

# GREENMAIL IN TAKEOVER LAW OF THE UNITED STATES: LESSONS FOR THE EMERGING SERBIAN MARKET

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## **Abstract**

The main purpose of this thesis is to analyze the greenmail phenomenon in the US practice, and to evaluate the legal possibility of the occurrence of greenmail in the Serbian emerging market.

The thesis presents and compares different views of greenmail that provides a clear understanding of the concept. US case law study locates possible problems and the analysis of Serbian legislation solves the question, whether greenmail as an US creation can take place in Serbian takeover scene.

This thesis argues that greenmail has both positive and negative effects, thus it should be legal but however strictly regulated in order to suppress all the potential harmful consequences. For the reason that Serbia and United States have different corporate policy choice greenmail is not likely to occur in Serbian emerging capital market.

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## Introduction

In the US greenmail is still one of the most controversial concepts in corporate governance.<sup>1</sup> In the 1980's greenmail was extremely popular in the US when corporate raiders found out that it is a fast and easy way to make profits without taking control of the company.<sup>2</sup> The statistic data show us that in 1984 companies in the US paid more than \$3.5 billion to repurchase their own shares from greenmailers at a premium price, paying \$600 million over the market price.<sup>3</sup> At that time greenmail was considered as a situation when a target company acquires its own shares from a shareholder or a group of shareholders at a premium price to protect itself from a hostile takeover. It represents a type of target share repurchase from a bidder, not available to all shareholders.<sup>4</sup> However, the definition has changed over time. This thesis will be focused on the US, since greenmail phenomenon firstly occurred, developed and evolved there.<sup>5</sup>

Although today in the US greenmail is not that common as it was back in the 1980's greenmail can be still of importance to some European emerging capital markets since there is a question whether greenmail can pop out in civil systems? We will analyze greenmail phenomenon to see what the economical effects are and whether greenmail should be allowed or not? Finally, we will examine Serbian

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<sup>1</sup> Christopher J. Bellini, *The Evolution of Greenmail: A Lawyer's Dilemma in Corporate Representation*, 2 Geo. J. Legal Ethics 533, 533 (1988).

<sup>2</sup> Eric Engle, *Green with Envy? Greenmail is good! Rational Economic Responses to Greenmail in a Competitive Market for Capital and Managers*, DePaul Business & Commercial Law Journal, Vol. 5, 427, 428 (2007).

<sup>3</sup> Note, *Greenmail: Target Stock Repurchases and the Management- Entrenchment Hypothesis*, 98 Harv. L. Rev. 1045, 1045 (1985).

<sup>4</sup> Bhagat and Jefferis, *The Causes and Consequences of Takeover Defense: Evidence from Greenmail*, Journal of Corporate Finance 1, 201, 202 (1994).

<sup>5</sup> See Patrick A. Gaughan, *Mergers, Acquisitions and Corporate Restructuring*, p.198 (4<sup>th</sup> ed. 2007).

legislation and answer the question whether US greenmail phenomenon can occur in Serbia?

The aim of this thesis is to find whether greenmail is possible to occur in Serbia and to recommend a model law solution for the future Serbian legislation regarding greenmail concept. This paper will examine legal boundaries and possibility of implementing American solution in our positive law, finding that US concept of greenmail is not likely to take place in the Serbian takeover scene.

The first chapter speaks about evolution and definition of greenmail, how the concept has been developing over time and it enumerates different definitions of greenmail. At the end we will choose the most practical definition.

The second chapter is about positive and negative economic effects of greenmail that divided US legal scholars in two opposing groups. At the end of the chapter we will conclude that truth about greenmail is somewhere in the middle.

The third chapter presents motivational theories of greenmail that explains what the true motives of directors are when they decide to make greenmail payments. Afterwards we analyze US case law.

The Fourth chapter examines the Serbian legislation and the possibility of greenmail occurrence focusing on Serbian Company Law. In the second part of the chapter we will analyze possible solution for the future Serbian legislation regarding greenmail phenomenon.

The thesis concludes that in the light of fundamental differences between US and Serbian legal systems, greenmail as an American concept is not likely to take place in Serbian takeover scene.

