenmail to counter a threat to the corporation.[143] It should not necessarily follow that the greenmailer may menace the corporation and thereby obtain a personal benefit without liability.

The essence of the duty of loyalty the controlling shareholder owes to minority shareholders is to act for the benefit of the shareholders as a body, rather than only for his own benefit.[144] The ability to sell control at a premium should properly be viewed as an exception to this general rule, which permits a controlling shareholder to reap the rewards of responsible monitoring of management by selling assets thus enhanced in the form of the power to control the board of directors and the corporation's assets. In addition, despite the various controversies about takeover tactics, there is a widespread view that the market for corporate control serves as a corporate accountability mechanism and makes for the more efficient deployment of corporate assets.[145] Depriving a seller of a control block or the

---

140. Zetlin v. Hanson Holdings, Inc., 48 N.Y.2d 684, 685, 421 N.Y.S.2d 877, 878, 397 N.E.2d 387, 388 (1979).

141. Caplan v. Lionel Corp., 20 A.D.2d 301, 246 N.Y.S.2d 913, *aff'd*, 14 N.Y.2d 679, 249 N.Y.S.2d 877, 198 N.E.2d 908 (1964). One commentator has classified such a transaction as a sale of management, as opposed to working or absolute control. *See* Santoni, *The Developing Duties of Controlling Shareholders and Appropriate Restraints on the Sale of Corporate Control*, 4 J. CORP. L. 285 (1979).

142. *See* Essex Universal Corp. v. Yales, 305 F.2d 572, 576 (2d Cir. 1962) (stating that ". . . a holder of corporate control will not, as a fiduciary, be permitted to profit from facilitating actions on the part of the purchasers of control which are detrimental to the interests of the corporation or the remaining shareholders"). *See* Goode v. Powers, 97 Ariz. 75, 397 P.2d 56, 59-60 (1964). A majority shareholder cannot dissipate, waste, or improperly dispose of corporate assets. Theodora Holding Corp. v. Henderson, 257 A.2d 398, 403-04 (Del. Ch. 1969).

143. *See supra* notes 86-93 and accompanying text.

144. Pepper v. Litton, 308 U.S. 295, 311 (1939); Jones v. H.F. Ahmanson & Co., 1 Cal. 3d 93, 108, 81 Cal. Rptr. 592, 599, 460 P.2d 464, 471 (1969); Zahn v. Transamerica Corp., 162 F.2d 36, 42 (3d Cir. 1947).

145. This view runs across a broad political spectrum. *See* Coffee, *Regulating the Market for Corporate Control: A Critical Assessment of the Tender Offer's Role in Corporate Governance*, 84 COLUM. L. REV. 1145 (1984); Easterbrook & Fischel, *The Proper Role of a Target's Management in Responding to a Tender Offer*, 94 HARV. L. REV. 1161, 1169-73,

control premium would put a damper on this market. It does not necessarily follow, however, that a greenmailer is entitled to a control premium, which he has neither paid for nor earned.

3. Is a Greenmailer a Dominant Shareholder?

Several of the greenmail cases go off on the tack that if the greenmailer possessed control and sold such control to assist in a management entrenchment scheme, the greenmail would be tortious. However, the greenmailer was thought not to be a controlling shareholder. Rather, he was someone who threatened to obtain control.[146] The logic of these cases is faulty, however, because they permit the greenmailer to receive and retain a portion of the control premium. The board is permitted to pay the premium over market that greenmail entails, and such a payment is not considered waste, only because the greenmailer's stake is given the value of a control block.[147]

It does not seem right that the greenmailer wins both ways: he is paid a control premium, yet he is not saddled with the fiduciary burdens of a controlling or dominant shareholder. There are two theories under which the duty of a controlling shareholder could be imposed upon a greenmailer. First, it could be argued that the greenmailer impliedly represents that he has or can readily obtain control, and he therefore undertakes the duty of a controlling shareholder when he offers to sell his shares to the corporation at a premium. If he does not really have control to sell, the greenmail payment is then waste and the greenmailer has defrauded the corporation. Although the directors may not have been deceived, the corporate entity may have been defrauded. In either case, the greenmailer should be estopped from denying he has control.

Second, it could be argued that the justification for imposing a fiduciary duty on a controlling shareholder applies to greenmailers. In an institutionalized stock market, in addition to the classic cleavage between ownership and management, there is a separation of savings and investment.[148] Control in fact therefore can be exercised by a much smaller block of stock than

1182 (1981); Epstein, *Who Owns the Corporation* (20th Century Fund Paper, Priority Press Publications 1986); Schwartz, *Federal Chartering Revisited*, 22 U. MICH. J.L. REF. 7, 12-14 (1988).

146. *E.g.*, Fry v. Trump, 681 F. Supp. 252 (D.N.J. 1988); Heckman v. Ahmanson, 168 Cal. App. 3d 119, 214 Cal. Rptr. 177 (1985). Under Delaware law only a controlling stockholder has fiduciary obligations. *In re* Sea-Land Corp., Civ. Action No. 8453, (Del. Ch. 1987), *reprinted in* 13 DEL. J. CORP. 795, 799 (1987 WL 11283, at 4); Gilbert v. El Paso Co., 490 A.2d 1050, 1055 (Del. Ch. 1984), *aff'd*, 575 A.2d 1131 (Del. Super. Ct. 1990).

