WACHTELL, LIPTON, ROSEN & KATZ

April 10, 2006

# Deconstructing American Business

As noted in the Wall Street Journal last week, Prof. Lucian Bebchuk of the Harvard Law School has personally submitted proposals for binding bylaw amendments to at least 10 major American corporations, turning these very real companies – with combined annual revenues in excess of $450 billion and employing more than 850,000 individuals – into his private "case studies."

Prof. Bebchuk's proposals cover a variety of topics, but all are structured not as suggestions or recommendations for change in corporate policy, but as mandatory amendments to the target company's bylaws. As such, these skillfully-worded proposals embed corporate policy directly into the targets' constitutional documents and increase shareholder power while reducing or neutralizing the role of the board of directors in safeguarding the interests of the corporation. More importantly, they form part of a larger but misguided campaign on the part of certain academics and special-interest activist shareholders to impose upon the corporate landscape a shareholder-centric governance model that is at odds with the fundamental construct of our corporate law and that runs contrary to some of the best current thinking – among both academics and practitioners – about corporate governance and long-term corporate performance.

It is very disturbing that a small group of law and business school professors, led by Prof. Bebchuk (and aided and abetted by corporate raiders and activist hedge funds that benefit from joining the cabal), equate immediate stockholder wealth maximization with the national good. Or, more precisely, they appear to have lost any perspective on the question of the national good because it cannot be measured by readily-available stock market statistics.

The most pernicious of Prof. Bebchuk's proposals, submitted to at least two major companies, would amend the target companies' bylaws to provide that, no matter what the circumstance, adoption of the takeover defense known as the shareholder rights plan would require a *unanimous* vote of the directors, and even then the plan could have a term of no more than one year. We have serious questions about the legality of such a unanimity requirement, which would effectively substitute the judgment of a single director for the judgment of the full board and potentially render the directors unable to fulfill their fiduciary duties. Indeed, one of the companies receiving this proposal has 12 directors, the other has 11 (including a former SEC commissioner and the faculty chairman of the Harvard Business School's Global Corporate Governance Initiative). Under Prof. Bebchuk's scheme, these directors could be rendered voiceless on one of the most significant and sensitive issues a corporation can face, by a vote 1-10 or 1-11. This is not even the tyranny of the minority; it's the tyranny of one.

The unanimous-approval bylaw proposals also have an unstated but even more invidious purpose, which is to destroy the staggered board. Under current practice, when the target has a staggered board, a raider needs to win two elections (over a period of 15 to 18 months, or more) to obtain the majority board control necessary to force the target to dismantle its takeover defenses. Any company with a staggered board that adopts Prof. Bebchuk's unanimous-approval proposal will be vulnerable after only one election, because the raider's designees (or even a single, lone designee on the shortest of "short-slates") will be able to veto any attempted renewal of the rights plan. This is significant because the staggered board is created in a company's certificate of incorporation, which cannot be amended by unilateral shareholder action. Prof. Bebchuk's proposal would have the practical effect of allowing shareholders to amend the certificate of incorporation unilaterally, without the "annoyance" of obtaining prior board approval as required by state law.

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More generally, the use of shareholder-initiated binding bylaw amendments to compel specific changes in corporate policy amounts to yet another attempt by this small band of academic malcontents to dismantle the director-focused approach to corporate governance that has, by and large, served U.S. corporations and shareholders remarkably well for more than a century. As we have argued extensively elsewhere, and as corporate law provides, the directors have a duty to actively oversee the management of the affairs of the corporation and to actively exercise their business judgment to advance or protect the corporate enterprise, as the situation demands. The shareholder-centric vision – which seeks to reduce the board to a mere conduit for shareholder referenda, and which insists on board passivity at the very moments when active business judgment is most keenly needed – runs directly counter to these fundamental precepts. It is bad policy. Shareholder referenda are a remarkably poor tool for determining shareholder will, and an even worse tool for advancing shareholder interests. Shareholder referenda make sense only if one buys into the most cynical view that directors cannot be and should not be trusted to make good decisions; but there is no evidence of that. No one who has actually been in the board room of a major U.S. corporation in recent times could plausibly argue that directors are not keenly focused on shareholder interests.

As Prof. Lynn Stout has forcefully described,[1] the director-centric model solves three key problems that the shareholder-centric approach advanced by Prof. Bebchuk's bylaws cannot. First, directors typically are better informed about the long-term prospects and value of the corporation. As Prof. Stout notes, the 1987 stock market crash and the bursting of the tech bubble in 2000 (not to mention the bursting of the telecom bubble in 2001) made conventional wisdom of the once-controversial notion that share price does not always reflect true value. Second, shareholders of most public companies are not a unified, homogenous group, but a collection of distinct shareholder types, with differing investment theories, approaches and time horizons, whose interests are often in conflict. The most obvious conflict, of course, being between short-term investors who seek to capitalize on short-term arbitrage opportunities versus long-term investors who seek to gain from long-term value creation. Third, excessive focus on short-term shareholder interests may discourage non-shareholder constituents (such as employees, customers, suppliers and even governmental agencies) from making the level of commitment to or investment in the firm that would optimize the long-term health and success of the corporation – for the benefit of shareholder interests as well as their own.

Directors of large public corporations bear the weight of tremendous responsibility. The situations they face and the decisions they must make are complex and nuanced and require the willingness to take risk, all the while knowing that failure may have devastating consequences for shareholders, employees, retirees, communities and even, in some cases, the economy as a whole. Referenda votes by diverse bodies of shareholders with conflicting objectives cannot begin to substitute for the situation-specific business judgment of a skilled and experienced board. In short, these are serious matters, and turning these companies into the experimental play-things of a handful of special-interest activists and academics with an ideology to advance (or publicize) is not in the national interest.

Martin Lipton
Mark Gordon

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[1] Lynn A. Stout, *Takeovers in the Ivory Tower: How Academics Are Learning Martin Lipton May Be Right*, The Business Lawyer, Vol. 60, p. 1435; Lynn A. Stout, *Shareholders Unplugged*, Legal Affairs, March/April 2006, p, 21.