## I. Evolution and Definition of Greenmail

### *I.1. Evolution of greenmail*

Greenmail was a natural step in the development of corporate takeovers in the US. While in the 1950's proxy fights<sup>6</sup> and in the 1960's tender offers were the most common ways for corporate raiders to take over a company, in the first half of the 1980's corporate raiders realized that they can make profit more easily, by forcing payments from the board of directors even without taking over the target company.<sup>7</sup> One way of achieving that was through a typically complex set of transactions that came to be known as 'greenmail' (blackmailing the target's directors by exploiting the tools offered by law).

Early reports suggest that greenmail appeared in July 1979 when Carl Icahn purchased 9.9 per cent of Saxon Industries shares for roughly \$7.21 per share. After some time, in February 1980 Saxon reacquired its own shares from Icahn for \$ 10.50 per share, making Icahn profiting from this transaction more than 2 million dollars back then.<sup>8</sup> This was just a start for Icahn that made him a famous corporate raider and eventually becoming one of the wealthiest people in the world.<sup>9</sup>

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<sup>6</sup> "A proxy fight is an attempt by a single shareholder or a group of shareholders to take control or bring about other changes in a company through the use of the proxy mechanism of corporate voting. Proxy contests are political processes in which incumbents and insurgents compete for shareholder votes through a variety of means including mailings, newspaper advertisements, and telephone solicitations. In a proxy fight, a bidder may attempt to use his voting rights and garner support from other shareholders to oust the incumbent board and/or management." Patrick A. Gaughan, *Mergers, Acquisitions and Corporate Restructuring*, p.263 (4<sup>th</sup> ed.2007).

<sup>7</sup> Eric Engle, *Green with Envy? Greenmail is good! Rational Economic Responses to Greenmail in a Competitive Market for Capital and Managers*, DePaul Business & Commercial Law Journal, Vol. 5, 427, 428 (2007).

<sup>8</sup> Patrick A. Gaughan, *Mergers, Acquisitions and Corporate Restructuring*, p.198 (4<sup>th</sup> ed. 2007).

<sup>9</sup> <http://www.forbes.com/profile/carl-icahn/>.

In spite of this, Carl Icahn was not the first greenmailer; actually the truly pioneer of greenmail was Charles Bluhdorn a former chairman of Gulf & Western Industries, who greenmailed Cannon which resulted a transaction in 1976 where Cannon repurchased Gulf & Western Industries at a higher than market price.<sup>10</sup> Even though greenmail phenomenon is present in the US practice for more than 35 years it is still very controversial<sup>11</sup> and it is opening up many questions.

## ***1.2. Definition of greenmail***

### **I.2.a. Difficulties in defining the term**

The term greenmail is not easy to define. The problem is that the phenomenon is complex and it has been developing over time.<sup>12</sup> However, lawyers usually agree about what this term generally denotes. We will introduce some of these definitions, evaluate them and choose the most practical solution that we will use for the purposes of this work. In the next chapter we will concentrate on the economical effects of greenmail.

### **I.2.b. Greenmail phenomenon**

Greenmailing represents a situation when a corporate raider starts buying stocks on the free market and pretends to begin the takeover procedure while giving a choice to the Board of directors to buy back its shares at a premium price.<sup>13</sup> Greenmailer makes a tender offer to the dispersed shareholders to purchase their stocks. Tender offer permits a greenmailer to avoid board of directors' acceptance making an offer directly to the shareholders. If the board of directors decides to defend the company

<sup>10</sup> Patrick A. Gaughan, *Mergers, Acquisitions and Corporate Restructuring*, p.198 (4<sup>th</sup> ed. 2007).

<sup>11</sup> Bhagat and Jefferis, *the Causes and Consequences of Takeover Defense: Evidence from Greenmail*, *Journal of Corporate Finance* 1, 201, 202 (1994).

<sup>12</sup> David Manry, David Stangeland, *Greenmail-Brief history*, *Stanford Journal of Law*, 217, 224 (2001).