147. Cheff v. Mathes, 199 A.2d 548, 554-56 (Del. 1964). Companies are given one value in the market for day-to-day purposes in marginal trading and a higher valuation when control of whole companies is at stake. The difference between the two values in known as the premium for control. Plender, *Malaise in Need of Long-Term Remedy*, Fin. Times, July 20, 1990, at I16, col. 4.

148. Clark, *The Four States of Capitalism: Reflections on Investment Management Treatises*, 94 HARV. L. REV. 561, 564-65 (1981).

legally necessary for formal control or stock that was formerly assumed necessary for operating or working control.[149]

The greenmailer's threat is that he is in touch with control and that he will use this power destructively. In consideration for a greenmail payment the only value a corporation receives is that the greenmailer either will refrain from continuing as a shareholder or that he will not effectively exercise his corporate franchise. He will surrender control to the corporation. Such a contract implicitly recognizes that the greenmailer is a dominant shareholder, at least in relation to the threatened contest for corporate control.

a. Diversion of a Corporate Opportunity

If the greenmailer has no liability for his conduct he obtains a profit for a sale of control which he never owned, and he does so in a transaction that evades the provisions of the Williams Act entitling all shareholders to fair treatment in tender offers.[150] Obtaining the greenmail payment for himself and preventing other shareholders from receiving a tender offer is seizing an opportunity that should be offered to all shareholders. However, if a greenmailer is treated as a dominant shareholder with a fiduciary duty to other shareholders, at the very least greenmail could not be paid in the absence of a shareholder vote.

If a controlling shareholder can sell a control block at a premium and such a sale is not ordinarily viewed as taking advantage of a corporate opportunity, why should the greenmailer be subject to a different duty? One important difference between a controlling shareholder and a greenmailer is that the greenmailer's investment is minimal in terms of both capital and time. It is this small financial stake and absence of managerial responsibility that makes greenmail abusive.

Moreover, in some cases where a buyer of control was willing to offer a control premium to all shareholders, either by tender offer or merger, and a majority shareholder usurped this opportunity, the courts have found a breach of fiduciary duty in the sale of control.[151] Greenmail similarly cuts off the opportunity of the majority to receive a tender offer.

b. Sale of Corporate Offices

Even if a controlling shareholder ordinarily can sell control at a premium and therefore reorganize the board of directors, where a shareholder does not in fact have control but contracts for the resignation of the board's directors, the contract is contrary to public policy and void.[152] This is

149. HERMAN, CORPORATE CONTROL, CORPORATE POWER 63 (1981).

150. *See infra* notes 199-203.

151. Birnbaum v. Newport Steel Corp., 193 F.2d 461 (2d Cir.), *cert. denied*, 343 U.S. 956 (1952); Perlman v. Feldmann, 219 F.2d 173 (2d Cir.), *cert. denied*, 349 U.S. 952 (1955); Brown v. Halbert, 271 Cal. App. 2d 252, 76 Cal. Rptr. 781 (1969).

152. Caplan v. Lionel Corp., 20 A.D.2d 301, 246 N.Y.S.2d 913, *aff'd*, 14 N.Y.2d 679, 249 N.Y.S.2d 877, 198 N.E.2d 908 (1964).

because the management of a corporation is not the subject of trade and cannot be bought apart from actual stock control.[153]

This principle is perhaps more suitable to greenmail than the corporate opportunity doctrine because the analogy is factually closer. In a public corporation control generally is "in a large, fluid, changeable and changing market."[154] Directors are in a position to control the corporation, even if their holdings are minimal, because they have control of the proxy machinery.[155] However, the institutionalization of the market has created the potential for capital cartels,[156] where a contest for corporate control can be set off by a shareholder with a small stake.[157]

Where greenmail is paid in this context, (and it usually is), the payment is made not to initiate a control contest. Whether or not there is any other proof of management entrenchment, the directors are authorizing the use of corporate funds to remain in office.[158] While this may be more subtle than a contract for the sale of corporate office, it is essentially the same thing. It is a contract to maintain control and should be equally contrary to public policy, and should result in the return of the greenmail payment to the corporation. Because control is of no value to the corporation (as opposed to management), payment for the control premium with corporate funds is waste.

The Delaware cases distinguishing illegal vote buying from legal greenmail draw a blurred line in order to give directors the benefit of the business judgment rule,[159] but the greenmailer needs no such protection. This distinction needs to be made. It should not be necessary to fault directors for paying greenmail in order to find the greenmail contract voidable as to the corporation. The directors may defend a greenmail payment under the theory that the board can respond appropriately to a threat to the corpo-

153. 20 A.D.2d at 303, 246 N.Y.S.2d at 915. *See also* Rosenfeld v. Black, 445 F.2d 1337, 1342 (2d Cir. 1971), *cert. dismissed sub nom.* Lazard Freres & Co. v. Rosenfeld, 409 U.S. 802 (1972).

