Platinum Parachutes: Who's Protecting the Shareholder?

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NOTE

PLATINUM PARACHUTES: WHO'S PROTECTING THE SHAREHOLDER?

Although golden parachute agreements have garnered a great deal of attention in the last three years from commentators and the

1. Wall St. J., July 18, 1985, at 27, col. 2 (describing a golden parachute which has such large benefits that "some insiders are calling [it] a platinum parachute").
2. Golden parachutes have been variously defined:
   a. "A generous severance package that protects certain key executives if control of their company changes." Moore & Tilton, Golden Parachute Restrictions Require Planning on Existing, Proposed Arrangements, 61 J. TAX'N 324 (Nov. 1984) (quoting Justice Arthur J. Goldberg in a statement he submitted to the Securities and Exchange Commission as part of the Report of Recommendations by the Advisory Committee on Tender Offers);
   b. any contract entered into by a corporation with any officer, shareholder, or highly-compensated individual (including any independent contractor) providing, at the time of execution, for contingent payments of cash (or property) which are to be made in the event of a change (or threatened change) in ownership or control of the corporation (or of a significant portion of its assets).
   c. "a compensation agreement which provides high level officials of a corporation with substantial financial remuneration, either in the form of severance payments, benefits, or both, in the event the corporation experiences a change in control." Comment, Testing the Flight of the Golden Parachute: Judicial Smooth Sailing or Turbulence Ahead?, 11 N. KY. L. REV. 519, 521 (1984).

This Note suggests the propriety of the following definition: An employment contract entered into by a corporation and an executive stipulating remuneration substantially in excess of the executive's usual salary and benefits in the event that the corporation undergoes any change of control, such change creating the presumption that the executive's job is threatened and entitling him to damages. See infra notes 31, 63-65 and accompanying text.

media, the most visible results of such attention have been an attempt by Congress to curtail the most abusive golden parachutes, an increasing amount of litigation involving golden parachutes, and larger and larger golden parachutes.

Indignation arises not merely from the excessive amount of executive compensation in golden parachutes, but from the fact that


The media has used satire to ridicule the practice of awarding exceptionally large amounts of money to corporate managers who leave the company and who may have committed egregious business mistakes. See, e.g., Barry, Wall Street Speaks: Triple Witches and Poison Pills, N.Y. Times, Oct. 26, 1986, § 7 (Book Review), at 42, col. 2; Trillin, Uncivil Liberties, Newsday, Oct. 1, 1986, Part II, at 2, col. 3.


7. See, e.g., ALLIED-SIGNAL INC., JOINT PROXY STATEMENT-PROSPECTUS 18-21 (Aug. 9, 1985); BURNUP & SIMS, PROXY STATEMENT 6-7 (July 27, 1984); PULLMAN CO. & PEBODY INT'L CORP., JOINT PROXY STATEMENT 21-22 (Sept. 30, 1985); REVlon, PROXY STATEMENT 9-11 (Mar. 26, 1985); WARD HOWELL INT'L, INC. 1983 SURVEY OF EMPLOYMENT CONTRACTS AND "GOLDEN PARACHUTES" AMONG THE FORTUNE 1,000: AN UPDATE OF THE 1982 SURVEY, Dec. 29, 1983 (available from Ward Howell, 99 Park Ave., New York, New York 10016) [hereinafter WARD HOWELL]; Morris & Johnson, Case of Indigestion: How Beatrice Adjusts to Latest Takeover, This Time of Itselt, Wall St. J., Dec. 5, 1985, at 1, col. 6 (seven top executives at Beatrice received golden parachutes totaling $27.3 million); Prokesch, supra note 4 (Revlon's chairman received $35 million in parachute payments; AMF awarded between $36.7 million and $50.4 million to its top executives; Union Carbide has $28 million of golden parachutes).


If comparisons are to be made, with whose compensation are they to be made—executives? Those connected with the motion picture industry? Radio artists? Justices of the Supreme Court of the United States? The President of the
by being triggered by a change in control, these agreements are taking advantage of the current flurry of merger and acquisition activity to compensate corporate officers beyond what their services would normally command. Adding fuel to the fire, the commentary surrounding these awards suggests that they have been granted at the behest of corporate officers without any element of good faith bargaining.

This Note will first look at federal attempts to control excessive golden parachutes. It will then demonstrate that courts possess established doctrines to protect shareholders properly, namely, the rule that unreasonably large stipulated damage clauses are unenforceable as penalties and the rule that corporate expenditures for no consideration constitute corporate waste. In connection with these legal remedies, obstacles to shareholder challenges of golden parachute payments will be considered.

This Note concludes that excessive compensation to management under the guise of golden parachute protection causes unwarranted detriment to corporations and their shareholders. In such cir-

United States? . . . Merit is not always commensurately rewarded, whilst medioc-

ity sometimes unjustly brings incredibly lavish returns . . . .

Courts are ill-equipped to solve or even grapple with these entangled economic problems. Indeed, their solution is not within the juridical province. Courts are concerned that corporations be honestly and fairly operated by [their] directors, with the observance of the formal requirements of the law; but what is reasonable compensation for its officers is primarily for the stockholders. This does not mean that fiduciaries are to commit waste, or misuse or abuse trust property, with impunity. A just cause will find the Courts at guard and implemented to grant redress.

Id. at 679-80.


10. For example, the annual compensation of the president of the Signal Companies was $926,663. ALLIED-SIGNAL INC., supra note 7, at 21. When Signal merged with Allied he became entitled to his parachute payments of more than $4 million although he was designated to be president of Allied-Signal, guaranteed to become chief executive officer within five years, given a new employment contract guaranteeing him at least $1,100,000 per year in salary, and benefits equal to or exceeding those he had at Signal, and permitting him to elect "inactive status" and still receive full benefits and payments. See infra note 104.

11. See, e.g., Geneen, Why Directors Can't Protect the Shareholders, FORTUNE, Sept. 17, 1984, at 28, 29; Pauly, supra note 4, at 46.

12. See infra notes 19-62 and accompanying text.

13. See infra notes 65-90 and accompanying text.

14. See infra notes 93-130 and accompanying text.

15. See infra notes 131-208 and accompanying text.

16. See infra notes 93-130 and accompanying text.
cumstances, golden parachutes violate public policy as well as contract and corporation law and, therefore, it is proper for courts to invalidate them.

I. LEGISLATIVE REMEDIES

The only federal legislation regulating golden parachutes is the Deficit Reduction Act of 1984 and the Tax Reform Act of 1986. In the context of abusive golden parachutes, the 1984 Act's significance lies beyond its specific regulatory provisions. By enlisting the Internal Revenue Service to assist the Securities and Exchange Commission as a "guardian of shareholder democracy" and by demonstrating a willingness to step into the regulation of executive compensation, Congress has made important policy decisions which should serve as guidelines for courts adjudicating contested golden parachute contracts.

It is Congress' view that corporate decisionmaking in takeover situations should not be critically influenced by executives' concern for their own personal benefit. Congress concluded that, despite all the claims advanced by corporations in support of golden parachutes, in many circumstances these agreements do little but

17. See infra notes 24-35 and accompanying text.
18. See infra notes 65-130 and accompanying text.
21. See infra notes 36-43, 52, 53, 55 and accompanying text.
23. Regulation of executive compensation is an enterprise that has traditionally been left to the states, Moore & Tilton, supra note 2, at 330, which have traditionally left it to boards of directors. See supra note 8. See also Krueger, supra note 19, at 847 (The Act is an example of tax legislation which is not expected to raise revenue, but to change human behavior).
26. See infra notes 98, 102 and accompanying text.
keep entrenched management in control. They discourage acquisitions by increasing the cost to a potential buyer. On the other hand, Congress was also concerned that under other circumstances, golden parachutes might encourage executives to implement a proposed takeover that would reward them handsomely, although it might not be in the best interests of the shareholders. Therefore, Congress determined that to the extent that golden parachutes either hinder or promote acquisitions for management's benefit, rather than shareholders' benefit, they should be discouraged.