<sup>13</sup> *Id.*



against this threat they need to find a way to block the bid .Payment of greenmail is one of the tactics to do so. By paying a higher than market price for greenmailer's shares, target company is defending itself against a hostile takeover.<sup>14</sup>

Greenmail payments are usually accompanied by standstill agreements.<sup>15</sup> Standstill agreement is a contractual agreement between a target company and a greenmailer. After the company repurchases its own shares, the greenmailer is prevented under the standstill agreement to use the same tactic again and to force the company for another payment. Every standstill agreement relates only to the payee of the greenmail fee since he entered the contract.<sup>16</sup> Now we shall present various definitions of greenmail:

Black's Law dictionary defines greenmail as an: "act or practice of buying enough stock in a company to threaten a hostile takeover and then selling the stock back to the corporation at an inflated price".<sup>17</sup>

In Unocal vs. Mesa case The Supreme Court of Delaware ruled that "greenmail refers to the practice of buying out a takeover bidder's stock at a premium that is not available to other shareholders in order to prevent the takeover".<sup>18</sup> Andrew J. T. Moore<sup>19</sup> used the same definition in his article<sup>20</sup>.

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<sup>14</sup> Fred S. McChesney, *Transaction Costs and Corporate Greenmail: Theory, Empirics and a Mickey Mouse Case Study*, Managerial and Decision Economics, vol. 14, 131, 133 (1993).

<sup>15</sup> Patrick A. Gaughan, *Mergers, Acquisitions and Corporate Restructuring*, p.197 (4<sup>th</sup> ed. 2007).

<sup>16</sup> Christopher J. Bellini, *The Evolution of Greenmail: A Lawyer's Dilemma in Corporate Representation*, 2 Geo. J. Legal Ethics, 533, 539 (1988).

<sup>17</sup> *Black's Law Dictionary*, Bryan A. Garner (Ed.), (9th ed. 2009).

<sup>18</sup> *Unocal Corporation v. Mesa Petroleum Company*, Del. Supr., 493 A.2d 946, 956, n.13 (1985).

<sup>19</sup> Andrew G.T. Moore II is a retired Justice of the Supreme Court of Delaware with experience in corporate litigation. In his 12 years as a Justice of the Delaware Supreme Court. He wrote many of the landmark decisions including *Unocal Corporation v. Mesa Petroleum Company* ([http://www.gibbonslaw.com/biographies/attorney\\_biography.php?attorney\\_id=556](http://www.gibbonslaw.com/biographies/attorney_biography.php?attorney_id=556)).

<sup>20</sup> Andrew J. T. Moore, *the Birth of Unocal – A Brief History*, 31 Del. J. Corp. Law, 865 (2006).

Gaughan's interpretation of federal tax law leads him to a practical definition. "Greenmail is defined as consideration paid to anyone who makes or threatens to make a tender offer for a public corporation. In order for the payment to be considered greenmail, the offer must not be available to all shareholders".<sup>21</sup>

Although these definitions are general, they provide us basic elements and useful information with the purpose to understand the concept of greenmail. The analysis is essential to clarify the whole idea of greenmail and identify the critical points of this mechanism that can have a direct influence to future problems. After that we will be ready to focus on economical effects that divided US legal scholars in two major groups.

The first definition is somehow incomplete because it does not mention the essential fact that the premium price offer for stocks is available only to the corporate raider (greenmailer), and not to every shareholder. Thus it can be inferred that greenmail presents some kind of discrimination.

Unocal definition covers the 'discrimination part' but it is not completely precise since it states that greenmail is paid to prevent a takeover but greenmailers do not have any motive to take over the control of the company. Their only goal is to make profits by reselling their stocks at a premium price. Greenmailer will threaten the company that he will initiate the takeover procedure by making a tender offer directly to the shareholders, if the target company does not repurchase his stocks. In most cases, greenmailer does not even have funds to complete the takeover procedure of the target company.<sup>22</sup>

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<sup>21</sup> Patrick A. Gaughan, *Mergers, Acquisitions and Corporate Restructuring*, p.202 (4<sup>th</sup> ed. 2007).

<sup>22</sup> See *Unocal Corporation v. Mesa Petroleum Company*, Del. Supr., 493 A.2d 946 (1985).

Besides, Unocal decision was written almost 30 years ago and the definition has changed over time.<sup>23</sup> We will completely analyze Unocal case in Chapter III.