154. Paramount Communications, Inc. v. Time, Inc. [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,514, at 93,280 (Del. Ch. July 14, 1989), *aff'd*, 571 A.2d 1140 (Del. 1989).

155. *See* HERMAN, *supra* note 149, at 17-52. This view dates back to BERLE & MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY 69-94, 114, 116-18 (1932).

156. *See* Block & Hoff, *Emerging Role of the Institutional Investor*, N.Y.L.J., Apr. 12, 1990, at 5, col. 1; Regan, *Pension Funds: New Power, New Responsibility*, Wall St. J., Nov. 2, 1987, at 28, col. 3; White, *Giant Pension Funds' Explosive Growth Concentrates On Economic Assets and Power*, Wall St. J., June 28, 1990, at C1, col. 3.

157. *See* HERMAN, *supra* note 149. The speed with which control can change hands was exemplified by SCM Corp. v. Hanson Trust PLC, 774 F.2d 47 (2d Cir. 1985), where the rapid accumulation of 25% of an issuer's shares, in the wake of a discontinued tender offer, from a handful of arbitrageurs, was accomplished within two hours after the close of the market. All but one of the sellers were subsequently exposed for insider trading in various stocks, raising questions about the "players" in corporate control markets.

158. *Cf.* Norlin Corp. v. Rooney Place, Inc., 744 F.2d 255 (2d Cir. 1984).

159. *See supra* notes 89-90 and accompanying text. The logic differentiating these cases is questionable, but the first *Good v. Texaco* case was a motion to dismiss and the second the approval of a settlement.

ration. Also, issuer repurchases may benefit shareholders by reducing the number of shares outstanding and thereby increasing book value and earnings per share. However, just as the corporation can recover the short swing trading profits of corporate insiders without any need to prove misuse of inside corporate information,[160] the corporation should be able to recover the payment of a control premium by the corporation without the need to prove a management entrenchment scheme. It is the excessive payment over market price for the property of a single shareholder of no intrinsic value to the corporation that raises a question of corporate waste. In the same way that the Exchange Act short swing profit prohibitions are a prophylactic for the prevention of insider trading, a policy against greenmail would be a prophylactic against management entrenchment.

It is currently unfashionable to upset corporate decision making on public policy grounds, nexus of contracts being the trendier corporate governance model.[161] Yet, nexus of contracts may be an imperfect model for changes in corporate control, which involve not only the shift of economic assets from one group of managers to another, but shifts of power and income. A recent popular account of the leveraged buy-out of R.J.R. Nabisco Inc. details the role of ego and personal greed in a highly publicized corporate control contest.[162]

One commentator has proposed a very interesting "power model" to explain recent corporate control shifts which would give a much larger role to the judiciary in monitoring management conduct.[163] Under the power model, a corporation is not a marketplace, "but an organic institution with its own internal structure and processes that impact on control of the firm." Management "holds a strategic position in the firm that it utilizes to minimize the influence of other constituencies."[164] A significant implication of such a model is that "fiduciary duties of directors become a matter for public policy determination rather than a decision to be made by shareholders on a company-by-company basis."[165]

Even under a contractarian approach to corporate law, it should be stressed that in the negotiation between corporate directors and a greenmailer, all other shareholders are not consulted and they generally lose out.[166] The purchase of the right to remain in office by an incumbent board that greenmail entails, if not set aside on public policy grounds, should at least be put to a shareholder vote.

---

160. Reliance Elec. Co. v. Emerson Elec. Co., 404 U.S. 418, 422 (1972); Blau v. Lehman, 368 U.S. 403, 411-12 (1962). Admittedly, this result was accomplished by statute.

161. Clark, *Contracts, Elites and Traditions in the Making of Corporate Law*, 89 COLUM. L. REV. 1703 (1989). *See supra* notes 63-65 and accompanying text.

162. BURROUGH & HELYAR, BARBARIANS AT THE GATE (1990). *See also* Chock Full O'Nuts Corp. v. Finkelstein, 548 F. Supp. 212 (S.D.N.Y. 1982).

163. Dallas, *Two Models of Corporate Governance: Beyond Berle and Means*, 22 U. MICH. J.L. REF. 19 (1988).

164. *Id.* at 25.

165. *Id.* at 115.

166. *See supra* note 29 and accompanying text.

c. Looting

Superficially, the cases which hold that a controlling shareholder may not knowingly sell control to a looter have little to do with greenmail. Yet, further analysis reveals a principle underlying the looting cases which may be relevant.

In the case of *Insuranceshares Corp. v. Northern Fiscal Corp.*[167] the Court enunciated the basic rationale for shareholder duties as follows:

> Those who control a corporation, either through majority stock ownership, ownership of large blocks of stock less than a majority, officeholding, management contracts, or otherwise, owe some duty to the corporation in respect of the transfer of the control to outsiders. The law has long ago reached the point where it is recognized that such persons may not be wholly oblivious of the interests of everyone but themselves, even in the act of parting with control, and that, under certain circumstances, they may be held liable for whatever injury to the corporation made possible by the transfer. Without attempting any general definition, and stating the duty in minimum terms as applicable to the facts of this case, it may be said that the owners of control are under a duty not to transfer it to outsiders if the circumstances surrounding the proposed transfer are such as to awaken suspicion and put a prudent man on his guard—unless a reasonably adequate investigation discloses such facts as would convince a reasonable person that no fraud is intended or likely to result.[168]

This language suggests that those who have power to affect the existence of a corporation or the value of the shares held by all other shareholders cannot use their power destructively or aid and abet another party who intends to damage the corporation.

