Attorney Conflicts of Interest in Corporate Acquisitions

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Although the subject of counsel's conflicts of interest has been treated in the general corporate context by several scholarly sources,\(^1\) such conflicts in the specialized corporate acquisition setting thus far have not been fully addressed.\(^2\) The Hastings Law Journal is to be applauded for devoting this Symposium principally to attorney conflicts of interest that arise in the corporate acquisition context.

This Article seeks to present a concrete analysis in conjunction with a recommended framework of attorney conflicts of interest in the publicly-held corporate acquisition context. First, the Article will present a general overview of conflicts of interest for the corporate counsel. Second, these conflicts issues will be addressed in the corporate takeover setting, followed by an examination of such conflicts in parent-subsidiary mergers and leveraged buy-outs in which incumbent management obtains a substantial equity interest in the entity. Third, the Article will


\(^2\) See, e.g., Developments, supra note 1, at 1342-43 (citing ABA Comm. on Professional Ethics, Informal Op. 1056 (1968)).
focus on counsel's conflicts of interest in the corporate acquisition context when advising committees of the board of directors. Finally, the substantive impact of various procedural mechanisms will be explored.

I. General Conflicts of Interest for Corporate Counsel

An attorney's general conflict-of-interest responsibilities under the Model Rules of Professional Conduct are governed by rule 1.7.3 Under this rule, counsel must not represent a client if there is a disabling conflict of interest.4 Where a conflict, however, is only potential and is unlikely to eventuate,5 counsel may undertake (or continue) the representation if the client consents after consultation.6 Where representation of multiple parties is involved, dual representation is permitted, provided that: the lawyer discloses the potential conflict and its ramifications to the parties, counsel believes that such multiple representation is consistent with each client's best interests, and each client consents after

3. MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.7 (1983) [hereinafter MODEL RULES]. Of course, a number of states have not adopted the Model Rules. See A. KAUFMAN, PROBLEMS IN PROFESSIONAL RESPONSIBILITY 16-21, 166-72 (2d ed. 1984); Hall, States Modifying ABA's Ethics Rules, Legal Times, Aug. 12, 1985, at 1. Reference to the Model Rules in this Article serves as a convenient method to assess counsel's general responsibilities in addressing conflicts-of-interest dilemmas.

4. Rule 1.7 of the Model Rules provides:
   (a) A lawyer shall not represent a client if the representation of that client will be directly adverse to another client, unless:
      (1) the lawyer reasonably believes the representation will not adversely affect the relationship with the other client; and
      (2) each client consents after consultation.
   (b) A lawyer shall not represent a client if the representation of that client may be materially limited by the lawyer's responsibilities to another client or to a third person, or by the lawyer's own interests, unless:
      (1) the lawyer reasonably believes the representation will not be adversely affected; and
      (2) the client consents after consultation. When representation of multiple clients in a single matter is undertaken, the consultation shall include explanation of the implications of the common representation and the advantages and risks involved.

MODEL RULES, supra note 3, Rule 1.7.

5. Hence, although a potential conflict does not itself prevent such representation, "[t]he critical questions are the likelihood that conflict will eventuate and, if it does, whether it will materially interfere with the lawyer's independent professional judgment in considering alternatives or foreclose courses of action that reasonably should be pursued on behalf of the client." MODEL RULES, supra note 3, Rule 1.7 comment.

6. Rule 1.7 does not expressly call for "reasonable" consent by the client. The comment to the rule, however, makes clear that obtaining the prospective client's consent does not effectuate compliance with rule 1.7 where a disinterested lawyer would conclude that the representation would be improper. Id.
A number of other Model Rules address particular situations in which conflicts of interest may arise for the corporate practitioner. For example, rule 1.9 addresses the issue of subsequent representation in a substantially related matter in which the prospective client’s interests are materially adverse to the interests of a prior client. Rule 1.11(a) focuses on the imputed disqualification of a law firm and the propriety of “screening” mechanisms when a former government attorney becomes associated with a firm which represents a client in a matter in which the former government attorney participated while serving with the government. Finally, rule 1.13(e) deals with the propriety of counsel simultaneously representing the corporation and defendant corporate fiduciaries in a shareholder derivative action.

7. See Model Rules, supra note 3, Rule 1.7(b); see supra notes 4-6.
8. Rule 1.9 provides:
   A lawyer who has formerly represented a client in a matter shall not thereafter:
   (a) represent another person in the same or a substantially related matter in which that person's interests are materially adverse to the interests of the former client unless the former client consents after consultation; or
   (b) use information relating to the representation to the disadvantage of the former client except as rule 1.6 would permit with respect to a client or when the information has become generally known.

MODEL RULES, supra note 3, Rule 1.9. For judicial construction of the “substantial relationship” standard, see, for example, Trone v. Smith, 621 F.2d 994, 998 n.3 (9th Cir. 1980); Westinghouse Elec. Corp. v. Gulf Oil Corp., 588 F.2d 221, 224 & n.3 (7th Cir. 1978); Silver Chrysler Plymouth, Inc. v. Chrysler Motors Corp., 518 F.2d 751, 756-57 (2d Cir. 1975); T. C. Theatre Corp. v. Warner Bros Pictures, 113 F. Supp. 265, 268 (S.D.N.Y. 1953). For commentary on this standard, see Riger, supra note 1, at 1007-18; Steinberg, supra note 1, at 584-88; Developments, supra note 1, at 1317-32.

9. Rule 1.11(a) provides:
   (a) Except as law may otherwise expressly permit, a lawyer shall not represent a private client in connection with a matter in which the lawyer participated personally and substantially as a public officer or employee, unless the appropriate government agency consents after consultation. No lawyer in a firm with which that lawyer is associated may knowingly undertake or continue representation in such a matter unless:
   (1) the disqualified lawyer is screened from any participation in the matter and is apportioned no part of the fee therefrom; and
   (2) written notice is promptly given to the appropriate government agency to enable it to ascertain compliance with the provisions of this Rule.

MODEL RULES, supra note 3, Rule 1.11(a). For case law and law review commentary addressing this issue, see, for example, Armstrong v. McAlpin, 625 F.2d 433 (2d Cir. 1980) (en banc), vacated on issue of appealability, 449 U.S. 1106 (1981); Cutler, Conflicts of Interest, 30 EMORY L.J. 1015, 1022-27 (1981); Ferber & Gonson, Disqualification of Law Firms, 13 REV. SEC. REG. 875 (1980); Mundheim, Conflict of Interest and the Former Government Employee: Rethinking the Revolving Door, 14 CREIGHTON L. REV. 707 (1981); cf. MODEL RULES, supra note 3, Rule 1.10.

10. The comment to rule 1.13(e) states:
Neither the Model Rules nor other codified rules of conduct, however, expressly focus on counsel's ethical responsibilities in the corporate acquisition setting. Given the relative frequency and the high financial stakes of these transactions, this omission is unfortunate. The dearth of judicial case law addressing this subject compounds the problem. Normative standards should be established, preferably by the American Bar Association's Section of Corporation, Banking and Business Law, to guide counsel's conduct.