In addition, Congress was concerned that golden parachutes "provide corporate funds to subsidize officers or other highly compensated individuals" and that "[f]requently, those payments are greatly in excess of the individual's historic compensation." The conference committee believed that executives in most large corporations are not undercompensated. Therefore, Congress decided that the tax law should not be used to subsidize excessive golden parachute payments by permitting corporations to take a business expense tax deduction for such payments and a tax penalty should be levied.

Finally, Congress decided to limit these agreements because the costs of the golden parachutes might ultimately be borne by the shareholders in the form of a reduced price offered by the acquiring corporation.

The 1984 Act discourages abusive agreements by imposing two penalties. It disallows a business expense deduction to the corporation for any excess parachute payment and imposes an excise tax equal to twenty percent of the excess parachute payment on the recipient of such payment. The penalties are triggered if any compensation payment is made to an officer, shareholder, or other highly compensated individual and such payment (1) is contingent upon a

30. Id. at 200.
32. Id.
33. DRA, Conf. Rep., supra note 24, at 1540.
37. Id. § 4999.
38. The 1984 Act did not define "highly compensated individual." The term is defined in the 1986 Act (TRA, Pub. L. No. 99-514, § 1804(j), 100 stat. 2085 (to be codified at 26
change in corporate control or ownership, and (2) is at least three times the individual’s five-year-average taxable compensation.\textsuperscript{39} The 1984 Act contains a presumption that any payment made pursuant to an agreement entered into within one year of a change in control is contingent upon such a change unless rebutted by clear and convincing evidence.\textsuperscript{40} Clear and convincing evidence is also required to support a claim that the amount treated as an excess parachute payment should be reduced because the payment is “reasonable compensation for personal services actually rendered.”\textsuperscript{41} The 1986 Act broadens the parachute exception to include reasonable compensation for personal services rendered on or after the change of control.\textsuperscript{42}

Under the 1984 Act, payments in violation of any securities law or regulation, regardless of their amounts, were subject to the Act’s penalties.\textsuperscript{43} The 1986 Act limits the penalties to payments violating any “generally enforced” securities laws or regulations and places the burden on the Internal Revenue Service to prove that a violation occurred.\textsuperscript{44}

Among the changes the 1986 Act made in the golden parachute rules were those exempting small business corporations\textsuperscript{46} and, under certain conditions, corporations without “readily tradable” stock.\textsuperscript{46} These exemptions were effectuated in response to criticism that the 1984 Act was overinclusive.\textsuperscript{47} The effectiveness of both Acts in achieving Congress’ purposes

\textsuperscript{39} DRA, 26 U.S.C. § 280G (Supp. III 1985). Under the 1986 Act, in determining whether a compensation payment exceeds three times the individual’s five-year-average taxable compensation, payments from small business corporations, reasonable compensation after the change in control, and payments from qualified pension, profit-sharing, stock bonus, or annuity plans will not be considered. TRA, Pub. L. No. 99-514, § 1804(j), 100 stat. 2085 (to be codified at 26 U.S.C. § 280G(b)(2)(A)).

\textsuperscript{40} Id. § 280G(b)(2)(C).


\textsuperscript{42} TRA, Pub. L. No. 99-514, § 1804(j), 100 stat 2085 (to be codified at 26 U.S.C. § 280G(b)(4)(A)).


\textsuperscript{44} TRA, Pub. L. No. 99-514, § 1804(j), 100 Stat. 2085 (to be codified at 26 U.S.C. § 280G(b)(2)(B)).

\textsuperscript{45} Id. § 280G(b)(5)(A)(i).

\textsuperscript{46} Id. § 280G(b)(5)(A)(ii).

\textsuperscript{47} Lear & Bagley, 'Excess' Golden Parachute Payment Specially Taxed, Nat'l. L. J., Nov. 4, 1985, at 5, col. 1.
cannot be determined until regulations are promulgated to deal with specific situations. Nevertheless, there is evidence that the twenty percent excise tax and the no-deduction-to-the-corporation provisions\(^4\) will reduce the size of some parachute payments to executives.\(^4\) On the other hand, corporations can be expected to develop executive compensation arrangements that circumvent the Acts' penalties.\(^5\) This possibility is heightened by the 1986 Act's exclusion from parachute payment treatment any payment made to or from a qualified pension, profit-sharing, stock bonus, or annuity plan.\(^5\) Furthermore, many excess parachute payments will continue to be made without incurring the Act's penalties because of the grandfather protection given to payments made pursuant to contracts entered into before June 15, 1984.\(^5\) In addition to grandfather exemptions, payments triggered by a change in control but made pursuant to stock options granted more than one year before a change of control would be considered "reasonable compensation" and would not be subject to the Acts' penalties.\(^6\) Finally, it is not inconceivable that a corporation's management, threatened by a hostile takeover and not adverse to protecting itself with excessive golden parachutes, would be willing to forego the corporation's deduction and increase the payments to offset the excise tax.\(^6\)

While the 1984 Act is clearly underinclusive as described above, commentators have also criticized it for being overinclusive and illegally extending the jurisdiction of the Tax Court.\(^6\) This contention


\(^{49}\) Scovill, Inc., for example, specified in the golden parachute agreements given to the company's four top executives in January 1985, that they were to be paid 2.99 times the average of their annual compensation over the past five years. Byrne, supra note 4, at 136. By limiting the payments in that way, Scovill will be able to deduct the payments as a business expense and the executives will not incur the excise tax.

\(^{50}\) Johnson, supra note 3, at 63.

\(^{51}\) TRA, Pub. L. No. 99-514, § 1804(j), 100 Stat. 2085 (to be codified at 26 U.S.C. § 280G(b)(6)).


As of the end of 1983, an estimated 25.5 percent of the largest United States companies had change of control provisions in employment contracts protecting their top executives. WARD HOWELL, supra note 7, at 1. As long as those contracts are not "amended or supplemented in a manner that provides significant additional benefits to the executive," Blue Book, supra note 24, at 206, the excess payments can be made with impunity. See, e.g., ALLIED-SIGNAL INC., supra note 7 (merger triggering Signal's golden parachutes of approximately $30 million occurred in 1985 but the parachute agreements predated June 15, 1984 and, thus, were not subject to the Act).

\(^{53}\) Blue Book, supra note 24, at 204.

\(^{54}\) Prokesch, supra note 4, at 28, col. 4.

\(^{55}\) Moore & Tilton, supra note 2, at 330 n.27.
stems from the Act's provisions that allow the Tax Court to capture payments pursuant to agreements that violate any state or federal securities laws or regulations. Thus, if an employment contract were successfully challenged for violating state corporation law, for example, the Tax Court could declare all payments made pursuant to that contract subject to the Act's penalties. The 1986 Act's limitations do not eliminate this problem.