The looting cases turn on the question of whether the seller of control has reason to know (generally, because of a highly inflated price paid for his shares) that the buyer intends to take corporate assets for his personal use. Similarly, a recent note on greenmail has suggested that the liability of a greenmailer for aiding and abetting a directorial breach of fiduciary duty should depend on the greenmailer's knowledge of that breach of duty.[169] While this analysis goes only so far as to make the greenmailer an aider and abetter, perhaps it can be pushed further. If a greenmailer has been aligned with a pool of buyers of control and his threat is to put a corporation in play, under circumstances that would harm the shareholders as a whole, he would appear to be guilty of coercive action, which is an

---

167. 35 F. Supp. 22 (E.D. Pa. 1940).

168. Insuranceshares Corp. v. Northern Fiscal Corp. 35 F. Supp. 22, 25 (E.D. Pa. 1940).

169. Note, *Aiding and Abetting the Breach of Fiduciary Duty: Will the Greenmailer Be Held Liable?*, 39 CASE W. RES. L. REV. 1271, 1294-1302, 1311-12 (1988-89).

independent wrong, and would not be liable merely as a participant in an improper scheme by directors.[170]

The Delaware cases view greenmail as a threat to the corporation to which directors can properly respond by paying greenmail.[171] However, they do not take the next step and make a greenmailer's conduct unlawful. While a greenmailer's liability, like all fiduciary duty cases, would have to depend on the facts and circumstances surrounding the payment, courts should at least consider whether the greenmailer has wielded a power to make him a dominant shareholder in the context of a contest for corporate control, and then, whether that power has been abused to the corporation's detriment.

B. Corporate Blackmailers

Greenmail has been likened to blackmail or extortion, and indeed it is remarkably similar.[172] One theorist has argued that the essence of blackmail "is the misuse of an informal (or formal) power or agency or representation."[173] This is precisely what the greenmailer does. Greenmailers usurp the power to elect a majority of the board, a power that they have neither earned nor purchased, and that lawfully resides with other shareholders of the corporation. The leverage they use to coerce a premium repurchase from the corporation is that they will instigate others to take over the corporation.

Greenmailers thrive on their terrible reputations. They are able to coerce boards into buying their shares at a premium (and this conduct is countenanced by the courts), because they are threats to corporate stability. This type of conduct is very similar to noninformational blackmail; for example, the threat by a labor leader to initiate a strike unless he is paid off.[174] In such a situation the blackmailer "is negotiating for his own gain with someone else's leverage or bargaining chips."[175]

---

170. The extent to which players in the takeover battles of the 1980s worked in concert is unclear, but there is some evidence of investor groups in certain transactions. *See* Frankel, *Drexel's Shakedown?*, AMERICAN LAW., July/August 1990 at 40; Meyers, *How Magnates Pick Partners*, N.Y. Times, Mar. 27, 1988, § 6 Business World Magazine, pt. 2, at 26, col. 1.

171. *See supra* notes 81-93 and accompanying text.

172. *See supra* note 24 and accompanying text. For a general definition of economic duress or business compulsion, see RESTATEMENT (SECOND) OF CONTRACTS § 176 (1981). Among other things, "A threat is improper if the resulting exchange is not on fair terms, and . . . what is threatened is otherwise a use of power for illegitimate ends." *Id.* at § 176(2)(c). For cases on economic duress or business compulsion as a basis for rescinding contracts, see S. WILLISTON, WILLISTON ON CONTRACTS § 1618 (W. Jaeger 3d ed. 1970).

173. Lindgren, *Unraveling the Paradox of Blackmail*, 84 COLUM. L. REV. 670, 703 (1984). *See also* Epstein, *Blackmail, Inc.*, 50 U. CHI. L. REV. 553, 565-66 (1983), (arguing that blackmail breeds fraud and deceit; it is sneaky and dirty). The tort of duress has been compared to fraud. Note, *Duress as a Tort*, 39 HARV. L. REV. 108 (1925).

174. United States v. Kramer, 355 F.2d 891 (7th Cir.), *vacated in part and remanded*, 384 U.S. 100 (1966); United States v. Provenzano, 334 F.2d 678 (3d Cir.), *cert. denied*, 379 U.S. 947 (1964). *Cf.* United States v. Margiotta, 688 F.2d 108, 133-36 (2d Cir. 1982), *cert. denied*, 461 U.S. 913 (1983).