II. Takeover Bids

A. General Rule

Courts and commentators generally agree that, in the absence of a disabling conflict of interest (which includes in this context the perpetration of illegal conduct), the incumbent board of directors may be looked to as representing the corporate entity. Hence, in corporate acquisitions, it is often presumed that, because the board's function is to act

Under generally prevailing law, the shareholders or members of a corporation may bring suit to compel the directors to perform their legal obligations in the supervision of the organization. Members of unincorporated associations have essentially the same right. Such an action may be brought nominally by the organization, but usually is, in fact, a legal controversy over management of the organization.

The question can arise whether counsel for the organization may defend such an action. The proposition that the organization is the lawyer's client does not alone resolve the issue. Most derivative actions are a normal incident of an organization's affairs, to be defended by the organization's lawyer like any other suit. However, if the claim involves serious charges of wrongdoing by those in control of the organization, a conflict may arise between the lawyer's duty to the organization and the lawyer's relationship with the board. In those circumstances, Rule 1.7 governs who should represent the directors and the organization.

Model Rules, supra note 3, Rule 1.13(e) comment. With respect to dual representation in the derivative suit context, "the trend appears to be that older cases have refused to disqualify counsel while the more recent decisions require the corporation to retain independent counsel." Steinberg, supra note 1, at 594.


in the best interests of the corporation, there is no conflict between management and the shareholders. For example, in the hostile takeover setting, an evidently accepted practice is for the board to evaluate the bid with the guidance of the corporation's counsel and investment bankers. Because the board, as indicated in several judicial decisions, is normally deemed disinterested in this context, no conflict of interest exists. As a result, separate counsel need not be retained to represent the interests of the various corporate constituencies.

B. Alternative Proposals for Reform

The general practice described above may be subject to criticism. In many takeovers the bulk of the shareholders, looking to the substantial premium normally paid by the acquirer, favor the successful consummation of the offer. The board of directors, on the other hand, may adopt defensive tactics with the intention to retain control rather than to benefit the corporation. Moreover, if the interests of other constituencies are to be considered, as now authorized by some state statutes, these inter-

15. See supra notes 13-14.
17. See supra notes 13-16. But see Federal Trade Commission v. Exxon Corp., 636 F.2d 1336 (D.C. Cir. 1980), where, in the acquisition context, the court precluded counsel for Exxon from representing certain divisions of Reliance Electric Company:
   Central to the existence of this conflict is the fact that while Exxon and the [subject Reliance Divisions] now share a corporate identity, that identity might be shattered as a result of the challenge mounted by the FTC to the acquisition of Reliance by Exxon. Should divestiture be ordered by the FTC, Exxon and the [subject Reliance Divisions] will become competitors. This possibility, which would result directly from the proceeding at which Exxon seeks joint representation, gives rise to a fundamental conflict between Exxon and the [subject Reliance Divisions].
   Id. at 1345; cf. Brown & Williamson Tobacco Corp. v. Daniel Int'l Corp., 563 F.2d 671, 673-74 (5th Cir. 1977) (challenged attorneys not disqualified from representing third- and fourth-party defendants in the absence of a conflict of interest between such defendants).
ests may diverge from the general shareholder populace. For example, corporate employees and communities with corporate operations in their locale justifiably may fear that approval of the acquisition may result in unemployment and the loss of a major benefactor to community well-being.  

(1) Counsel for the Constituencies

Accordingly, an argument can be made that, in light of these conflicting views, separate counsel (counsel for the constituencies) with no prior affiliation with the corporation or its fiduciaries should be retained to represent these various corporate constituencies. Counsel’s principal role in this context would be to ensure that the views of the major constituencies from both a legal and policy perspective are brought to the board’s attention. Although management may reject the positions asserted, the presence of separately retained independent counsel would help ensure that the various countervailing arguments will be communicated and explained to the board. 

There are, however, at least two significant problems with such an approach. First, because the different corporate constituencies likely will take diverse positions in response to the takeover bid, there may be an actual conflict, precluding multiple representation. Second, the decision whether to accept or oppose the acquiror’s offer remains within the board’s discretion, the very body whose alleged inability to consider impartially the various interests prompted the appointment of “counsel for the constituencies.” Consequently, the role of appointed counsel might well be superfluous, providing no tangible benefits.

Nonetheless, supporters of such a proposal might argue that counsel

1983 Pa. Legis. Serv. 773, 774 (Purdon) (providing that corporate fiduciaries “may, in considering the best interests of the corporation, consider the effects of any action upon employees, suppliers and customers of the corporation, communities in which offices or other establishments of the corporation are located and all other pertinent factors”). For commentary on the Pennsylvania statute, see Sargent, Do the Second Generation State Takeover Statutes Violate the Commerce Clause? A Preliminary Inquiry, in TENDER OFFERS: DEVELOPMENTS AND COMMENTARIES 75, 80-83 (M. Steinberg ed. 1985); Steinberg, The Pennsylvania Anti-Takeover Legislation, 12 SEC. REG. L.J. 184 (1984).

20. See O’Boyle & Carey, Gulf’s Departing Pittsburgh Would Deal a Harsh Blow to City’s Economy and Pride, Wall St. J., Mar. 9, 1984, at 33, col. 4 (“Standard Oil Co. of California’s $13.3 billion bid to acquire the oil giant has brought shudders to Pittsburgh charities, university presidents, tax officials, ministers, and everyone else who benefits from Gulf’s financial and civic might.”).

21. See supra notes 16, 18. It may be argued that counsel may act solely as the communicator of the diverse views held by the various constituencies. Counsel need not advocate one particular constituency’s position over another. See infra notes 23-24 and accompanying text.

22. See MODEL RULES, supra note 3, Rule 1.7; supra notes 4-6.
for the constituencies need not advocate one constituency’s position at the expense of others. Rather, counsel may serve solely as the “communicator” of the diverse views held by the constituencies to ensure that the board is cognizant of the various positions. Alternatively, it may be contended (although probably not convincingly because the interests of the constituencies may be more antagonistic than mutual) that counsel’s role may be likened to that of an “intermediary” under Rule 2.223 of the Model Rules of Professional Conduct. By engaging in this multiple representation as intermediary, counsel would utilize his or her persuasive skills in an effort to convince management why certain actions should or should not be taken. Such dialogue might shed new light for the board in determining what response should be made to the takeover bid.24

23. See infra note 24. Rule 2.2 provides:
   (a) A lawyer may act as intermediary between clients if:
      (1) the lawyer consults with each client concerning the implications of the common representation, including the advantages and risks involved, and the effect on the attorney-client privileges, and obtains each client’s consent to the common representation;
      (2) the lawyer reasonably believes that the matter can be resolved on terms compatible with the clients’ best interests, that each client will be able to make adequately informed decisions in the matter and that there is little risk of material prejudice to the interests of any of the clients if the contemplated resolution is unsuccessful; and
      (3) the lawyer reasonably believes that the common representation can be undertaken impartially and without improper effect on other responsibilities the lawyer has to any of the clients.
   (b) While acting as intermediary, the lawyer shall consult with each client concerning the decisions to be made and the considerations relevant in making them, so that each client can make adequately informed decisions.
   (c) A lawyer shall withdraw as intermediary if any of the clients so requests, or if any of the conditions stated in paragraph (a) is no longer satisfied. Upon withdrawal, the lawyer shall not continue to represent any of the clients in the matter that was the subject of the intermediation.