Gaughan's interpretation of tax law does not have any of the previously mentioned problems; it covers the whole phenomenon with very simple language. The tax law had to be very accurate and to specifically define greenmail as a term in order to indicate what payments should be regarded as greenmail and taxed as such. For now it seems that the Gaughan's understanding of tax law is the closest to most precise definition but we will also analyze some other definitions.

After landmark decisions, Unocal<sup>24</sup> in Delaware and particularly Disney case<sup>25</sup> in California, there were a lot of criticisms in public about the effects of greenmail.<sup>26</sup> In 1987 the US Congress enacted the federal tax law that imposed 50% excise tax on profits gained by greenmail payments.<sup>27</sup> Under the U.S. tax law, greenmail is defined as:

"Any consideration transferred by a corporation (or any person acting in concert with such corporation) to directly or indirectly acquire stock of such corporation from any shareholder if:

- 1) Such shareholder held such stock ... for less than 2 years before entering into the agreement to make the transfer,
- 2) at some time during the 2-year period ending on the date of such acquisition:
  - A) Such shareholder,
  - B) Any person acting in concert with such shareholder, or
  - C) any person who is related to such shareholder or person described in subparagraph (B), made or threatened to make a public tender offer for stock of such corporation, and
- 3) Such acquisition is pursuant to an offer which was not made on the same terms to all shareholders".<sup>28</sup>

<sup>23</sup> David Manry, David Stangeland, *Greenmail-Brief history*, Stanford Journal of Law, 217, 224 (2001).

<sup>24</sup> *Unocal Corporation v. Mesa Petroleum Company*, Del. Supr., 493 A.2d 946 (1985).

<sup>25</sup> *Heckmann v. Ahmanson* 168 Cal. App. 3d 119, 214 Cal. Rptr. 177 (1985).

<sup>26</sup> Daniel Hartnett, *Greenmail: Can the abuses be stopped?* Northwestern University Law Review, Vol. 80, 1271, 1275 (1986).

<sup>27</sup> Roberta S. Karmel, *Greenmail the Control Premium and Shareholder Duty*, 48 Wash. & Lee L. Rev. 937, 944 (1991).

<sup>28</sup> 26 U.S.C. § 5881(b) (1988).

The huge tax rate resulted that greenmail became increasingly less popular.<sup>29</sup> Naturally, the law is not perfect, in order to avoid tax, corporations just need to wait for 2 years limitation period to pass. After the law was enacted in 1987, Manry and Stangeland found in their research that one case out of thirteen cases with threats would be greenmail for the two year rule.<sup>30</sup>

Bhagat and Jefferis elaborate in their work how often there is a management turnover in companies that are paying greenmail.<sup>31</sup> They conclude that greenmail is a target share repurchase and that it refers to a situation when a target company acquires a block of shares from a shareholder or group of shareholders at a premium.<sup>32</sup> “The motivation for the repurchase is presumably the deterrence of a takeover on terms that would be unfavorable to incumbent management”.<sup>33</sup>

The authors found out that the performance of companies that pay greenmail is no weaker than the performance of similar size companies from the same branch that did not pay greenmail, before and after the repurchase of its own shares at a premium price. However this is not a proof that companies that pay greenmail are performing badly and are trying to defend themselves from a hostile takeover by paying out a greenmailer.<sup>34</sup>

Other authors like Freeman, Gilbert and Jacobson in their work “Ethics of Greenmail” took a different approach to define greenmail that seems to be more philosophical than legal. They are analyzing the ethical side of greenmail, whether every

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<sup>29</sup> Patrick A. Gaughan, *Mergers, Acquisitions and Corporate Restructuring*, p.202 (4<sup>th</sup> ed. 2007).

<sup>30</sup> David Manry, David Stangeland, *Greenmail-Brief history*, Stanford Journal of Law, 217, 236 (2001).

<sup>31</sup> Bhagat and Jefferis, *the Causes and Consequences of Takeover Defense: Evidence from Greenmail*, Journal of Corporate Finance 1, 201, 201-231, (1994).

<sup>32</sup> Id. at 202.

<sup>33</sup> Id.