The 1986 Act's fine-tuning of the golden parachute provisions indicates that Congress is unlikely to make sweeping changes in the near future. Initially, in 1984, the Securities and Exchange Commission recommended to Congress that federal regulation of change of control compensation might be required because potential conflicts of interest between management and shareholders could undermine the public's confidence in the integrity of the takeover process. In 1986, however, the Commission reversed its position and unanimously voted against a proposal to outlaw golden parachute contracts awarded to corporate executives during takeover negotiations. The Commission's general thrust now is in the direction of self-governance rather than regulation.

The golden parachute provisions of the Deficit Reduction Act of 1984, as modified by the Tax Reform Act of 1986, are the only legislative remedy on which shareholders can rely. The Acts and the Committee Reports demonstrate that certain golden parachute contracts constitute corporate behavior which Congress wants to discourage as a policy matter. The underinclusive and overinclusive defects in the Acts, however, suggest that courts, which can examine the facts of individual cases, may be the better institution for implementing these policies.

56. Blue Book, supra note 24, at 205.
57. Moore & Tilton, supra note 2, at 327, 330. It might even be argued that the fee of the lawyer who drew up the contract was an excess parachute payment under the Act. Id.
58. See supra note 44 and accompanying text.
62. But see Krueger, supra note 19, at 848 (holding out the possibility that the poor design of the statute to accomplish the Congressional purpose might be mitigated by significant changes through technical corrections or regulations).
II. JUDICIAL REMEDIES

A. Liquidated Damages or Penalty?

A chief rationale for golden parachutes presupposes employees of a company that has experienced a change of control are being unfairly treated in favor of the conquerors of the acquiring corporation. In fact, most golden parachute agreements are not triggered unless there is an effective, although not necessarily actual, job termination. The company is, in effect, promising to compensate its employees if they are no longer permitted to do their jobs because of a change in control. The benefits thus conferred by golden parachutes are stipulated damages for breached employment contracts.

Because the object of the contract remedy system is to provide compensation, not punishment, for breach, stipulated damage clauses that are clearly unreasonable are viewed as penalties and are not enforceable. The two factors which are determinative in distinguishing liquidated damages from penalties are the difficulty of accurately proving the loss and, more important, the reasonableness with which the stipulated sum approximates the probable loss. The parties' intention either to compensate or penalize is generally irrelevant in determining the clause's validity.

63. Comment, Golden Parachutes, supra note 3, at 249.

64. WARD HOWELL, supra note 7, at 3 (The trigger may be a “material change in duties,” a change in job location, an “inability to carry out duties” or merely the option of the executive.).

65. RESTATEMENT (SECOND) OF CONTRACTS ch. 16 § 356 comment a (1980).


68. Jaquith, 5 Mich. at 136. The court noted, with great perception, that even though courts generally profess to base their decisions on intent, “intention is not, and can not, be made the real basis of these decisions.” Id. (emphasis in original). See also Wassenaar v. Panos, 111 Wis. 2d 518, 530, 331 N.W.2d 357, 363 (1983); Jaffe & Jaffe, supra note 66, at 648.

Courts have indicated their lack of regard for intent by enforcing clauses the parties have labeled “penalty." See, e.g., United States v. Bethlehem Steel Co., 205 U.S. 105 (1907); Blewett v. Front St. Cable Ry., 51 F. 625 (9th Cir. 1892). Conversely, courts have invalidated
Controversy has arisen regarding the relevancy of actual harm to the enforceability of a stipulated damage clause. Most courts will not enforce such a clause when there has not been any actual damage or the damage clearly does not bear a reasonable relationship to the stipulated amount. For example, if an executive leaves his company when it merges and immediately secures a similar position with equal or better pay and benefits, it would be difficult to maintain that a multi-million dollar golden parachute was not wholly disproportionate to the damage he actually suffered. If an executive remains with the new company after a change in control, continuing under the terms of his old contract but triggering the parachute at his option, principles of compensation, justice, and equity would suggest that the parachute should be unenforceable. In analogous situations, courts have reached this result. In Norwalk Door Closer Co. v. Eagle Lock & Screw Co., the Supreme Court of Connecticut held that neither justice nor reason would permit the recovery of $100,000 in stipulated damages when there had been no actual harm. In reaching this result, the court invoked the principles of justice, fairness, and equity. Similarly, in Fields Foundation, Ltd.


70. See, e.g. Rispin v. Midnight Oil Co., 291 F. 481 (9th Cir. 1923); Norwalk Door Closer Co. v. Eagle Lock & Screw Co., 153 Conn. 681, 220 A.2d 263 (1966); Fields Found. Ltd. v. Christensen, 103 Wis. 2d 465, 309 N.W.2d 125 (Ct. App. 1981); Caplan v. Schroeder, 56 Cal. 2d 515, 364 P.2d 321, 15 Cal. Rptr. 145 (1961). See also Comment, supra note 69 (concluding that the criterion for enforcing liquidated damage clauses should be reasonableness in light of actual harm); Jaffe & Jaffe, supra note 66, at 670-71 (concluding that judges, the Uniform Commercial Code, and the Restatement rely on actual damages to determine the validity of a stipulated damage clause).

71. See infra notes 72-76 and accompanying text.


73. Id. at 689-90, 220 A.2d at 268.

74. Id.
v. Christensen,” the Wisconsin Court of Appeals noted that even if the parties believed at the time of contracting that a breach would cause harm, the subsequent showing of no harm at breach would make a stipulated damage clause unenforceable.

In two of the most complete court discussions regarding stipulated damage clauses in employment contracts, Wassenaar v. Panos and Koenings v. Joseph Schlitz Brewing Co., the Supreme Court of Wisconsin noted that the threshold question of the clause’s enforceability should be answered by using a single test of validity: whether the clause is reasonable under the totality of circumstances including anticipated and actual injury. The reasonableness test strikes a balance between the policy of allowing parties to bargain for themselves and the policy against imposing penalties. Permitting penalties undermines the compensatory nature of the contract remedy system. In addition, it is inefficient to coerce full performance by large stipulated damages when breaching would otherwise make economic sense. In discussing these two competing policies, the court noted that stipulated damages which are much greater than the actual harm suffered may suggest that there has been unfairness in the bargaining process. This implication is frequently justified when golden parachute agreements are given to corporate officers presently under contract because the agreements often are not the result of arms’ length bargaining. Such a conclusion lends

75. 103 Wis. 2d 465, 309 N.W.2d 125 (Ct. App. 1981).
76. Id. at 476, 309 N.W.2d at 131.
77. 111 Wis. 2d 518, 331 N.W.2d 357 (1983).
78. 126 Wis. 2d 349, 377 N.W.2d 593 (1985).
79. Wassenaar, 111 Wis. 2d at 526-27, 331 N.W.2d at 361. See also Note, supra note 69, at 879.
80. Wassenaar, 111 Wis. 2d at 528-29, 331 N.W.2d at 362.
81. Koenings, 126 Wis. 2d at 369, 377 N.W.2d at 603.
82. Id.
83. Wassenaar, 111 Wis. 2d at 528, 331 N.W.2d at 362.
84. See generally Geneen, supra note 11, at 28.

Nominally, outside directors are elected by the stockholders; actually, in most instances they serve at the pleasure of the chief executive . . . It is well known and accepted that only those men and women who can “get along” [with the chief executive] are elected to the board and stay on it. One might also ask how independent board members can be if they accept all the perks heaped on them by the management they are to judge. Isn’t there a fundamental conflict of interest here?