MODEL RULES, supra note 3, Rule 2.2.

24. The comment to rule 2.2 provides in part:
   A lawyer acts as intermediary in seeking to establish or adjust a relationship between clients on an amicable and mutually advantageous basis; for example, in helping to organize a business in which two or more clients are entrepreneurs, working out financial reorganization of an enterprise in which two or more clients have an interest, arranging a property distribution in settlement of an estate or mediating a dispute between clients. The lawyer seeks to resolve potentially conflicting interests by developing the parties’ mutual interests. The alternative can be that each party may have to obtain separate representation, with the possibility in some situations of incurring additional cost, complication or even litigation. Given these and other relevant factors, all the clients may prefer that the lawyer act as intermediary.

Id. Rule 2.2 comment (emphasis added).
Even assuming that appointment of "counsel for the constituencies" is ill-advised from both a legal and practical standpoint, alternative approaches remain. One such approach is the appointment of the "consultative" attorney (or law firm) to render a second-opinion.25 Although a second opinion is common in the medical profession, the consultative attorney, although utilized more now than in the past,26 is still resorted to on a relatively infrequent basis.27 The consultative attorney, having no prior affiliation with the corporation or its fiduciaries, would be retained to evaluate the relevant circumstances and to render a second opinion regarding management's contemplated course of action.

Such a second opinion may be appropriate because, in most cases, the corporation's outside general counsel has been retained for a prolonged period of time. Perhaps as a result of the substantial legal fees earned and the long-term association with incumbent management, such counsel may find it troublesome to advise the corporate client with the requisite independence. Accordingly, the consultative attorney may play the meaningful function of providing legal advice and insights from a more neutral perspective.28

There are important differences between the roles of counsel for the constituencies and the consultative attorney. First, unlike counsel for the constituencies, the consultative attorney represents the entity as a whole rather than the various constituencies. Accordingly, the multiple repre-

26. See Letter to the Editor from Lawrence B. Pedowitz, N.Y.L.J., Jan. 26, 1983, at 2, col. 6 ("[W]hile I wholeheartedly endorse the suggestion that lawyers should regularly consult in order to improve the quality of their judgments, I believe it is incorrect to suggest that the 'second opinion' practice is not already extant in our profession.").
27. See Sporkin & Steinberg, supra note 25, at 1, col. 2; Editorial, A Second Opinion, Nat'l L.J., Jan. 10, 1983, at 12, col. 1 ("We agree with Mr. [now Judge] Sporkin and Mr. Steinberg that the concept [of a 'second opinion'] is a good one, and that attorneys should be open to its use in the future. It is a provocative and workable area within the legal profession.").
28. See Sporkin & Steinberg, supra note 25, at 3, col. 2:

There are few events as important to a corporation's welfare as when a tender offer is made to its shareholders by another corporation, that is, an unfriendly takeover attempt. Normally, in these instances the client will retain specialized counsel in defending such takeover attempts. There are a number of decisions that arise during the course of a hostile battle for control that present disparate choices to the various interests comprising the corporate framework. Such points of decision are susceptible to having independent counsel render a second opinion to help ensure that the disparate interests are being duly represented.

The same "consultative" role may be played by an investment banker. See infra notes 93-105 and accompanying text.
sentation conflict-of-interest dilemma does not surface, at least not as explicitly, in this setting. Hence, like the outside general counsel, the consultative attorney initially may look to the incumbent board of directors as the proper representative of corporate interests. Second, the advice rendered by the consultative attorney may have a greater impact upon board conduct. Unlike counsel for the constituencies, the consultative attorney does not legally analyze the situation at issue from the perspectives of certain diverse interest groups but rather from that of the corporation in its entirety. As a result, management may be in a more difficult position to reject out-of-hand advice with which it disagrees. Moreover, faced with the prospect that the consultative attorney is retained to proffer its opinion, the corporation's general outside counsel may be even more circumspect in formulating his or her advice.

Hence, the consultative attorney concept may have a beneficial impact on corporate accountability. Nonetheless, in either of the foregoing alternatives, the incumbent board determines the corporation's response to the takeover bid. Even if members of the board do not have a material financial interest as evidenced by their lack of substantial stock ownership, the inside directors certainly have an interest in maintaining their positions of power within the corporate structure. Any legitimate take-

29. To ensure that the presence of consultative counsel is more than an insignificant gesture, such counsel, although initially looking to the incumbent board of directors as the proper representative of corporate interests, must maintain the requisite independence.

30. This statement should not be construed as implying that retained counsel is necessarily biased. In this regard, however, the following assertion may be made:

Undoubtedly, it may be argued that, where a law firm composed of a fairly large number of attorneys serves as counsel, such second opinions are unnecessary. This is based on the premise that an attorney working within his or her law firm often consults with other attorneys in the firm before recommending action. Although this may well be true, the principal value of a second opinion is its independence. Although lawyers in the same firm are often free to express their independent judgments, nevertheless they cannot be truly as objective as a third party examining the situation. Further, as important as the fact of independence may well be the appearance of independence.

Sporkin & Steinberg, supra note 25, at 3, col. 2.

31. “Inside” directors include those who also hold positions as officers of the corporation, or who are otherwise employed by the company, for example, as in-house corporate counsel. “Inside” directors also include those directors who may have a pecuniary interest in the corporation’s affairs greater than that arising from ownership of a less-than-controlling block of the corporation’s shares. See Cheff v. Mathes, 199 A.2d 548, 554-55 (Del. 1964) (burden of proof as to whether a stock repurchase was in the corporate interest was not as great for directors who were merely “substantial shareholders” as for those who were the Chief Executive Officer and corporate counsel, since the former did not have “a personal pecuniary interest in the decisions made by the board of directors . . .”).

over bid, particularly one that is successful, may also signify to the financial world that the insiders are inadequate managers, an image that any reputable corporate executive loathes.\textsuperscript{33} To a certain extent, some courts have recognized this claim of bias. When a majority of the board is comprised of outside directors\textsuperscript{34} who oppose the takeover bid, these courts have been more inclined to invoke the broad protection of the business judgment rule.\textsuperscript{35}