<sup>34</sup> Patrick A. Gaughan, *Mergers, Acquisitions and Corporate Restructuring*, p.200 (4<sup>th</sup> ed. 2007).

greenmail is immoral or not.<sup>35</sup> They compared greenmail with blackmail. Although there is a general opinion that blackmail is morally wrong, they concluded that it is not always immoral like it seems to be in most cases.<sup>36</sup> The same concept is with greenmail: They stated that minimum two conditions are necessary for creation of greenmail: threat condition and compliance condition. Threat for greenmail means that the raider is threatening to engage in a hostile takeover fight unless the management buys back his stocks at a premium. The compliance for greenmail means that management buys stocks at a premium to prevent raiders from engaging in a hostile takeover.<sup>37</sup> The authors found that there is no foundation whether every greenmail is morally wrong or not.<sup>38</sup> Therefore, this is one of the reasons why greenmail should be observed on case by case basis.

It is interesting that there is a possibility that greenmail can occur in some civil legal systems like in Finland. Although it is only theoretical since in Finland companies can repurchase its own shares from a certain shareholder only if it is approved by all the shareholders. In case of public companies this possibility is almost impossible to happen.<sup>39</sup>

A leading Finnish expert in corporate law, Ari Savela suggests that: "Greenmail means that the target company acquires its own shares from a hostile bidder to induce the bidder to give up the takeover attempt".<sup>40</sup> He is saying that the price of shares is

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<sup>35</sup> R. Edward Freeman, Daniel R. Gilbert, Jr. and Carol Jacobson, *The Ethics of Greenmail*, ACT Guide to Ethical Conflicts in Finance, 143, 143-176 (1994).

<sup>36</sup> Id. at 152.

<sup>37</sup> Id. at 153.

<sup>38</sup> Id. at 174.

<sup>39</sup> Ari Savela, *Hostile Takeovers and Directors*, Faculty of Law of the University of Turku, p.284 (1999).

<sup>40</sup> Id. at 281.

higher than usual. Shareholders would not suffer any losses if the company would acquire its own shares at a market price.<sup>41</sup>

In practice that is not the case. Usually greenmail transactions are favorable for the corporate raider<sup>42</sup> and in most cases quite harmful for the nonparticipating shareholders. The target company always pays a premium price to the bidder with the aim to protect itself from a hostile takeover. That is the price that the Board of directors has to pay to retain control. The main motive of greenmailers is to make profit by reselling their stocks at a price higher than the one on the open market.

This research is relevant because Serbian and Finnish systems are both from the same legal family (continental, civil legal system) and the capital markets are less developed comparing to American. As well Serbian legal system is more similar to Finnish than to American mainly regarding the situation when companies acquire its own shares. In both Finland<sup>43</sup> and Serbia<sup>44</sup> this possibility is strictly limited. We will focus on these matters in forthcoming chapters.

### ***1.3. Conclusion***

Greenmail became popular in the US during the Fourth Merger wave<sup>45</sup> in the 1980's, when raiders found out that it is a fast and easy way to get paid "without even

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<sup>41</sup> Id.

<sup>42</sup> Id.

<sup>43</sup> Id. at 283.

<sup>44</sup> Company Law, art. 282 (Zakon o privrednim društvima), Official Gazette of the Republic of Serbia No. 36/2011 and 99/2011.

<sup>45</sup> Fourth Merger Wave (1984-1989). "In the fourth wave, the term *corporate raider* made its appearance in the vernacular of corporate finance. The corporate raider's main source of income is the proceeds from takeover attempts. The word *attempts* is the curious part of this definition because the raider frequently earned handsome profits from acquisition attempts without ever taking ownership of the targeted corporation." Patrick A. Gaughan, *Mergers, Acquisitions and Corporate Restructuring*, p.57 (4<sup>th</sup> ed. 2007).

taking control of the target company”<sup>46</sup>. The most suitable definition that we presented is the one formulated by Patrick Gaughan who relied on tax law. However, even this definition needs to be modified in order to be complete. Hence, for the purposes of this thesis, the following understanding of greenmail will be governing:

*Greenmail is a consideration paid for repurchase of company’s own shares at a premium by the Board of directors in order to defend itself against hostile takeover from “anyone who makes or threatens to make a tender offer”<sup>47</sup>. Payment is considered greenmail only if the offer is not available to all shareholders.<sup>48</sup> In return greenmailer agrees not to use the same tactic again.<sup>49</sup>*

Therefore we will use the new definition for the purposes of this study. Gaughan’s understanding of greenmail is one of the most recent definitions, dating from 2007<sup>50</sup> which is important because the term has been developing over time.<sup>51</sup> As well Gaughan’s definition is simple but however it covers all the aspects of greenmail. Moreover it is not descriptive like most of the previously mentioned opinions.

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<sup>46</sup> Eric Engle, *Green with Envy? Greenmail is good! Rational Economic Responses to Greenmail in a Competitive Market for Capital and Managers*, DePaul Business & Commercial Law Journal, Vol. 5, 427, 428 (2007).

<sup>47</sup> Patrick A. Gaughan, *Mergers, Acquisitions and Corporate Restructuring*, p.202 (4<sup>th</sup> ed. 2007).

<sup>48</sup> Id.

<sup>49</sup> Christopher J. Bellini, *The Evolution of Greenmail: A Lawyer’s Dilemma in Corporate Representation*, 2 Geo. J. Legal Ethics, 533, 539 (1988).

<sup>50</sup> Patrick A. Gaughan, *Mergers, Acquisitions and Corporate Restructuring* (4<sup>th</sup> ed. 2007).

<sup>51</sup> David Manry, David Stangeland, *Greenmail-Brief history*, Stanford Journal of Law, 217, 224 (2001).

## II. Economic Effects of Greenmail

In the US there are different opinions among legal scholars regarding the economic effects of greenmail. Two confronting ideas are dominating: one looking at greenmail in positive manner and the other one taking the opposite stance. Scholars that support the first theory suggest that greenmail is good since it has positive influence on the market. As opposed to that, the other theory is based on the opinion that greenmail is similar to blackmail and thus is dangerous as it has negative economic effects especially on non participating shareholders' welfare.

### ***II.1. Greenmail is good***

Eric Engle argues that "greenmail occurs when a shareholder acquires a significant amount of a company's stock and then threatens to take over the company unless the purchaser's shares are bought back by the company at a premium."<sup>52</sup> In his view greenmail is good and beneficial for the economy since it weeds out bad management.<sup>53</sup> Engle suggests that greenmail is promoting competition among managements on the market because it is a threat to inefficient managers.<sup>54</sup> He concluded that greenmail promotes the welfare of the whole economy by reallocating the capital from inefficient to efficient entities.<sup>55</sup> His response to the critics is that if the

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<sup>52</sup> Eric Engle, *Green with Envy? Greenmail is good! Rational Economic Responses to Greenmail in a Competitive Market for Capital and Managers*, DePaul Business & Commercial Law Journal, Vol. 5, 427, 429 (2007).

<sup>53</sup> Id. at 431.

<sup>54</sup> Id.

<sup>55</sup> Id at 435.



repurchases of shares for a premium is available for founders and white knights, it should be also allowed to the regular shareholders.<sup>56</sup>

Although Engle's view is of the most importance to our research he is ignoring all the negative effects that can occur. He is solely focusing on the positive sides that are not main features of the mechanism. He is not analyzing what effects greenmail has to non participating shareholders.

Christopher Bellini believes that: "Greenmail is the non-pro rata stock repurchase from a shareholder at a premium above current market price. The term encompasses payments made to shareholders who make or threaten tender offers for the corporation as well as dissident shareholders who disagree with current management's policy decisions".<sup>57</sup> Although his position is neutral, we are putting him in the group with Engle and other scholars who are observing greenmail in positive context, since he is not criticizing the phenomenon. In his view the effects of greenmail should be analyzed individually for each case.<sup>58</sup>

Bellini's approach is very practical and useful because it solves one of the dilemmas. It is almost impossible to say that greenmail is absolutely good or bad. The complexity of greenmail and a constant development persuade us that it should be observed on a case by case basis.