175. Lindgren, *supra* note 173, at 702.

Extortion is made unlawful under federal law by the Hobbs Act, which prohibits "the obtaining of property from another, without his consent, induced by wrongful use of actual or threatened force, violence or fear, or under color of official right."[176] In *Viacom International Inc. v. Icahn*[177] a suit was brought by a corporation which had paid greenmail to Carl C. Icahn and various corporations controlled by him (the "Icahn Group"), which had acquired almost 17% of its common stock. For purposes of a summary judgment motion, it was conceded that the greenmail payment had a value of $79.50 per share at a time when the actual market value of a share of common stock was $62, representing a premium over market of $60,525,000. The complaint alleged violations of the Hobbs Act as predicate acts for a pattern of racketeering activity in violation of RICO and the fraudulent sale of securities. The Court held that a jury could find that the corporation had a reasonable fear of harm to existing or potential economic opportunities as long as the Icahn Group owned such a large block of its shares and were in a position to threaten a takeover.

According to the Court, greenmail is not inherently unlawful, but it could constitute a wrongful means of obtaining property under the Hobbs Act if the Icahn Group had no lawful claim to the property obtained. The court examined two such scenarios. One is where the victim receives in exchange for his property something that is of no value to the victim; for example, where a union uses fear to induce an employer to pay wages for an additional worker to do exactly what another worker was being paid to do. A second scenario is where the victim receives something that the victim values. In this category, however, some acts constitute extortion while others are found to be hard bargaining.

Analyzing the first type of extortion, the Court found that the Icahn Group provided the plaintiff corporation with a standstill agreement and shares of stock in return for the consideration received. This analysis, however, does not go far enough. The premium of over $60 million paid to the Icahn Group was a control premium. Yet, control is of no value to the corporation. Further, Icahn did not have control, but only threatened to obtain it. As to the second type of extortion, the Court found the corporation had no right to be free from the problems and fears of a takeover threat and therefore any intentional exploitation of this fear by the Icahn Group was only hard bargaining in a deal which resulted in plaintiff receiving an eleven year standstill agreement, a benefit to which it was not otherwise entitled by law. Because the Hobbs Act claim failed, so did the RICO claim.

Viacom is the first case that seriously comes to grips with the claim that greenmail is extortion. It failed to find a Hobbs Act violation primarily because the court accepted the contract between the corporation and the Icahn Group at face value and did not distinguish between the value of the

---

176. 18 U.S.C. § 1951(b)(2) (1988).

177. 747 F. Supp. 205 (S.D.N.Y. 1990).

agreement to the corporation's officers and directors and its value to the corporation and its shareholders. The court perhaps was affected by the complicity of management in the greenmail payment and the business judgment rule cases validating greenmail contracts. An analogy to the cases holding that a corporation can be deceived even if its directors are not, because they are participants in a fraud on the corporation, might be helpful. Although control, or whatever portion of the control premium $60 million represented, may have been of value to management, it was paid for with corporate funds and was of no value to the corporation. Therefore, the real victim of the greenmail payment did not receive anything of value, and the plaintiff should have been permitted to pursue Hobbs Act allegations.

In any event, greenmail could fit into the state law tort of economic or business duress. In one case, a claim under New York law for economic duress against a greenmailer was made, which the court dismissed on the ground that it was not duress to threaten a tender offer, because a tender offer was a legally permissible action.[178] Although New York law may support such an analysis,[179] under the law of other jurisdictions tortious duress may be accomplished through lawful means, if those means are used to trade upon the victim's financial position with the improper purpose of securing personal advantage.[180] Acts that are wrongful in a moral sense, if made use of as a means of causing fear, vitiate a transaction induced by that fear, though the acts may not in themselves be legal wrongs.[181]

In *Neibuhr v. Gage*[182] the plaintiff sued for damages for duress in the transfer of shares of stock to the defendant. The plaintiff claimed that the defendant had falsely accused him of grand larceny and threatened to expose him. The plaintiff believed that the defendant would produce false testimony to this effect and therefore he entered into a contract for the stock transfer. The court struggled with the novelty of the allegations and concluded that duress and fraud should be treated as equivalent grounds for invalidating a contract for the transfer of stock.

> [I]s a party who has been injured by duress entitled to the same remedies as one who has been injured by deception? We are unable to see why there should be any distinction made between these two classes of cases. Fraud is ordinarily accomplished by deceit, but it is also accomplished by many other practices. As commonly under-

178. *See supra* notes 99-100 and accompanying text.

179. Hammelburger v. Foursome Inn Corp., 54 N.Y.2d 580, 593 n.4, 431 N.E.2d 278, 285 n.4, 446 N.Y.S.2d 917, 924 n.4 (1981). *But see* National American Corp. v. Federal Republic of Nigeria, 448 F. Supp. 622, 644 (S.D.N.Y. 1978), *aff'd*, 597 F.2d 314 (2d Cir. 1979).

180. Wolf v. Marlton Corp., 57 N.J. Super. 278, 287, 154 A.2d 625, 630 (App. Div. 1959); Fowler v. Mumford, 48 Del. 282, 286-87, 102 A.2d 535, 537-38 (Del. Super. Ct. 1954); Rich & Whillock, Inc. v. Ashton Dev., inc., 157 Cal. App. 3d 1154, 204 Cal. Rptr. 86 (1984).