\textit{(3) Counsel for the Committee}

Taking the above approaches a step (or perhaps several steps) further, an argument can be made that a corporation's response to a takeover bid should be formulated by a committee comprised solely of outside directors. To help ensure detachment from the inside directors, the general inside or outside counsel should play no significant role. Rather, separate counsel with no prior affiliation with the corporation or its fiduciaries should be retained for the purpose of advising the committee ("counsel for the committee"). Any communication required of the general counsel should be made directly to the counsel for the committee and not to the outside directors. Given the outside directors' lack of pecuniary interest and the threat (although diminishing) of monetary liability for breach of their fiduciary duties,\textsuperscript{36} it may be asserted that this proposal provides a viable alternative: the response to the takeover bid is

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\textsuperscript{34} "Outside" directors should be defined as those directors who do not otherwise enjoy a substantial personal or business relationship with the corporation or its fiduciaries. \textit{See Securities Exchange Act Release No. 15,384 16 SEC Docket 348,350} (Dec. 6, 1978); M. STEINBERG, \textit{CORPORATE INTERNAL AFFAIRS: A CORPORATE AND SECURITIES LAW PERSPECTIVE} 30-31 (1983).
\textsuperscript{35} See, e.g., Panter, 646 F.2d at 293-98 (applying Delaware law). Outside directors also are subject to claims of bias. \textit{See infra} notes 37-39 and accompanying text.
\textsuperscript{36} For example, Delaware recently enacted a statute permitting directors to be absolved from monetary liability for breach of the duty of care, provided that an appropriate provision to that effect is contained in the subject corporation's articles of incorporation. Delaware Senate Bill No. 533, \textit{amending}, DEL. CODE ANN. tit. 8, § 102 (1986); \textit{see} Veasey, Finkelstein & Bigler, \textit{Delaware Supports Directors With a Three-Legged Stool of Limited Liability, Indemnification, and Insurance}, 42 BUS. LAW. 399 (1987). A number of states are following Delaware's lead by enacting similar statutes. \textit{See Glasgow, Changes in Liability Laws to Shield Directors Called Critical to Companies}, Baltimore Sun, Feb. 11, 1987, at C-1 ("Thirteen states have already enacted legislation limiting the legal [liability] of corporate directors; another 15, including Maryland, have such legislation pending."). Moreover, some of these state statutes are more lax than the Delaware version. \textit{See, e.g.}, 18 Sec. Reg. & L. Rep. (BNA) 1719 (1986) ("Under the new [Ohio] law, the business judgment rule protects directors from monetary liability [including actions brought for injunctive relief] except where clear and convincing evidence demonstrates a deliberative intent to injure the company or a reckless disregard for its
delegated to the most disinterested members of the board who, with the advice proffered by counsel for the committee, will seek to represent the corporation's best interests.

This alternative, however, is not without problems. Irrespective of whether one is an inside or outside director, the problem of structural bias remains. Outside directors are selected by insiders and owe their retention on the board to the insiders. During their tenure, outside directors are likely to develop friendships with their colleagues, affecting their impartiality. Moreover, a number of the outside directors may come from the same background as the insiders (e.g., they may themselves be insiders of other corporations) and may have known the insiders long before they were requested to serve as directors. There is also a certain prestige of serving as a director of a reputable publicly held company. A takeover bid may be viewed by outside directors as an unjustifiable insult to their business acumen which should be swiftly rebuked. Hence, far from being assumed to be independent, outside directors are potentially biased.

37. "Structural bias" may be defined as "inherent prejudice...resulting from the composition and character of the board of directors [and management]." Note, The Business Judgment Rule in Derivative Suits Against Directors, 65 CORNELL L. REV. 600, 601 n.14 (1980) [hereinafter Note, Derivative Suits]. For further discussion of the concept of structural bias, see id. at 619-26; cf. Clark v. Lomas & Nettleton Fin. Corp., 625 F.2d 49, 53-54 (5th Cir. 1980) (recognizing the possibility of structural bias, the court held that, due to conflicts of interest, the board was incompetent to compromise the plaintiff shareholders' derivative claims), cert. denied, 450 U.S. 1029 (1981); Miller v. Register & Tribune Syndicate, 336 N.W.2d 709, 716-18 (Iowa 1983) (recognizing structural bias problem in refusing to dismiss derivative suit against corporate fiduciaries where members comprising the special litigation committee were appointed to the committee by defendant fiduciaries).

The inherent problem of structural bias is discussed at length in Note, The Propriety of Judicial Deference to Corporate Boards of Directors, 96 HARV. L. REV. 1894 (1983) [hereinafter Note, Judicial Deference]. Drawing upon studies of group dynamics, the author of the Note concluded: "Given cohesiveness and informational dependence in the boardroom, directors are likely to conform to the expectations both of management and of their fellow board members." Id. at 1901.

38. Hence, although not financially interested, such outside directors may be "interested" in maintaining their positions of power, prestige and prominence. . . . They are "interested" in defending against outside attack the management which they have, in fact, installed or maintained in power . . . . And they are "interested" in maintaining the public reputation of their own leadership and stewardship against the claims of "raiders" who say that they can do better.


39. See Steinberg, Some Thoughts on Regulation of Tender Offers, 43 MD. L. REV. 240,
There is an even more practical reason why outside directors should not control the corporation's response to a takeover bid: they may not possess the requisite familiarity with and knowledge of the enterprise.40 Because many outside directors do not work intimately with the corporation on a frequent basis and may lack the necessary sophistication to assess both the short- and long-term value of the corporation, they should not be saddled with this difficult task. Accordingly, outside directors should have input but not the sole or even primary responsibility in determining the corporation's response to a takeover bid.41

An alternative approach would employ the counsel for the committee concept but would structure the committee's role as advisory in nature. Hence, the committee, with the assistance of separately retained counsel (and investment bankers), scrutinizes the merits of the takeover bid and informs the board of directors of its position. In this way, the outside directors have a significant, yet not a determinative impact, upon the corporation's response to the third-party offer.

Although appealing, this approach has certain drawbacks. First, for the reasons set forth above,42 outside directors may be incapable of reaching an informed, impartial, and competent determination. Second, far from being advisory, the committee's opinion, in practice, may preclude the board of directors from taking a contrary position. The monetary liability exposure may be simply too great for insiders to implement a defensive posture inconsistent with the committee's determination.43 Third, the approach may be impractical. In many contested takeover bids, time is of the essence. To mount a successful takeover defense, ac-

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244 (1984) ("Incumbent management's control of the proxy machinery and general informational processes, combined with its control of the methods for selecting outside directors, frequently result in undue directorial loyalty to management rather than the exercise of independent judgment.") (footnotes omitted).

40. See Revised Model Business Corp Act § 8.42(b) (1984); Note, Judicial Deference, supra note 37, at 1898 ("Confronted by difficult issues of business policy and largely dependent upon management for information about these issues, [outside] directors are likely to believe that management's views and judgments are worth adopting.") (footnote omitted).

41. See supra note 40. But see Williams address, "Corporate Accountability." at 26. before the Fifth Annual Securities Regulation Institute, San Diego, Calif. (Jan. 18, 1978). where former SEC Chairman Harold M. Williams described his ideal board of directors as consisting entirely of outside directors except for the chief executive officer who would not be chairman of the board. For further discussion of the Williams' address and related issues. see M. Steinberg, supra note 34, at 18-23.