Id.; Prokesch, America’s Imperial Chief Executive, N.Y. Times, Oct. 12, 1986 § 3 (Business), at 25, cols. 3-6 (noting that “nominating committees to choose supposedly impartial outside directors . . . act as the arm and will of the chief executive, who feeds them names” and that “[b]oard members have normally grown up in the same culture—even the same country
weight to the argument that these agreements are unreasonable.

Unreasonableness is also suggested by the lack of difficulty in proving the executive's loss upon a change in control. The existing employment contract makes lost wages and benefits easy to assess. A stipulated damage clause may be used, however, to provide for consequential damages including injury to reputation, emotional distress, and lost opportunity which are difficult to assess monetarily and are rarely awarded by operation of law for breach of an employment contract. This does not, nevertheless, negate the reasonableness requirement in setting the damage amount.

Koenings is of particular interest because the court specifically declined to treat the case as a "golden parachute case." The court noted in dicta that calling an agreement a golden parachute does not imply any legal conclusions; it merely describes a particular kind of employment contract. This suggests that courts should not treat golden parachute contests as cases of first impression, but should scrutinize them using basic employment contract doctrine.

Commentators recommend a fact sensitive approach in evaluating stipulated damage clauses with the emphasis on reasonableness and actual damages. Even commentators who advocate strict en-
forcement as the best method for dealing with stipulated damage provisions recognize the need for courts to curb abuse. They suggest resorting to doctrines of fraud and unconscionability and to an examination of the inequalities in the bargaining process. The foregoing analysis of cases and comments suggests that courts should uphold a golden parachute agreement as liquidated damages unless a preponderance of the evidence indicates (1) it was not achieved by arms' length bargaining, and (2) it is not reasonable under the totality of circumstances using a combined prospective and retrospective approach with substantial weight given to actual harm. If a golden parachute agreement cannot withstand judicial scrutiny using these standards, it should be invalidated as a penalty which is against public policy.

B. The Doctrine of Consideration

Common law requires that there must be consideration in order for a contract to be enforceable. Thus, in exchange for a promise, a legal detriment must be bargained for and suffered. Past consideration and good motive are insufficient consideration to make a contract enforceable. These basic concepts must be kept in mind when breach.” (emphasis omitted)); Note, Recovery, supra note 69, at 879 (“The need for a flexible policy of allowing courts to invalidate a clause that was reasonable when made, but is disproportionate to actual losses, justifies an infringement on the parties’ freedom to contract.”); Comment, supra note 69, at 1094 (“[T]he requirement that preagreed damages clauses be reasonable in light of actual harm is preferable to other enforcement policies.”).

91. Jaffe & Jaffe, supra note 66, at 671.
92. Id.
95. Baehr v. Penn-O-Tex Oil Corp., 258 Minn. 533, 539, 104 N.W.2d 661, 665 (1960); Fisher v. Jackson, 142 Conn. 734, 737, 118 A.2d 316, 317 (1955); J. Calamari & J. Perillo, supra note 68, at 134-35. Cf. Keith & Hastings v. Miles, 39 Miss. 442 (1860)(since a ward had a legal duty to obey his guardian, performance of that legal duty was not consideration in exchange for the guardian’s promise to provide free board and tuition); Ruffin v. Mercury Record Prod., Inc., 513 F.2d 222 (6th Cir.)(Oral promises concerning national advertising and singing tours were unenforceable because the plaintiffs had a legal obligation under a previously signed written contract and, thus, were giving no consideration for the oral promises.), cert. denied, 423 U.S. 914 (1975).
the validity of golden parachute agreements is at issue.

Several reasons are advanced for extending golden parachutes to present employees already bound by legal obligations. One reason is to reinforce and encourage the dedication of executives to their assigned duties without their being distracted. As a general proposition, courts have held that when one does what one is already legally obligated to do, one does not incur detriment and, thus, one is not giving consideration. Corporate executives have a pre-existing duty to give the proper attention and dedication to their corporate duties by virtue of statutes, their employment contracts, and/or basic business ethics.

A second justification for bestowing golden parachutes is to encourage key executives to remain with the corporation. It is alleged that such encouragement benefits the stockholder by assuring high quality management during a tender offer and, if the takeover attempt succeeds, in the new company, since the latter will be more disposed to retain the target's executives than to pay large severance benefits. In fact, however, corporations give their executives

97. See infra notes 98 and 102 and accompanying text.
100. See, e.g., N.Y. BUS. CORP. LAW § 715(h) (McKinney 1977); REV. MODEL BUS. CORP. ACT § 8.42(a)(1984).
101. Riger, supra note 93, at 26, col. 4.
102. See, e.g., SCOVILL INC., FORM 10-K at 43 (1984) ("The key executives will be entitled to payments under the termination agreements upon the occurrence of a 'change in control' . . . of the Company, such termination agreements being intended to encourage key executives to remain in the employ of the Company by providing them with greater security."); BURNUP & SIMS, PROXY STATEMENT 6 (Aug. 28, 1984) ("[T]he Company . . . entered into agreements with twenty-one key employees . . . in an effort to induce them not to act upon resignations . . . ").

The third reason most often given for change of control compensation agreements is their efficacy as a defensive maneuver to ward off hostile takeovers. See, e.g., Note, Executive Contracts, supra note 3, at 1133-35. Although this is an accepted rationale, Blue Book, supra note 24, at 199, it is unlikely golden parachutes achieve this end or are actually undertaken for this reason. Scotese, Fold Up Those Golden Parachutes, HARV. BUS. REV., Mar.-Apr. 1985, at 168, 170 (citing takeover attorneys, Joseph Flom and Martin Lipton). In most agreements the parachute is triggered whether the change of control is hostile or friendly. WARD HOWELL, supra note 7, at 3 (In a survey of 560 of the Fortune 1000 companies, among companies with executive employment contracts with change of control triggers, only 14% define change of control either as an "election of some number of hostile directors" or as a "hostile merger.").

103. Comment, supra note 2, at 532.
golden parachute benefits without requiring that in exchange they remain with the corporation beyond the moment of change in control.\textsuperscript{104}

Although there have been no decisions on the issue of whether golden parachutes constitute corporate waste, analogies can be drawn to cases in which shareholders challenged other company actions on grounds of corporate waste.

In \textit{Michelson v. Duncan},\textsuperscript{105} a stockholder brought a derivative suit against the Household Finance Corporation, its officers and directors, to set aside a stock option plan granted to key employees. One of the theories of the case was that options were granted without consideration and, thus, constituted a gift or waste of corporate assets.\textsuperscript{106} The Delaware Supreme Court defined the essence of gift as a transfer without consideration and the essence of waste of corporate assets as use of corporate assets for improper or unnecessary purposes.\textsuperscript{107} The court, overruling a lower court's grant of summary judgment, held that when waste of corporate assets is alleged and there are genuine issues of fact about the existence of consideration,

\textsuperscript{104} \textit{See, e.g., Scovill, supra note 102; Burnup & Sims, supra note 102.}