181. Miller v. Eisele, 111 N.J.L. 268, 275-76, 168 A. 426, 429-30 (1933).

182. 99 Minn. 149, 108 N.W. 884, *aff'd on rehearing*, 109 N.W. 1 (1906) (per curiam).

stood, fraud is a wrong accomplished by deception but . . . duress is a species of fraud in which compulsion in some form takes the place of deception in accomplishing the injury.[183]

C. Stock Manipulators

Greenmail seems to skirt various antifraud provisions of the Exchange Act. Although affirmative misrepresentations by greenmailers have on occasion been found actionable under the antifraud rules of the Exchange Act,[184] the act of greenmail itself is difficult to place within the restrictions that the Supreme Court has imposed upon the antifraud provisions in recent years. The principles that securities fraud cases require manipulation or deception,[185] that the plaintiff be a buyer or seller of stock,[186] and that the defendant in an omission case be guilty of a breach of duty, beyond a generalized duty to the marketplace,[187] pose serious barriers to a case by shareholders that they were defrauded by a greenmailer.[188] Further, it is difficult for the corporation to claim it was deceived.[189]

Nevertheless, there are several theories under which greenmail could be deemed to violate the Exchange Act. These include the argument that greenmail is a manipulative or deceptive device under Rule 10b-5[190] or Rule 14e-3,[191] and that greenmail is a manipulation under Section 9(a)[192] of the Exchange Act. While these theories could be implemented by judicial decisions, the SEC also could outlaw greenmail by rule-making under Section 13(e)[193] of the Exchange Act and other pertinent provisions.

In *Shreiber v. Burlington Northern, Inc.*[194] the Supreme Court held that an antitakeover corporate action was not a manipulative or deceptive device under the Williams Act. The Court suggested that in order for conduct to be actionable under Rule 10b-5 or Rule 14e-3, there must be nondisclosure or deception. One commentator has argued that the rationale of the *Shreiber*

---

183. Neibuhr v. Gage, 99 Minn. 149, 156, 108 N.W. 884, 887, *aff'd on reh'g*, 109 N.W. 1 (1906) (per curiam).

184. *See supra* notes 110-15 and accompanying text.

185. Schreiber v. Burlington Northern, Inc., 472 U.S. 1 (1985); Santa Fe Industries, Inc. v. Green, 430 U.S. 462 (1977).

186. Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723 (1975); Christophides v. Porco, 289 F. Supp. 403 (S.D.N.Y. 1968). Before the corporation purchases the greenmailer's stock, this doctrine is a serious barrier to the corporation's standing or the standing of a nonselling shareholder as a plaintiff. *See* Dan River, Inc. v. Icahn, 701 F.2d 278, 284-85 (4th Cir. 1983). After the greenmail purchase, however, the corporation would have standing. A nonselling shareholder might still have a standing problem.

187. Chiarella v. United States, 445 U.S. 222 (1980).

188. *See supra* notes 119, 123-24 and accompanying text.

189. *See supra* notes 117-19 and accompanying text.

190. 17 C.F.R. § 240.10b-5 (1990).

191. 17 C.F.R. § 240.14e-3 (1990).

192. 15 U.S.C. § 78i(a) (1988).

193. 15 U.S.C. § 78m(e) (1988).

194. 472 U.S. 1 (1985).

case stands in the way of holding that greenmail is a manipulative device under the Exchange Act, because greenmail is coercive rather than fraudulent.[195] Under this analysis, manipulative conduct must contain an element of deception in order to violate the Exchange Act.

Although the SEC and the courts have emphasized the full disclosure underpinnings of the Exchange Act, particularly in Rule 10b-5 cases, the Congress that passed the Exchange Act in 1934 was concerned primarily with regulating speculation and manipulation. The legislative history supporting such a conclusion is comprehensively laid out in a recent law review article, which explains that Congress debated whether absolutely to outlaw certain conduct perceived as contrary to the public interest such as short selling, securities credit transactions and collusive trading, all of which generated speculation in the stock market.[196] Instead, Congress gave the SEC the authority to regulate such activities. Furthermore, Congress believed that manipulation was not limited to deceptive stock market activities. Rather, the concept of manipulation included pool activities which involved concerted trading power that caused price changes, thereby enabling pool operators to sell securities they had purchased at a profit.[197]

Viewed from this perspective, greenmail can be analyzed as a manipulative device or contrivance. When a greenmailer purchases his toe-hold position, the share price of the targeted issuer generally rises and then falls after the greenmailer is paid off.[198] The market rises because these purchases signal a takeover,[199] but the greenmailer does not intend or accomplish a takeover. In this sense greenmail does contain an element of deception in addition to its coercive qualities.

In addition to the provisions of Rules 10b-5 and 14e-3 prohibiting deceptive or manipulative devices, there are specific Exchange Act provisions in Section 9(a) of the Exchange Act barring stock market manipulations. These provisions generally were directed at the pool operators of the 1920s. It could be argued that greenmail violates Section 9(a) of the Exchange Act because it is manipulative in the sense that it is "a series of transactions . . . creating actual or apparent active trading in such security or raising . . . the price of such security, for the purpose of inducing the purchase . . . of such security by others."[200] Furthermore, if these purchases are accompanied by any false statements about the greenmailer's intentions (generally, "I am not a greenmailer" protestations), there is authority for

---

195. Poser, *Stock Market Manipulation and Corporate Control Transactions*, 40 U. MIAMI L. REV. 671, 719-21 (1986).

196. Thel, *The Original Conception of Section 10(b) of the Securities Exchange Act*, 42 STAN. L. REV. 385 (1990).

197. *Id.* at 451.