42. See supra notes 37-41 and accompanying text.

43. See, e.g., Smith v. Van Gorkom, 488 A.2d 858, 899 (Del. 1985). The enactment by Delaware and other states of legislation certainly lessens this risk but does not eliminate it. See supra note 36.
tion often needs to be promptly undertaken. In this context, the subject corporation may not afford the luxury of a time-consuming advisory opinion.

(4) The Preferable Approach—The Consultative Attorney

Under the framework adopted by several courts, a board of directors under the business judgment rule may fend off a takeover bid in order to maintain the enterprise as an ongoing viable entity. With this

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44. See, for example, Judge Friendly's statement in Electronic Specialty Co. v. International Controls Corp., 409 F.2d 937 (2d Cir. 1969), that takeover contests are not conducted "in the peace of a quiet chamber," but under the stresses of the market place." Id. at 948 (quoting Hellenic Lines Ltd. v. Brown & Williamson Tobacco Corp., 277 F.2d 9, 13 (4th Cir.), cert. denied, 364 U.S. 879 (1960)). Because boards of directors on both sides must "act quickly, sometimes impulsively, often in angry response to what they consider, whether rightly or wrongly, to be low blows by the other side," Judge Friendly concluded that there will "probably . . . no more be a perfect tender offer than a perfect trial." Id. at 948.

On the other hand, because of the Supreme Court's decision upholding the constitutionality of the Indiana "anti-takeover" statute in CTS Corp. v. Dynamics Corp. of Am., 107 S. Ct. 1637, 1652 (1987), target management in states enacting similar legislation will be provided with more time to engineer defensive maneuvers. Under the Indiana statute a shareholder meeting need not be called until fifty days after the acquiror's request. Id. at 1647. In view of the twenty-business-day period that tender offers must remain open under federal law, SEC rule 14e-l(a), 17 C.F.R. § 240.14e-l(a) (1987), the Indiana and similar state legislation have the effect of increasing the time period in which target management can implement defensive actions. Note, moreover, that where a takeover bid occurs in a regulated industry, such as the banking industry, the battle may proceed at a more leisurely pace. See, e.g., First Interstate Bancorp's hostile bid for Bank America Corporation, described in 4 Corp. Control Alert No. 4 (April 1987).

45. This problem may be alleviated by having management and the committee comprised of outside directors simultaneously undertake their assessments. If this is implemented, management will initially develop its course of conduct without the input of the outside directors. After developing a strategy, given applicable time pressures, it may be difficult on a practical level for management to alter that strategy after hearing from the committee. But see supra note 44. Moreover, even if this "timing" situation is resolved, other significant problems remain with respect to the counsel for the committee concept. See supra notes 37-45 and accompanying text.

46. See cases cited supra note 16. Note, however, that the business judgment rule does not apply where the company is to be broken up and not maintained as a separate ongoing entity. See, e.g., Edelman v. Fruehauf Corp., [1986-1987 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 92,863, at 94,211 (6th Cir. 1986) (applying Michigan law); Hanson Trust PLC v. ML SCM Acquisition, Inc., 781 F.2d 264, 273 (2d Cir. 1986) (applying New York law); Revlon, Inc., v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 185 (Del. 1986) (applying Delaware law). Moreover, even where the defensive maneuvers are undertaken to maintain the company's independence, a number of courts apply a modified version of the business judgment rule (e.g., Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 954 (Del. 1985) (applying Delaware law)), or decline to apply the rule where a purpose underlying management's tactics is to retain control (e.g., Norlin Corp. v. Rooney, Pace, Inc., 744 F.2d 255, 265 (2d Cir. 1984) (applying New York law)). For further discussion, see Brennan, New Cases on the Business Judgment Rule: Defending Defensive Tactics Becomes More Difficult, 14 SEC. REG. L.J. 245 (1986).
principle in focus, attention should turn to providing the means by which
the board can more effectively represent the corporation's best interests.
In the legal-advice context, the appointment of the consultative attorney
to provide a second opinion, although far from perfect, should be viewed
as a preferable route.47

The consultative attorney (or consultative law firm), however, may
itself have an inherent bias. A number of major law firms today have the
reputation of counseling subject corporations to ward off hostile bidders.
With each successful defense, the law firm's reputation is enhanced in the
eyes of potential target managements. Hence, it is to such a law firm's
financial benefit to devise successful legal strategies for implementation
by subject corporations.48 Retention of such a law firm as separate coun-
sel may be appropriate after an informed board acting in good faith de-
termines to oppose a takeover bid; but it may be questioned whether
retaining the firm prior to a bidder indicating interest serves the corpo-
ration's and shareholders' best interests. Given the realities of corporate
practice, however, these firms will certainly continue to be separately re-
tained prior to any acquiror overtures. On balance, this approach can be
justified. The development of anti-takeover strategies with expert coun-
sel's input is a valid planning arrangement. With these defensive meas-
ures in place, the board is more likely to defeat inadequate bids, rather
than having to fend off such bids without sufficient ammunition. More-
over, the adoption of these measures, at least in theory, does not prevent
the board from making a dispassionate assessment of the bid's merits. In
this regard, however, separately retained expert counsel's role in devising
and counseling the board's adoption of anti-takeover strategies precludes
it from being retained as consultative counsel.

Although in depth discussion of "poison pill" anti-takeover provi-
sions unilaterally adopted by a board of directors49 is beyond the scope of

47. See supra notes 25-35 and accompanying text.
Supreme Court's decision in CTS Corp. v. Dynamics Corp. of America, 107 S. Ct. 1637
(1987), upholding the constitutionality of the Indiana anti-takeover statute, the Journal
opined: "Lawyer Martin Lipton, king of the entrenched-manager bar, is doing cartwheels.");
see also Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 177 (Del. 1986):
Lipton, Takeover Bids in the Target's Boardroom, 35 Bus. Law. 101 (1979); infra notes 90-92
and accompanying text.
49. A "poison pill" is "[a]n antitakeover provision whereby a class of certain securities,
dividends or warrants of the target company are convertible upon consummation of any enu-
merated transaction or event into the common stock or other security of the target [or cash]."M. STEINBERG, SECURITIES REGULATION 744 (1986), derived from Appendix 3 to Honorable
Arthur J. Goldberg's Separate Statement for the SEC Advisory Committee on Tender Offers
(1983).
this Article, certain of these provisions may have the practical effect of being "show-stoppers," in essence deterring hostile bids from being made. Absent adequate disclosure to shareholders and their approval of such poison pill-provisions, serious conflicts-of-interest issues may be present. In such "show-stopper" situations, counsel is advising unilateral board adoption of anti-takeover provisions that may be contrary to shareholder welfare and wealth maximization for the corporation. Although the argument has been made that such provisions merely provide the board with the leverage to bargain rigorously in order to procure the optimum price, the attorney conflict of interest dilemma in drafting and advising unilateral board adoption of these provisions should be acknowledged.