\textsuperscript{105} \textit{In the case of The Signal Cos., for example, a change in control of the corporation was the only requirement for corporate officers to receive special cash payments, payment of all outstanding stock options, payment of all unvested restricted units under a stock option plan, and cash awards for performance targets which had not been met. Allied-Signal Inc., Joint Proxy Statement-Prospectus 19-21, 122-23 (Aug. 9, 1985). These benefits amount to about $4 million for Signal's president alone, Meier, Officers at Allied and Signal Will Reap $50 Million in Cash, Benefits in Merger, Wall St. J., Aug. 12, 1985, at 2, col. 3; nonetheless he "may elect 'at his sole discretion' to go on 'inactive' [i.e., perform no duties for the corporation] status, in which case he would still receive his full benefits and payments." Ex Parte Application for Temporary Restraining Order at App. A, 12, Weinberger v. Shumway, Civ. No. 547586 (Super. Ct. Cal. Sept. 19, 1985) (order granting temporary restraining order). In addition, in the case of Signal, as at most of the largest corporations, the top executives are already very generously compensated with long-term contracts so no further incentive is needed for them to stay with the corporation. Wall St. J., Oct. 8, 1985 at 1, col. 5 ("Chief [executive pay at the top 100 U.S. industrial companies was a median $869,000 [in 1984]."). This is particularly true in the case of a friendly merger where management is the one that has orchestrated the change in control and will continue its present role in the new company. In the Signal example, the Merger Agreement guarantees that all existing employment contracts of Signal will continue to be honored . . . and that the existing officers of Signal will continue in their same capacities immediately following the merger . . . . In addition, employee benefit plans, programs and arrangements shall be provided to Signal officers and shall be "at least as favorable" as their existing plans.


\textsuperscript{106} \textit{407 A.2d 211 (Del. 1979).}

\textsuperscript{107} \textit{Id. at 215-16.}

\textsuperscript{107} \textit{Id. at 217.}
the court is required to examine the transaction.\textsuperscript{108} The court noted that even though directors' judgments regarding adequacy of consideration may be statutorily protected from court interference, there was no such protection when no consideration was alleged.\textsuperscript{109}

The Appellate Division of the New York Supreme Court similarly precluded summary judgment in \textit{Aronoff v. Albanese},\textsuperscript{110} where genuine issues of fact existed about whether certain corporate transactions were void as gifts or corporate waste. The court cited \textit{Michelson} in defining gift and waste and then stated that "clearly inadequate consideration invokes the same principles as the absence of consideration."\textsuperscript{111} The motives or personal benefit of the directors was also a relevant concern.\textsuperscript{112} Courts will infer improper motives if the corporate assets expended were much greater than the benefits received in exchange.\textsuperscript{113} The court in \textit{Aronoff} also noted the fact sensitivity of the issue of a gift of corporate assets.\textsuperscript{114}

In an earlier case, \textit{Olsen Bros. v. Englehart},\textsuperscript{115} in which a stock option plan was upheld when challenged as constituting gifts of corporate assets, the Delaware Supreme Court stated that one of the fundamental requirements for this kind of transaction was that there must be a reasonable relationship between the value of the benefit to the corporation and the value of the options granted.\textsuperscript{116}

When the enforceability of golden parachute agreements is being contested, among the facts the court should consider are motives, personal benefits to directors,\textsuperscript{117} and the disparity in values between

\begin{itemize}
\item \textsuperscript{108} \textit{Id.} at 223.
\item \textsuperscript{109} \textit{Id.} at 224. \textsc{Del. Code Ann. tit.} 8, § 157 (1983) provides that "[i]n the absence of actual fraud in the transaction, the judgment of the directors as to the consideration . . . and the sufficiency thereof shall be conclusive." The court found, however, that that section was meant to protect directors' business judgment when the allegation was no consideration and, thus, becomes a bar to any claim for relief from corporate waste.
\item \textsuperscript{110} 85 A.D.2d 3, 446 N.Y.S.2d 368 (1982).
\item \textsuperscript{111} \textit{Id.} at 5, 446 N.Y.S.2d at 370.
\item Generally, mere inadequacy does not make a contract insufficient, warranting recission by a court. O'Brien v. Shirk, 186 Kan. 311, 321, 350 P.2d 1, 10 (1960); Straus v. Madden, 219 Md. 535, 542, 150 A.2d 230, 235 (1959). However, if the inadequacy is extreme or if it is accompanied by other factors such as bad faith, misrepresentations, undue advantage, fraud, or other inequitable situations, courts will be inclined to grant relief. Woodard v. Bruce, 47 Tenn. App. 525, 535-36, 339 S.W.2d 143, 148 (1960); \textit{Straus}, 219 Md. at 543, 150 A.2d at 235; Seaboard Ice Co. v. Lee, 199 Va. 243, 252-53, 99 S.E.2d 721, 727 (1957).
\item \textsuperscript{112} \textit{Aronoff}, 85 A.D.2d at 16, 446 N.Y.S.2d at 371.
\item \textsuperscript{113} \textit{Id.}
\item \textsuperscript{114} \textit{Id.}
\item \textsuperscript{115} 245 A.2d 166 (Del. 1968).
\item \textsuperscript{116} \textit{Id.} at 168.
\item \textsuperscript{117} \textit{Aronoff}, 85 A.D.2d at 6, 446 N.Y.S.2d at 371.
\end{itemize}
the assets expended and the benefits received.118 Most often directors will have had strong personal reasons for serving the interests of the corporate officers, and not the interests of the shareholders.119 The same can be said of investment bankers120 and accountants121 who

118. Id.
119. Geneen, supra note 11, at 28; supra note 84 and accompanying text.
120. Joint proxy statements relating to mergers typically contain statements that the information therein has been approved by an independent public accounting firm. See, e.g., ALLI8D-SIGNAL INC., supra note 7, at 142; PULLMAN CO. & PEABODY INT'L CORP., supra note 7, at 97-98.
121. See also Berton, CPA Firms Diversify, Cut Fees, Steal Clients in Battle for Business,
offer, and are relied on for, advisory opinions stating that the corporate transactions in question are fair to shareholders. At the same time, the amount being spent on the parachutes is, in some cases, so large that the disparity between the parachute and the benefit received in return is overwhelming. In *Rose v. Lurvey*, the Michigan Court of Appeals held that the $1.05 paid as consideration for a property worth $12,000 was so grossly inadequate as to “shock the conscience of the court” and that this alone mandated the cancellation of the contract. The court explained that grossly inadequate means that “a man of common sense” or a “conscientious person” would be shocked at the inequality.

Corporate officers have argued that golden parachutes should be


122. *See generally* Bachelder, *Golden Parachutes Revised: II*, N.Y.L.J., Dec. 31, 1986, at 1, col. 1 (advising corporate officers and directors, who have a common interest in having golden parachutes withstand judicial scrutiny, to seek independent advice and noting cases where obtaining the advice of investment bankers with significant fees at stake did not satisfy directors’ obligations to obtain disinterested opinions).

123. Among the Fortune 1,000 companies, approximately 62% of the golden parachutes, as of 1983, contained cash benefits of over $1 million for each covered employee. *Ward Howell, supra* note 7, at 7.

Golden parachutes where the bargaining aspect is questionable and the amounts qualify them as “platinum parachutes” include:


Prentice-Hall’s president and chief executive officer, $945,000. Mutter, *supra* note 98.


Allied’s chairman and chief executive officer, $4.2 million. Wall St. J., Aug. 12, 1985, at 2, col. 3. Allied’s chairman will be getting his parachute even though he will be remaining as chairman and CEO at the merged Allied-Signal with equal or better salary and benefits and the majority of Allied-Signal directors are former Allied directors. Only nineteen months earlier, the chairman was quoted [referring to the elimination of Allied’s golden parachutes after its acquisition of Bendix]: “There was so much adverse publicity generated by the golden parachutes, we didn’t need them.” *Golden Parachutes May Go the Way of the Dodo, supra* note 4.