198. *See supra* note 29 and accompanying text.

199. *See* Basic, Inc. v. Levinson, 485 U.S. 224 (1988). *See also* SLATER, THE TITANS OF TAKEOVER 17 (1987); *supra* note 26 and accompanying text.

200. Exchange Act, § 9(a)(2), 15 U.S.C. § 78i(a)(2) (1988). *Cf.* Crane Co. v. Westinghouse Air Brake Co., 419 F.2d 787 (2d Cir. 1969), *cert. denied*, 400 U.S. 822 (1970).

considering the trading a violation of the antimanipulative provisions of the Exchange Act. *Securities and Exchange Commission v. Wolfson*[201] involved a public announcement by Louis Wolfson, a well known stock speculator, that he intended to sell a large position of American Motors Corp. stock. In fact, he had a large short position in this stock, which had been steadily rising in price. The SEC charged that his misstatement violated Section 9(a)(4) of the Exchange Act and an injunction on consent was issued.[202]

The securities laws recognize that purchases by an issuer of its own stock have a special potential for manipulation. Sections 3(e)(1) and (2) of the Exchange Act[203] give the SEC authority to regulate issuer repurchases. Pursuant to this authority, the SEC has adopted Rule 10b-18,[204] which specifies certain time, price, and other parameters for issuer repurchases. The object of this regulation is to prevent the issuer repurchases from artificially raising the price of the issuer's shares. Greenmail presents the opposite problem. Greenmail can artificially depress the price of the issuer's shares. Additionally, issuer tender offers are regulated under Rule 13e-3.[205] If the corporation repurchasing a greenmailer's shares were required to make a tender offer to do so, all shareholders would have the opportunity to share in the premium the greenmailer obtains.[206] Presumably, the SEC could extend this rule to greenmail by requiring an issuer paying greenmail to tender to all shareholders, but it has not chosen to do so.[207] In order to go further and subject the greenmailer to liability the SEC would have to find a way to impose a duty to other stockholders on the greenmailer.

There are a number of provisions under the Exchange Act that impose a duty to other shareholders or buyers or sellers of stock upon shareholders. Generally, such shareholders are "insiders" or large shareholders. The term "insider" is not defined in the federal securities laws, but in 1934 Congress took the view that 10% holders should be treated as insiders for certain purposes and not allowed to speculate in an issuer's securities.[208] More

---

201. SEC Lit. Rel. No. 1315 (Aug. 1, 1958).

202. 15 U.S.C. § 78i(a)(4) (1988). Section 9 applies to exchange listed securities, but trading in an over-the-counter stock that would be manipulative under Section 9 is deemed to be fraudulent under Section 10(b) of the Exchange Act. SEC v. Allison, [1981-82 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 98,427 at 92,550 n.7 (D. Ore. 1982).

203. 15 U.S.C. § 78m(1), (2) (1988).

204. 17 C.F.R. § 240.10b-18 (1990).

205. 17 C.F.R. § 240.13e-3 (1990). A fully disclosed issuer tender offer does not violate the Exchange Act, even if it involves a breach of fiduciary duty. Vaughn v. Teledyne, 628 F.2d 1214 (9th Cir. 1980).

206. This result is required by SEC Rule 14d-10, 17 C.F.R. § 240.14d-10 (1990).

207. Despite doubts about the SEC's authority to adopt a rule requiring a tender offeror to give all shareholders the best price of any offer, Rule 14d-10, 17 C.F.R. 240.14d-10 (1990), was upheld by the Third Circuit in Polaroid Corp. v. Disney, 862 F.2d 987, 995 (3d Cir. 1988).

208. Under Section 16(b) of the Exchange Act, 15 U.S.C. § 78p(b) (1988), a 10% shareholder must account to a corporation and repay profits made on trading its equity securities within a six-month period. *See* Gratz v. Claughton, 187 F.2d 46 (2d Cir.), *cert. denied*, 341 U.S. 920 (1951) (giving policy justification for treating 10% holders as insiders).

recently, 5% holders have been required to disclose their purchases to other shareholders, as well as their investment intentions and sources of securities credit.[209]

Greenmail can be analogized to insider trading, which is tortious conduct by one shareholder against the remaining shareholders. Both are destructive of investor confidence in the fairness of the markets. In an early case, the SEC justified the prohibition against trading on inside information on two grounds:

> [F]irst, the existence of a relationship giving access, directly or indirectly, to information intended to be available only for a corporate purpose and not for the personal benefit of anyone, and second, the inherent unfairness involved where a party takes advantage of such information knowing it is unavailable to those with whom he is dealing.[210]

Trading on inside information destroys the integrity of the market place by giving informational advantage to a select group of corporate insiders.[211] A greenmailer is not a corporate insider in the sense that he is an officer or director of the issuer whose shares he is trading. However, the greenmailer receives favored treatment as a result of his possession of a strategic block and a special relationship with potential bidders.