Due to the presence of structural bias and the appearance of impropriety, a lawyer or firm qualified to serve as consultative attorney to render an impartial second opinion should have no prior association with the corporation or its fiduciaries and should be knowledgeable in matters of takeover law. Attorneys associated with such a law firm generally


51. "A 'show-stop' maneuver is any action taken by target management, such as the sale of the company's crown jewel, which has the effect of materially impeding or precluding shareholders from tendering their stock to the 'hostile' bidder." Steinberg, supra note 39, at 250.


55. See Dawson, Pence, & Stone, supra note 50, at 425-26.

56. But see SEC Study, supra note 50, at 88,044 (Upon evaluating the 2.4% decline in the market price of stocks of corporations over a two-day period following the adoption of poison pills, the SEC's Chief Economist concluded that "the effect of poison pills to deter prospective hostile takeover bids outweighs the beneficial effects that come from increased bargaining leverage of the target management.").

57. It may be asserted that the consultative attorney should be required to have recently represented on a fairly equal basis both offerors and subject corporations in contested takeover bids. The frequency of representation of offerors and targets need not be precisely equal. Such representation, however, must be rendered during contested bids in order to be relevant in this context. By representing both bidders and targets in contested bids, counsel will be less likely
will be highly qualified to advise in this consultative role. Nonetheless, such counsel, if retained by incumbent management, may give the appearance that they favor the incumbent board. To lessen this effect as much as practicable, the selection of the consultative attorney (or law firm) should be within the outside directors' purview. In this way, the corporation and its various constituencies benefit from procuring expert advice from counsel who has no prior affiliation with the corporation or its fiduciaries, thereby increasing the likelihood that the second opinion will be truly independent.58

III. Parent Squeeze-Outs And Leveraged Buy-Outs

The foregoing discussion presumed that the subject corporation's board of directors or a controlling shareholder did not have a material financial interest in the proposed transaction. Such a financial stake, however, increases the potential for conflict. This section will consider two types of transactions in which this problem exists, namely, squeeze-out mergers59 in which the parent corporation eliminates the public shareholders of its subsidiary (or alternatively when a controlling shareholder of a corporation uses his or her power to take the enterprise private) and leveraged buy-outs60 in which corporate management procures a substantial equity interest in the enterprise.

A. Controlling Shareholder Squeeze-Outs

With respect to squeeze-out mergers, the parent corporation, as con-
trolling shareholder, owes a fiduciary duty to the subsidiary's public shareholders. According to the Delaware Supreme Court, the parent corporation in such transactions must accord the minority both fair dealing and fair price. Disregard of these obligations may give rise to a shareholder action premised on breach of fiduciary duty. Although a number of other states have relegated a minority shareholder solely to his appraisal rights based on claims of unfair treatment, this consequence does not alleviate counsel's conflict-of-interest dilemma. Counsel who represents both the parent and the subsidiary corporation in a squeeze-out situation will find it difficult to represent the interests of minority shareholders adequately. Even where the subsidiary has retained separate counsel, such counsel is faced with the dilemma that what is beneficial to the subsidiary's controlling shareholder (i.e., the parent corporation) may unfortunately be detrimental to the minority.

From the perspective of corporate accountability, minority shareholders comprise an essential component of a parent-controlled subsidiary. Additionally, the parent, over a period of time, has elected to reap the benefits of a public equity market for its subsidiary's stock rather than taking the enterprise private. Consequently, the interests of the

63. Id. at 714.
65. See, e.g., Joseph v. Shell Oil Co., 482 A.2d 335, 342 (Del. Ch. 1984). Moreover, SEC rules 13e-3 and 13e-4 apply to going-private transactions. 17 C.F.R. § 240.13e-3, 13e-4 (1987). With respect to rule 13e-3, see Exchange Act Release No. 34-16,075, 44 Fed. Reg. 46,736 (1979). In general, rule 13e-3, prohibits "fraudulent, deceptive or manipulative acts or practices in connection with going private transactions and prescribes filing, disclosure, and dissemination requirements as a means reasonably designed to prevent such acts or practices." Id. at 46,737; see also Exchange Act Release No. 34-16,112, 44 Fed. Reg. 49,406 (1979) (Commission adopted rule 13e-4 to govern an issuer's tender offer for its own securities). In general, rule 13e-4 requires that a schedule 13-E be filed with the SEC, and establishes disclosure, dissemination, and compliance requirements. Note that an issuer's tender offer, which is regulated by rule 13e-4, may also be a going private transaction subject to rule 13e-3; in such instances, the issuer must comply with both rules.
67. See Brudney & Chirelstein, supra note 61, at 1354; Toms, Compensating Shareholders
minority should be viewed as an integral aspect in ascertaining the limits of permissible corporate conduct. Because the interests of the parent corporation as controlling shareholder of the subsidiary often conflict with the best interests of the minority, a disabling conflict of interest should be presumed, thereby precluding the attorney from representing all affected parties.68

Accordingly, the outside directors of the subsidiary should be designated as a duly authorized committee charged with the task of bargaining with the parent corporation to help ensure fair treatment for the minority.69 To effectuate this objective, the committee should retain an investment banker and counsel with no prior affiliation with either corporation or its fiduciaries.70 Although the problem of structural bias among directors is not resolved by this proposal,71 the impact of any such bias is likely to be alleviated by the retention of outside experts who should have the requisite independence.72 Although imperfect, the pro-

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68. See generally Weinberger v. UOP, Inc., 457 A.2d 701, 709-10 n.7 (Del. 1983) (parent-designated director on subsidiary's board owes subsidiary and its shareholders an "uncompromising duty of loyalty"); K. Davidson, Megamergers: Corporate America's Billion-Dollar Takeovers 10 (1985) ("In theory, shareholders are the source of all power in a free enterprise system because they are the owners. In practice, however, the modern corporation is run by its executives.").

69. See ALI, Principles of Corporate Governance: Analysis and Recommendations § 5.10, at 19 (Tent. Draft No. 7, 1987) ("In the context of a parent-subsidiary relationship, directors of the subsidiary should not be considered disinterested and independent if they have a relationship to the parent as a director, senior executive, or employee of the parent or as a senior executive or employee of the subsidiary."). In the setting of a parent-subsidiary merger, bargaining principally will involve matters of fair value, namely price, although fair dealing also plays an integral role. See Weinberger, 457 A.2d at 710 n.7, 711-15; Steinberg & Lindahl, supra note 58, at 366-81.

70. To an extent, it appears that this proposal is being implemented. See 19 Sec. Reg. & L. Rep. (BNA) 175 (1987) (statement of Arthur Fleischer, Jr.); Putka & Winter, BP Increases Bid For Standard Oil By $450 Million, Wall St. J., Apr. 29, 1987, at 2, col. 2 ("The new bid [by British Petroleum Co. which owns 55% of Standard Oil Co.] won the acceptance of seven outside Standard Oil directors who had sought better terms."). Note, however, that the investment banker and counsel selected by the outside directors often may have a prior affiliation with either of the corporations or subject fiduciaries, hence giving rise to the structural bias problem. See infra notes 93-105 and accompanying text.