124. Prokesh, *supra* note 4. California Representative Fortney H. Stark, Jr. has commented that “[t]hey [golden parachutes] are outrageous—I can’t believe these guys are worth that kind of money.” *Id.* at 1, col. 1. Leo Herzel, a Chicago attorney, echoed Stark’s belief, stating that golden parachutes are like “throwing money away.” *Id.* at 28, col. 4. Moreover, Edward H. Bowman, management professor at the University of Pennsylvania’s Wharton School remarked “Nearly three times a guy’s salary is adequate. Anything more than that may border on greed.” *Id.*


126. *Id.* at 235-36, 198 N.W.2d at 842.
validated by virtue of the benefit accruing to shareholders as a result of a corporate merger. That reasoning confuses two separate issues. Shareholders' benefit from a merger is probative of management's good faith in approving that merger. It does not address the charge that management recipients are getting extremely large monetary rewards for which they have given the corporation no more than they owed under their original employment contracts. In the Allied/Signal merger, for example, a $12.38 per share benefit to a stockholder obtained because of the merger may indicate management carried out its fiduciary duty in approving the merger. It does not, however, establish that corporate officers gave consideration for $50 million in parachute payments. In such circumstances courts should scrutinize the agreements for proof of a genuine exchange and invalidate golden parachute agreements that lack consideration and are a waste of corporate assets.

III. OBSTACLES TO SHAREHOLDERS' REMEDIES

A. The Business Judgment Rule

A shareholder who wants to challenge the validity of a golden parachute agreement may be faced with the defendant corporation's invocation of the business judgment rule as an absolute bar to ju-

127. Joint Memorandum in Opposition to Plaintiffs' Application for Temporary Restraining Order at 13-15, Weinberger v. Shumway, No. 547586 (Cal. Super. Ct., filed Aug. 22, 1985)(Signal Cos. argued in support of its golden parachute agreements that the change of control precipitating payments under the agreements was clearly in the best interests of the shareholders and the triggered payments were immaterial to the transaction as a whole.).

128. See supra note 104.

129. The price of a share of Signal stock at the end of 1984 was $32.62. The merger price was $45. ALLIED-SIGNAL INC., supra note 7, at F-49.

130. Meier, supra note 104.

131. The business judgment rule has been defined:

a. A director or officer who makes a business judgment in good faith fulfills his duty under this Section if:

(1) he is not interested . . . in the subject of his business judgment;

(2) he is informed with respect to the subject of his business judgment to the extent he reasonably believes to be appropriate under the circumstances; and

(3) he rationally believes that his business judgment is in the best interests of the corporation.

PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS § 4.01(c)(Tent. Draft No. 4, 1985).

b. "[A]bsent evidence of self-dealing, conflict of interest, bad faith or fraud, directors of the corporation will be presumed to have exercised their business judgment in the best interests of the corporation, and the courts will respect their determination." Asarco, Inc. v. MRH Holmes A Court, 611 F. Supp. 468, 473 (D.N.J. 1985).
dicial scrutiny. An analysis of contract law, as well as an examination of recent cases, suggests that the rule should not be a significant obstacle.

The business judgment rule was formulated by courts to reflect the basic corporate principle that it is the directors, not the shareholders, who manage the affairs of the corporation. Part of this basic principle is that the shareholders' remedy for dissatisfaction with management decisions lies in the corporate voting process: they may vote management out. This principle has been widely recognized since 1932 and is still generally relied on by courts.

The business judgment rule traditionally has been merely a starting point for inquiry into directors' decisionmaking processes, and not an absolute bar that precludes judicial review. In the context of a very large volume of merger and acquisition activity and the concomitant publicity and scrutiny being given to the business

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132. See supra notes 64-130 and accompanying text (noting that allegations of fraud, unconscionability, penalty, and corporate waste, inter alia, will be scrutinized by the court).

133. See infra notes 146-75 and accompanying text.

134. Zapata Corp. v. Maldonado, 430 A.2d 779, 782 (Del. 1981); Principles of Corporate Governance, supra note 131, at 58. But see, e.g., Cal. Corp. Code § 309 (West 1977); N.Y. Bus. Corp. Law § 717 (McKinney 1986) (both statutes describing the standard of care to which directors are held, but not defining the business judgment rule).


137. W. Cary & M. Eisenberg, Corporations 208-09 (5th ed. 1980). See also Holmes v. St. Joseph Lead Co., 84 Misc. 278, 283, 147 N.Y.S. 104, 107 (Sup. Ct. 1914), an earlier case suggesting the business judgment rule:

There is merely the assertion of the plaintiffs' disagreement with the directors as to the expediency of the transaction . . . . Because of this diversity of view, the court is asked to revise the judgment of the directors, and substitute its conclusion for theirs . . . . "This is no business for any court to follow."

Id. (citations omitted), aff'd, In re Jaquish, 163 A.D. 926, 147 N.Y.S. 1118 (App. Div. 1914).


140. Blue Book, supra note 24, at 199.
decisions of corporate directors and officers, some courts have demonstrated a willingness to weigh the desirability of affording management the protection of the business judgment rule for legitimate business purposes against the undesirability of encouraging management to engage in defensive and self-dealing tactics that serve primarily to entrench management and restrain business purposes at the expense of shareholders. The Court of Appeals for the Second Circuit, for example, applying New York law, has held that the business judgment doctrine does not bar judicial inquiry into the actions of corporate directors when there is a breach of fiduciary duty which includes both duty of care and duty of loyalty. The exercise of the latter involves avoiding conflicts of interest, fraud, self-dealing and bad faith.

Some in the business community have acknowledged that the personal interests of the directors have been an influence on executive compensation and entrenchment of management. In Norlin Corp. v. Rooney, Pace Inc., a case involving a defensive action taken by Norlin when it feared a takeover attempt, the New York Court of Appeals, applying New York common law, noted that the

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142. See, e.g., Minstar Acquiring Corp. v. AMF Inc., 621 F. Supp. 1252 (S.D.N.Y. 1985), which states:

The business judgment rule is a rule of judicial restraint which holds that courts will not inquire into the business judgment of directors who are acting without self-interest and in good faith. As an initial matter we question whether it is appropriate to apply the rule in the context of defensive tactics. The rule was developed to protect directors' judgments on questions of corporate governance. Questions like “should we buy a new truck today?” or “should we give Joe a raise?” are simplistically, types of business judgments which the rule was developed to protect. Courts have no place substituting their judgments for that of the directors.