Insider trading violates Rule 10b-5 under the Exchange Act, which makes it unlawful for *any person* in connection with the purchase or sale of a security, among other things "to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person."[212] Similarly, Rule 14e-3 defines insider trading relating to a tender offer by *any person* as a "fraudulent, deceptive or manipulative act or practice."[213] If, as previously argued,[214] coercion can be considered as a species of fraud, greenmail could be encompassed within the literal language of Rules 10b-5 and 14e-3.

Facially, Rule 14e-3, unlike Rule 10b-5 as interpreted by the Supreme Court,[215] does not require that the insider trader breach a fiduciary relationship or confidential duty. For this reason, in a 2-1 decision, the Second Circuit expressed doubt as to the validity of Rule 14e-3.[216] The author

---

209. Under Section 13(d) of the Exchange Act, 15 U.S.C. § 78m(d) (1988), a 5% holder must file disclosure statements pursuant to the Williams Act. Some claim greenmailers intentionally limit their holdings to less than 5% to avoid disclosure. *See* Nussbaum, *The Greenmailers Learn to Play in the Shadows*, Bus. Wk., May 5, 1986, at 105.

210. In re Cady, Roberts & Co., 40 S.E.C. 907, 914 (1961) (footnote omitted).

211. 2 T. Hazen, The Law of Securities Regulation 137-38 (2d ed. 1990).

212. 17 C.F.R. § 240.10b-5(c) (1990).

213. 17 C.F.R. § 240.14e-3(a) (1990).

214. *See supra* notes 172-83 and accompanying text.

215. Dirks v. S.E.C., 463 U.S. 646 (1983); Chiarella v. United States, 445 U.S. 222 (1980).

216. United States v. Chestman, [Current Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 95,214 at 95,906, 95,908 (2d Cir. May 2, 1990), *rehearing en banc granted*, [Current Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 95,439.

believes such an interpretation of Rule 14e-3 is erroneous and that any person with the requisite intent in the possession of inside information relating to a tender offer should be subject to a duty to disclose that information or abstain from trading.[217] If it is necessary to spell out a duty to impose liability on a greenmailer, then the analysis required would be similar to that required under state corporation law doctrines.[218]

To put an activity like greenmail in the straight jacket of state law fiduciary duty concepts, however, seems contrary to the intent of Congress in enacting the Exchange Act to supplement common law investor protections.[219] Manipulation is essentially an interference with fully informed trading in the public markets. Greenmail is manipulative because it plays a trick on reasonable shareholder expectations by driving up share prices to reflect a phony control premium and then, adding insult to injury, coercively extracting such an increase in share price from the corporation.

VI. Conclusion

From a certain perspective, the search in this article for theories of liability for greenmail has been a futile exercise. Despite consistent criticisms of greenmail, the SEC has declined to urge its abolition or bring cases to stop it, Congress has not legislated against it, and the Delaware courts have turned a blind eye to its evils. Furthermore, the excesses of the takeover frenzy of the past decade appear to be subsiding, and greenmail is now discouraged by the tax laws. Although the California and some federal courts have held greenmailers liable as aiders and abetters of directorial wrongdoing, no court has held that greenmail is an independent tort.

Yet, in view of the institutionalization of the securities markets and the widespread suspicion and criticism of investor behavior,[220] it is important to consider what types of conduct by large investors might be a breach of duty to other investors. Greenmail cries out for analysis as a tort. While it could be banned or conditioned upon a shareholder vote by statute or SEC rule, a case by case analysis might be more flexible in distinguishing between egregious block sales to a corporation of its own stock and situations where there is a justification for the premium sale.

This article has suggested that the greenmailer can breach a duty to the corporation and other shareholders because he possesses or purports to possess shares commanding a control premium. Accordingly, he has assumed a duty to the corporation and other shareholders with respect to the sale of his block. Furthermore, his conduct is a type of coercion that should be

---

217. Karmel, *Limitations on SEC Rule-Making*, N.Y.L.J., Aug. 16, 1990, at 6, col. 1.

218. *See supra* notes 146-71 and accompanying text.

219. Seligman, *The Reformulation of Federal Securities Law Concerning Nonpublic Information*, 73 Geo. L.J. 1083, 1109, 1134 (1985).

220. *See* Lipton, *supra* note 23, at 32; *Punters or Proprietors?* (Survey), Economist, May 5, 1990, at 64. *See generally Our Money's Worth*, The Report of the Governor's Task Force on Pension Fund Investment (June 1989).

classified as economic duress or a similar tort. These theories sound primarily under state law, but in appropriate fact situations could involve violations of the federal securities law or other federal statutes. In addition, the trading activities of a greenmailer should be regarded as a fraudulent or manipulative device or contrivance in violation of the federal securities laws. When the financial history of the 1980s is fully revealed, greenmailers could well be seen as the lookouts for the takeover pools that engulfed American enterprise. Yet, greenmailers were loyal neither to the corporations whose stock they purchased nor the bidders they purported to represent, but served only their own opportunistic ends.