71. See supra notes 37-39 and accompanying text.

72. Cf. Steinberg & Lindahl, supra note 58, at 406:
Under the present framework... few independent parties would thoroughly evaluate a company without a reasonable chance of successful purchase, except for the investment banker selected by management to render a fairness opinion. Generally, the minority interest cannot afford to hire its own investment banker. Therefore, to help effectuate the intent of the independent evaluation alternative, the outside directors
posal provides a practical and more enlightened solution.

The same standards as set forth above arguably should apply when a controlling individual shareholder, by means of a forced transaction such as a merger with an entity wholly owned by such shareholder and created for the singular purpose of effectuating the transaction, takes the corporation private, thereby eliminating the minority. In such situations, for the reasons stated above, the outside directors of the corporation should be designated as a duly authorized committee to represent the interests of the minority. The committee should retain an investment banker and counsel who have no prior affiliation with the corporation or its fiduciaries. This scenario, however, manifests the potential of outside director structural bias in an individually dominated corporation (presuming there are outside directors on the board). As a result, these added procedural mechanisms, such as the appointment of separate counsel, may provide little substantive protection for the minority. Thus, the minority may be provided with more meaningful relief by a flexible interpretation of fiduciary duty obligations and of valuation in the appraisal proceeding. In any event, and particularly if separate counsel is not retained, the corporation's general counsel should remain cognizant of the conflicting interests implicated and should advise the board of directors to adhere to the fiduciary duties owed to the minority. Indeed, because the controlling shareholder will benefit financially from the transaction, counsel should look solely to the financially disinterested members of the board to represent the enterprise.

of the subsidiary corporation should retain an investment banker who has no previous contacts with the parent or subsidiary corporation or with either corporation's management. Through the use of the fairness opinion relied on by minority shareholders, an independent investment banker who is free of the usual structural biases will help insure that the going private transaction is fair to the minority. The likelihood of fairness will further increase if the courts hold the investment banker to a standard of reasonable care in the preparation of the opinion. Moreover, when the corporation hires the investment banker specifically to render an opinion for the benefit of the minority, a stronger basis exists for recognizing a fiduciary relationship.

77. See supra notes 66-69.

78. In short, this is an interested director's transaction in which the participating director should be disabled from exerting undue influence upon the corporation's response to the transaction. See, e.g., REVISED MODEL BUSINESS CORP. ACT § 8.31 (1984); Bulbulia & Pinto, Statutory Responses to Interested Directors’ Transactions: A Watering Down of Fiduciary Stan-
B. Leveraged Buy-Outs

Leveraged buy-outs in which public shareholders are cashed-out and corporate insiders obtain a substantial equity interest in the ongoing enterprise raise troublesome questions of conflicts of interest. In this situation, the insiders’ interests in procuring a bargain price are adverse to the public shareholders’ objective of maximizing their returns. Moreover, the concept of insiders enhancing their pecuniary interests through the use of borrowed funds collateralized with corporate assets and subject to repayment out of corporate profits strikes some authorities as repugnant to public shareholder welfare.

It thus should not be surprising that both the insiders and public shareholders should have separate counsel to represent their opposing interests. Because the insiders have a financial stake in the transaction, they no longer should be looked to as representing the corporate entity. Hence, the role of the corporation’s general counsel in this context may well be to help ensure that adequate disclosure is made (to the board of directors and shareholders) and to advise the disinterested directors as to the legality of the buy-out. In this context, corporate counsel should apprise the disinterested directors of their fiduciary duties and have them informed of the material facts (including the procurement of a fairness opinion). Such precautions increase the likelihood that a disinterested board determination to authorize the buy-out and the valuation reached by such a board will be reasonably informed. In addition, the very real possibility of structural bias calls for the consultative attorney concept as discussed above to be implemented in the managerial leveraged buy-out

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79. See, e.g., Sommer, “Going Private”: A Lesson in Corporate Responsibility, [1974-1975 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 80,010, at 84,700 (1974) (“The shareholder must no longer be a second class citizen. Once he is invited to feast and pays his admission, those who own the tent must not be able to usher him out at the end of the second course with only the menu as his souvenir.”).


81. See supra notes 61-71 and accompanying text.

82. See supra notes 70, 78-80.

83. See A. BORDEN, GOING PRIVATE § 9.01 (1982). The investment banker retained to render the fairness opinion should have no prior affiliation with any of the parties or fiduciaries. See Steinberg & Lindahl, supra note 58, at 406; supra note 72; infra notes 93-105 and accompanying text.

IV. Substantive Effect Of Procedural Mechanisms

This Article has suggested that in the takeover bid context, special counsel, such as the consultative attorney, be retained by the outside directors to advise the board of directors and that, in certain other acquisition situations, committees comprised of disinterested directors be advised by separate counsel. After receiving the advice of separately retained counsel and investment bankers, the board and pertinent committees may better represent the interests at stake. This scenario raises the question whether procedural mechanisms provide any meaningful substantive protection to corporate and minority shareholder interests.

The problem of director structural bias has been discussed above and elaborated upon by courts and commentators. Moreover, the alleged bias of investment bankers in rendering fairness and other valuation opinions has been raised but certainly not resolved. Attorney conflict-of-interest dilemmas also come into play in the corporate acquisition context. A law firm that annually derives hundreds of thousands if not millions of dollars in fees from a corporate client has a financial self-interest in maintaining that entity as an ongoing, independent concern.
with the incumbent management intact.\textsuperscript{89} Successful consummation of a third-party takeover bid—whether by merger, tender offer, or otherwise—normally signifies that the third-party's law firm will be retained to represent the combined enterprise.\textsuperscript{90} Although a number of courts have refused to recognize this potential for conflict,\textsuperscript{91} such an approach ignores the realities of law-firm economics. The loss of a major client often causes a financial setback for members of a firm, and the loss of a few such clients may spell catastrophe.\textsuperscript{92}

Consequently, purportedly protective mechanisms may offer no meaningful benefit to corporate and shareholder interests if boards of directors and committees comprised of disinterested directors are advised by counsel and investment bankers who have a material economic stake in maintaining the status quo. The inherent structural bias of the outside directors (and the more obvious pecuniary interests of the insiders),\textsuperscript{93} when combined with the opinions rendered by their professional advisers (e.g., counsel and investment bankers), normally will effectuate the response desired by incumbent management.\textsuperscript{94} Moreover, because such actions taken to maintain the corporation as a viable entity\textsuperscript{95} will be engineered by directors who are likely to be deemed disinterested under the applicable case law,\textsuperscript{96} the inveterate business judgment rule will apply

\textsuperscript{89} The key aspect here, irrespective of whether a leveraged buy-out or hostile takeover bid is involved, is that incumbent management will continue to operate the enterprise on an ongoing basis.