Defensive tactics, however, raise a wholly different set of considerations. The problem is that defensive tactics often, by their very nature, act as a restraint on business purposes. Therefore, the application of the business judgment rule in this context seems, to us, questionable, however, the weight of authority dictates that the rule be applied.
Id. at 1259-60. See also Treadway Cos. v. Care Corp., 638 F.2d 357, 382 (2d Cir. 1980) (applying N.J. law).
143. Hanson Trust PLC v. ML SCM Acquisition, Inc., 781 F.2d 264, 273-74 (2d Cir. 1986).
144. Id. See also Norlin Corp. v. Rooney, Pace Inc., 744 F.2d 255, 265 (2d Cir. 1984); Treadway Cos. v. Care Corp., 638 F.2d 357, 382 (2d Cir. 1980); Lewis v. S.L.&E., Inc., 629 F.2d 764, 768-69 (2d Cir. 1980); Horwitz v. Southwest Forest Ind., 604 F. Supp. 1130 (D. Nev. 1985); Enterra Corp. v. SGS Assoc., 600 F. Supp. 678, 685-86 (E.D. Pa. 1985).
145. Geneen, supra note 11.
146. 744 F.2d 255 (2d Cir. 1984).
business judgment rule can bar judicial inquiry into the actions of corporate directors only when the directors are shown not to have a self-interest in the transaction at issue.\textsuperscript{147} Self-interest was demonstrated in this case and the court did not hesitate to examine all the details of the contested actions.\textsuperscript{148}

In \textit{MacAndrews & Forbes Holdings, Inc. v. Revlon, Inc.},\textsuperscript{149} the Delaware Chancery Court held that the Revlon board of directors did not satisfy the duty of loyalty component of the business judgment rule in fending off Pantry Pride’s takeover attack.\textsuperscript{150} The board served its self-interest, not the needs of the shareholders, in its selection of a takeover defense and, thus, its action was not protected by the business judgment rule.\textsuperscript{151} In \textit{Unocal Corp. v. Mesa Petroleum Co.},\textsuperscript{152} the Delaware Supreme Court concluded that the Unocal directors had reasonably investigated and therefore acted in good faith in opposing Mesa’s tender offer. Accordingly, the court would not substitute its judgment for that of the board.\textsuperscript{153} The court found, however, that in a takeover context where the board may be acting in its own interest, rather than the shareholders’ interest, “there is an enhanced duty which calls for judicial examination at the threshold before the protections of the business judgment rule may be conferred.”\textsuperscript{154} The court then proceeded to examine the reasonableness of the board’s action to determine if it came within the ambit of the business judgment rule.\textsuperscript{155}

Even when a conflict of interest was not at issue, courts have applied judicial scrutiny when shareholders have challenged management’s actions as not being in the corporation’s best interests.\textsuperscript{156} In \textit{Asarco, Inc. v. MRH Holmes A Court},\textsuperscript{157} shareholders challenged the issuance of a series of stock which would readjust intraclass voting rights. The district court held that, under New Jersey law, the directors of Asarco kept the presumptions of the business judgment rule.\textsuperscript{158} Nevertheless, the court held that the directors had the bur-
den of showing that their actions were in the best interests of the stockholders\textsuperscript{159} and the court made a detailed inquiry into the validity of the corporate action under the New Jersey Business Corporation Act.\textsuperscript{160}

In \textit{Smith v. Van Gorkom},\textsuperscript{161} the Delaware Supreme Court did not permit the directors of TransUnion to keep the presumption of the business judgment rule even though there were no allegations of self-dealing or bad faith.\textsuperscript{162} The court's holding that the directors breached their fiduciary duty\textsuperscript{163} to their shareholders when they voted to approve the Pritzker merger proposal without being adequately informed\textsuperscript{164} shocked the business world.\textsuperscript{165} The business community had assumed that under these and similar circumstances the business judgment rule would protect corporations from having their behavior scrutinized by a court.\textsuperscript{166}

In \textit{Hanson Trust PLC v. ML SCM Acquisition, Inc.},\textsuperscript{167} the Court of Appeals for the Second Circuit overruled the district court and held that Hanson had made a prima facie case showing that SCM's directors breached their duty of care in approving a lock-up option of substantial corporate assets in their attempt to thwart Hanson's takeover bid.\textsuperscript{168} Under New York law, SCM then had the burden, which it did not sustain, of justifying the fairness of the lock-up option.\textsuperscript{169} The court held that SCM directors made their decision too quickly and with too little information to satisfy their duty of care.\textsuperscript{170} In addition, the directors did not attain the reasonableness standard by relying only on the opinions of their attorneys and their invest-

\begin{itemize}
  \item 159. \textit{Id.}
  \item 160. \textit{Id.} at 474-80.
  \item 161. 488 A.2d 858 (Del. 1985).
  \item 162. \textit{Id.} at 873.
  \item 163. The meaning of fiduciary duty is codified in some states. \textit{See}, e.g., \textit{CAL. CORP. CODE} § 309 (West 1977); \textit{N.Y. BUS. CORP. LAW} § 717 (McKinney 1986); \textit{REV. MODEL BUS. CORP. ACT} § 8.30 (1984). In other states, such as Delaware, the standard for fiduciary duty is set by common law. \textit{Smith}, 488 A.2d at 872. In \textit{Smith}, the court restates the Delaware standard as "the concept of gross negligence." \textit{Id.} at 873.
  \item 164. 488 A.2d at 893.
  \item 165. Leisner, \textit{Boardroom Jitters A Landmark Court Decision Upsets Corporate Directors}, \textit{Barron's}, Apr. 22, 1985, at 34, col. 1; Glaberson & Powell, \textit{A Landmark Ruling that Puts Board Members in Peril}, \textit{Bus. Wk.}, Mar. 18, 1985, at 56.
  \item 166. \textit{See supra} note 165.
  \item 167. 781 F.2d 264 (2d Cir. 1986).
  \item 168. \textit{Id.} at 272.
  \item 169. \textit{Id.}
  \item 170. \textit{Id.} at 274.
\end{itemize}
ment bankers. The court noted that a director's due care is a prerequisite for satisfying his duty of loyalty. In addition, the court observed that a director's usual review procedure may be inadequate when he is presented with management decisions in which management has a self-interest. In such situations, directors have a particular duty to protect shareholders because management may not fully represent shareholder interests.

Courts should apply the same kind of analysis in the golden parachute context. To satisfy their duty of care, directors must make an independent determination that golden parachutes are necessary and reasonable without indiscriminate reliance on the opinions of management, attorneys, and investment bankers whose self-interest may preclude them from fully representing shareholders.

These recent cases illustrate not only the courts' sensitivity to the risks of self-dealing and abuses which are inherent in corporate decisions involving change of control transactions, but also the courts' willingness to examine the corporate decisionmaking process before refusing to review the merits of a complaint. Although executive compensation has traditionally been an area in which courts will not substitute their judgment for that of corporate directors, the circumstances of self-interest, entrenchment of management, and discouragement of takeovers without proper regard for the corporate interest surrounding golden parachutes should encourage courts to go behind the shield of the business judgment rule and to review these agreements.

B. Procedural Obstacles

The contract doctrines discussed above suggest that shareholder

171. Id.
172. Id. at 276.
173. Id. at 277.
174. Id.
176. Asarco, 611 F. Supp. at 468; Smith, 488 A.2d at 858.
177. See supra note 8.
Courts are properly reluctant to interfere with the business judgment of corporate directors; they do so only if there has been so clear an abuse of discretion as to amount to legal waste . . . . [A] triable issue of fact exists as to whether the directors did exercise their honest business judgment or were motivated by the alleged purpose of favoring the president.

_Id._ at 662.
plaintiffs could make persuasive arguments for invalidating golden parachute agreements. The problem has been that they have not been able to reach the merits of the cases.

In *Brown v. Ferro Corp.*, the plaintiff-shareholder brought a derivative suit challenging fourteen golden parachute agreements given to company executives in response to a perceived hostile takeover attempt. The plaintiff claimed that the agreements served no valid business purpose. The Court of Appeals for the Sixth Circuit affirmed the dismissal of the claim by the district court by invoking the ripeness doctrine, because the agreements were contingent upon a change in control which had not occurred and was not presently foreseeable. The dissent argued that the majority was misapplying the ripeness doctrine because its application would have "the plain consequence of eliminating any opportunity to challenge the legality of the severance agreements through a shareholder's derivative action." The dissent indicated that an Ohio statute prevented shareholders from challenging golden parachutes after the change of control which triggers their payment. Thus, under the majority's decision, the shareholder is barred by the ripeness doctrine from challenging the parachutes before a change of control and barred by standing requirements from challenging the parachutes after a change of control.