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<sup>56</sup> Eric Engle, *Green with Envy? Greenmail is good! Rational Economic Responses to Greenmail in a Competitive Market for Capital and Managers*, DePaul Business & Commercial Law Journal, Vol. 5, 427, 429 (2007).

<sup>57</sup> Christopher J. Bellini, *the Evolution of Greenmail: A Lawyer's Dilemma in Corporate Representation*, 2 *Geo. J. Legal Ethics*, 533,533 (1988).

<sup>58</sup> *Id.* at 540.

McChesney supports the opinion of lawyers like Bhagat and Jefferis and argues that greenmail is one of the most controversial transactions in corporate finance.<sup>59</sup> From his point of view, greenmail is not harming non participating shareholders; in fact it can be useful for them. The first tender offer is usually not the biggest one and after the Board pays a premium to the first bidder this new situation will benefit other shareholders when it will attract another individual or group (for them the takeover will be easier) who will increase the bid and thus shareholders value.<sup>60</sup> He is stating that:

“Greenmail refers to corporations’ repurchasing a block of their shares from persons declaring themselves (or seemingly about to become) bidders to take over the firms (...) Typically, a key term of the repurchase agreement is payment of a substantial premium over market for the bidder’s shares, in exchange for the bidder’s agreement not to acquire the firm’s shares again or otherwise to seek control of the firm”.<sup>61</sup>

The effect of greenmail to non participating shareholder’s welfare should be observed in couple of stages. When the payment of greenmail is announced the stock price will almost always fall. This is definitely a signal that greenmail has a negative effect on shareholders.<sup>62</sup> Sometimes greenmail can attract other investors who will offer a more generous offer that will pay off both greenmail payment and value decrease of shareholder’s stocks.<sup>63</sup> But this situation is more an exception rather than a rule.

Andrei Shleifer and Robert W. Vishny consider greenmail as a “practice that permits managers to avert a takeover by repurchasing a potential acquirer’s shares,

<sup>59</sup> Bhagat and Jefferis, *the Causes and Consequences of Takeover Defense: Evidence from Greenmail*, Journal of Corporate Finance 1, 201, 202 (1994).

<sup>60</sup> Fred S. McChesney, *Transaction Costs and Corporate Greenmail: Theory, Empirics and a Mickey Mouse Case Study*, Managerial and Decision Economics, vol. 14, 131, 133 (1993).

<sup>61</sup> Id. at 131.

<sup>62</sup> David Manry, David Stangeland, *Greenmail-Brief history*, Stanford Journal of Law, 217, 221 (2001).

<sup>63</sup> Andrei Shleifer and Robert W. Vishny, *Greenmail, white knights and shareholders’ interest*, Rand Journal of Economics, Vol. 17(3), 293, 294 (1986).

usually at a substantial premium over the market price”.<sup>64</sup> In their article, they are elaborating, that eliminating a bidder can serve the interests of the shareholders of the target firm. They found that greenmail is an act of management in the interest of shareholders because when management is raising the expected takeover premium they are doing something beneficial for the shareholders.<sup>65</sup> They are presenting that:

“By eliminating a likely bidder, the target may induce other firms to study the possibility of taking it over. The increased likelihood of bids from these firms may be sufficient to compensate shareholders for the elimination of a potential acquirer as well as for the direct costs of discouraging him”.<sup>66</sup>

This view is very similar to the previous one of McChesney. They both defend the claim that greenmail is actually promoting shareholders’ welfare by attracting other investors who will offer better terms than the greenmailer and compensate any losses. As we previously mentioned this scenario is not going to happen in every case.

## ***II.2. Greenmail is bad***

Patrick Gaughan states that: “greenmail refers to the payment of a substantial premium for a significant shareholder’s stock in return for the stockholder’s agreement that he or she will not initiate a bid for control of the company”.<sup>67</sup> He is implying that greenmail is a type of target share repurchase.<sup>68</sup>

It means that the company buys back its shares in order to protect itself from a hostile takeover. This privilege is only available to the shareholder or a group of shareholders who is either initiating or threatening to make a tender offer with the purpose to acquire the control of the target company. When the payment of greenmail

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<sup>64</sup> Id. at 293.

<sup>65</sup> Id. at 294.