\textsuperscript{90} See L. Solomon, R. Stevenson, & D. Schwartz, supra note 73, at 1100 ("The [target's] professional advisors, whether they are investment bankers or lawyers, are likely to lose a client, and, especially in the case of a lawyer, the loss may have severe consequences.").

\textsuperscript{91} See, e.g., Maldonado v. Flynn, 597 F.2d 789, 794 (2d Cir. 1979) (court refused to label counsel an "interested" director absent a claim that counsel voted in exchange for continued retention of his firm).

\textsuperscript{92} See Gray, Law Firms' Big Fee Hikes Reflect Higher Pay and Booming Business, Wall St. J., Mar. 19, 1987, at 37, col. 4 ("Several law firms have collapsed in recent months: Sage Gray Todd & Sims, one of the oldest on Wall Street, and Memel, Jacobs & Ellsworth in Los Angeles.").

\textsuperscript{93} See supra notes 31-39 and accompanying text.


\textsuperscript{96} See, e.g., Panter, 646 F.2d at 294 (applying Delaware law); Crouse-Hinds Company
in many jurisdictions to insulate such actions from successful challenge.97

The presence of structural bias cannot be eliminated under the present corporate governance framework. Nonetheless, proper implementation of the consultative attorney in the takeover bid context and of counsel for the outside directors in certain other acquisition settings, such as in squeeze-out mergers, may enhance corporate accountability with relatively minor costs. Although directors may tend to retain advisers who are predisposed to rendering advice having justifiable grounds in favor of incumbent management,98 implementation of the following practices with respect to consultative counsel and similar experts may lessen this potential for bias. First, the attorney and investment banker separately retained should be selected by the outside directors. Second, such advisers should have no professional or personal affiliations with any of the subject companies or their managements, including the outside directors. Third, if these advisers have engaged in this type of representation (such as serving as consultative attorney) on a fairly frequent basis, the


97. Of course, certain requirements must be met before the business judgment rule may be invoked, including that such decision be (a) a deliberative one (b) which was reasonably informed (c) made by directors who acted in good faith without a disabling conflict of interest and (d) had a rational basis. See Smith v. Van Gorkom, 488 A.2d 858, 872-74 (Del. 1985); Steinberg, The American Law Institute's Draft Restatement on Corporate Governance: The Business Judgment Rule, Related Principles, and Some General Observations, 37 U. MIAMI L. REV. 295, 301-04 (1983). Moreover, a few courts have declined to construe the business judgment rule expansively in the takeover context. See supra note 46.

98. See, e.g., Cox, Searching for the Corporation's Voice in Derivative Suit Litigation: A Critique of Zapata and the ALI Project, 1982 DUKE L.J. 959. Referring to special litigation committees comprised of outside directors, Professor Cox opined:

Commentators have explained in detail why the special litigation committee's independence may be more apparent than real. Their concern is founded on the observation that the defendants and the members of the special litigation committee share a common cultural bond: directorship of a public corporation. The natural empathy and collegiality that this bond engenders makes an adverse judgment of a colleague's behavior distasteful at best. Also, when the committee is formed after the instigation of the derivative suit, the situation is rife with opportunities for the defendants to select for committee membership those directors most sympathetic to their position. The committee's independence may be further undermined by its members' desire to curry favor with their fellow directors or with the business community in general. Finally, special litigation committees operate under the constant threat of dissolution should they displeasure the board by pursuing the plaintiff's cause with excessive zeal.

The likelihood that these factors will corrupt the committee's independent judgment will be referred to as "structural bias." Whatever one's view about the impact of the factors that feed a committee's structural bias, the committee's record is itself disquieting: although there have been more than a score of special litigation committee cases to date, in all but one the committee concluded that the suit in question was not in the corporation's best interest.

Id. at 962-63 (footnotes omitted).
advice rendered (providing that the position recommended is known) should not favor management or the committee retaining such advisers on a near unanimous basis. Fourth, during the representation, the insiders should communicate any information to a committee comprised of outside directors through counsel rather than directly to the outside directors. Fifth, after the representation terminates, the separately retained counsel and investment banker should not be permitted to represent any of the subject entities for a substantial period of time—for example, ten years.99

Adherence to these suggested practices will reduce the potential for bias and, at the same time, will not have an adverse effect in procuring expertized advice. Requiring that specially retained investment bankers and counsel (such as the consultative attorney or counsel for the outside directors) be selected by the outside directors, have no prior affiliation with the pertinent "actors," have not continually proffered advice favorable to management, and cannot thereafter be retained by the subject entities for a substantial time period,100 significantly increases the likelihood of the board or committee receiving disinterested professional assistance. Moreover, by channeling communications through counsel,101 the parties most directly interested will have less opportunity to exert undue influence on a committee comprised of outside directors.

It may be asserted that this proposal is too formalistic and seeks to implement a rigid monitoring mechanism where none is necessary. A survey of so-called disinterested board and committee determinations belies this assertion. For example, in derivative suits, the special litigation committee,102 after receiving the advice of specially retained counsel,103

99. At times, these requirements may not be practical to implement on a rigorous basis. For example, there may be compelling circumstances present that should permit counsel to represent one of the subject entities before the expiration of the ten-year period. Nonetheless, the burden should be placed upon the party seeking an exception to the enumerated practices. The gist of the practices is to help ensure as much as feasible that the board or a committee comprised of outside directors receives separately retained advice that is of high caliber. Although perfection is not possible, any significant breach of the listed practices threatens the objectives sought to be achieved by the proposed framework.

100. See supra note 99.

101. Hence, for example, the insiders can communicate in this context with the outside directors comprising the committee only indirectly through the corporation’s general counsel (or through the insiders’ separately retained counsel if that is the case) who in turn will communicate with counsel advising the committee. This means of communication reduces the risk of undue influence by the insiders.


103. Significantly, such separately retained counsel for the committee often has some prior
nearly always determines that the derivative action against the corporate fiduciaries should be dismissed. Moreover, in corporate acquisitions, the evidence illustrates that, irrespective of whether counsel or an investment banker is retained by a potential acquiror, target, or other relevant party, the advice proffered normally is that desired by the retaining party. Hence, there is a very real problem. Unfortunately, however, there has been a general refusal by the corporate bar and investment bankers to acknowledge the conflicts of interest implicated. The proposals set forth in this Article are intended to stimulate discussion and induce corrective actions.

Conclusion

This Article takes the position that there are serious conflicts-of-interest dilemmas confronting counsel in the corporate acquisition context and accordingly has recommended a framework for application. Thus far, however, little has been done to resolve (let alone address or even recognize) this problem. This Article, as well as others contained in the Symposium, should bring into sharper focus the difficult issues present in this setting. The time is now for the corporate bar to face these issues.

affiliation with members of the committee or the insiders. See, e.g., Zapata Corp. v. Maldonado, 430 A.2d 779, 781 (Del. 1981) (committee retained as counsel the law firm of one of the directors). Hence, the enumerated recommended practices discussed above are not satisfied. See supra notes 99-100 and accompanying text.