The American Law Institute (ALI) suggests a solution to the

180. The agreements provided that if the executive left the company for any reason within the two years after a change in control, he would receive two or three years' pay, retirement benefits, and the cash value of all his stock options. The executive would receive his golden parachute even if a change of control was not hostile, if he was fired for cause, if he voluntarily resigned, or if he obtained more lucrative employment elsewhere. Id. at 799.
181. *Id.* at 800.
182. *Id.* at 800-01.
183. *Id.* at 800.
184. *Id.* at 803.
185. *Id.* at 804 (citing OHIO REV. CODE ANN. § 1701.82 (Anderson 1985)). The Brown dissent found that "a target company's former shareholder had no standing after the target had become the wholly owned subsidiary of its acquiror to bring a derivative action challenging golden parachutes," analogizing to a "very similar Delaware statute," which was interpreted in *Lewv. Anderson*, 477 A.2d 1040 (Del. 1984). *Id.*
186. *Id.*
problem outlined by the Brown dissent. If a shareholder's interest is involuntarily terminated by a merger or similar technique and (1) he had already started an action, or (2) the surviving entity would not be able to represent fairly the interests of the injured shareholders, then he may be permitted to pursue his derivative action. "Any contrary rule might permit a self-interested management to abort an action it could not otherwise terminate simply by eliminating the minority stockholders through a cashout merger."

This position was sustained in a California appellate court which held that "a derivative suit challenging a company's 'golden parachutes' can be pursued by a plaintiff who no longer owns company stock." The opinion concluded that "[t]o hold that a merger has the effect of destroying such causes of action would be tantamount to giving free reign to deliberate corporate pilfering by management and then immunizing those responsible from liability by virtue of the merger which they arranged. This would be a grossly inequitable result." The court specifically mentioned a Delaware Chancery Court decision imposing a continuous ownership requirement, but noted that California, in contrast to Delaware, followed a "judicial and legislative trend of a liberal and expansive construction of derivative suit standing requirements." Even Delaware courts, however, have acknowledged that in extreme circumstances equity would require permitting a shareholder to maintain a derivative action after a merger.

Other difficulties in contesting golden parachute agreements are illustrated by two suits, Smachlo v. Birkelo and Schreiber v. Burlington Northern, Inc. Both were brought against The El Paso Company, which gave such agreements to four top executives when the company was threatened by a takeover attempt by Burlington Northern, Inc. Smachlo was a shareholder derivative suit alleging, in

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188. Id. at 40 (giving the example of a golden parachute where there would be no available legal remedy by which to assert a legally meritorious claim).
190. Id. at 420, 219 Cal. Rptr. at 80.
191. Id.
192. Id. at 420-21, 219 Cal. Rptr. at 81.
part, that the golden parachutes constituted a waste of corporate assets and a breach of fiduciary duty. The case was dismissed because plaintiff failed to satisfy the demand requirement. Schreiber, on the other hand, was a direct action for violation of the Williams Act. The Court of Appeals for the Third Circuit affirmed the lower court's dismissal because, although failure to disclose the golden parachutes did incorporate a claim of deception, the nondisclosure was not the cause of the shareholder's damages.

The possibility of collusive settlements in derivative suits must also be recognized. The derivative suit loses its potency as an effective shareholder remedy if corporate management is simply able to add something extra to its golden parachutes to offer plaintiffs' attorneys an "incentive" to procure a settlement in a suit challenging the payments. Courts must be vigilant in considering the adequacy and fairness to shareholders of proposed settlements.

A class action may also be brought to invalidate golden parachutes. In Brandon v. Chefetz, the New York Supreme Court, Appellate Division, reversed a lower court and ruled that plaintiffs were proper class representatives, even though one plaintiff had a personal interest in the case and the other was not well informed about the case. The plaintiffs charged the defendants

1986 | 679

197. 576 F. Supp. at 1441.
198. Id. at 1445.
200. Id. at 166 (The losses were caused by Burlington's decision to withdraw its December offer for El Paso stock, not by Burlington's alleged nondisclosure in January.).
202. Shareholder suits challenging golden parachutes are becoming commonplace, but they are frequently settled out of court. Prokesch, supra note 4, at 1, col. 4.

The executives at Signal Cos. were awarded parachutes of approximately $30 million. See supra note 52. The proposed settlement of the shareholder suit challenging those parachutes would reduce them to approximately $18.2 million and would award plaintiffs' attorneys $3.5 million in fees and costs. Weinberger v. Shumway, No. 547586 (Cal. Super. Ct. Nov. 27, 1985)(notice of proposed settlement of derivative action and hearing thereon). The result of the litigation would, thus, be to save the corporation and its shareholders approximately 28% of the payments being challenged as corporate waste.

204. Defendants opposed the motion for class action certification because Brandon was a friend of two of the corporation's directors and was very familiar with the corporation's compensation arrangements. Sippel, on the other hand, allegedly had never read the tender offer and was totally unfamiliar with the actions being challenged. Notwithstanding this, the court ruled they could adequately represent the class. Id. at 165, 485 N.Y.S.2d at 57.
with a breach of fiduciary duty and unjust enrichment because the president and the chairman of Wells Management Corporation were given golden parachutes worth at least $1,250,000 when a tender offer was made by BIS, S.A.\textsuperscript{206} Thus, the president and the chairman were given $10.33 per share, while all other shareholders received only $5.00 per share.\textsuperscript{207} The case was remanded to the lower court.

In general, the difficulty with bringing class actions is that plaintiffs must prove that shareholders actually received less for their shares because of the parachute payments. In a billion dollar merger, it would be difficult to prove the significant per share financial impact of several million dollars in parachute payments.\textsuperscript{208}

The derivative suit is the most appropriate device for shareholders to protect themselves against abusive golden parachutes which harm the corporation. When the facts of the case indicate the suit is not frivolous, the courts should not leave shareholders without a remedy.

\textbf{IV. CONCLUSION}

In reality, shareholders and the corporation are not protected by normal corporate procedures when top corporate officers award themselves unearned multi-million dollar golden parachutes.

When golden parachutes are contested, courts should not afford them automatic protection behind the business judgment rule\textsuperscript{209} or derivative suit rules.\textsuperscript{210} Courts should examine the facts surrounding the making of each agreement and, applying a reasonableness test, determine whether executives have bargained for the terms therein or have unilaterally granted them to themselves. Courts should inquire whether executives have given any consideration for the agreements beyond that given for their existing employment contracts and whether the stipulated damages approximate the actual damages.

If courts act with firmness, they can accomplish four desirable results: (1) deterring corporations from attempting to abuse golden parachutes\textsuperscript{211} and, thus, reducing the need for courts to make business decisions; (2) eliminating the need for additional federal legisla-
tion which would probably be underinclusive and overinclusive as to the facts of specific cases;\textsuperscript{212} (3) protecting shareholders when they cannot protect themselves because existing mechanisms are inadequate; and (4) maintaining confidence in the corporate system whose integrity is challenged by highly publicized "platinum parachute"\textsuperscript{213} excess.

Susan L. Martin

\textsuperscript{212} See supra notes 19-61 and accompanying text.
\textsuperscript{213} See supra note 1.
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