<sup>66</sup> Id.

<sup>67</sup> Patrick A. Gaughan, *Mergers, Acquisitions and Corporate Restructuring*, p.198 (4<sup>th</sup> ed. 2007).

<sup>68</sup> Id.

is announced the stock price will fall, influencing the shareholders' value.<sup>69</sup> Gaughan supports Espen Eckbo's study where is suggested that anti-greenmail charters have positive effects on shareholders wealth and influenced good market response.<sup>70</sup> The effects of these charters and tax changes resulted that greenmail became less popular and almost totally disappeared in practice.<sup>71</sup>

In US, anti-greenmail charters are recommended and useful when the company wants to restrict greenmail payments. This is not mandatory; everything depends on what aims the company is pursuing. There are different types of these amendments; some of them allow greenmail payments if nonparticipating shareholders approve it.<sup>72</sup>

Daniel Hartnett, points out that greenmail is undesirable since it presents kind of an abuse. In his work he is analyzing the possibility to stop its negative effects towards shareholders' interests. He is comparing greenmail with blackmail because of the bidder's threatening to make a hostile takeover, or to sell his shares to other unfriendly corporation unless the target repurchases the bidder's shares.<sup>73</sup> He defined the term as a "type of buy-back transaction in which the target corporation, in an effort to avert a hostile takeover, repurchases the shares held by the hostile bidder at a price substantially higher than the market price".<sup>74</sup>

Hartnett's research had a big influence on practice, suggesting that the most effective solution for greenmail problem is that the courts should determine whether conflicts of interest exist or not, applying the doctrine of fiduciary duty and analyzing the

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<sup>69</sup> David Manry, David Stangeland, *Greenmail-Brief history*, Stanford Journal of Law, 217, 221 (2001).

<sup>70</sup> Espen Eckbo, *Valuation Effects of Antigreenmail Prohibitions*, Journal of Financial and Quantitative Analysis, 25, December, 491, 491-505 (1990).

<sup>71</sup> Patrick A. Gaughan, *Mergers, Acquisitions and Corporate Restructuring*, p.202 (4<sup>th</sup> ed. 2007).

<sup>72</sup> Id. at 191.

<sup>73</sup> Daniel Hartnett, *Greenmail: Can the abuses be stopped?* Northwestern University Law Review, Vol. 80, 1271, 1271-75 (1986).

<sup>74</sup> Id. at 1275.

economical effects to shareholders' welfare.<sup>75</sup> Although we agree with Hartnett's idea that courts should analyze greenmail on case by case basis we should be careful in implementing his solution given that the phenomenon and solutions changed and developed since his research from 1986. This does not change the fact that his research was a big contribution for the development of various solutions for limiting greenmail negative effects, like introducing the practice of implementing anti-greenmail charter amendments.

In her article, Roberta S. Karmel considers greenmail in negative context as something undesirable that affects shareholders and harm U.S. business interests in general as it presents a threat to the corporate stability.<sup>76</sup> In her work Karmel uses Leefeldt definition that says: "Greenmail-named after blackmail-is the repurchase of stock from an unwanted suitor at a higher-than-market price. Companies pay greenmail to end the threat of a takeover".<sup>77</sup> She is describing greenmail as a 'Corporate Blackmail'.<sup>78</sup>

David Cowan Bayne suggests that greenmail is blackmail by the insurgent (corporate raider) and an act of embezzlement by incumbent (the Board of directors), and reckons that it is illegitimate as such. He even calls greenmail 'Corporate Bribery' because the aggressor is paid to stop an act of aggression.<sup>79</sup> Bayne's approach is

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<sup>75</sup> Id. at 1318.

<sup>76</sup> Roberta S. Karmel, *Greenmail the Control Premium and Shareholder Duty*, 48 Wash. & Lee L. Rev. 937, 937-976 (1991).

<sup>77</sup> Ed Leefeldt, "Greenmail" Far From Disappearing, Is Doing Quite Well in Disguised Forms, Wall St. J., Dec. 4, at 10, col. I. (1984).

<sup>78</sup> Roberta S. Karmel, *Greenmail the Control Premium and Shareholder Duty*, 48 Wash. & Lee L. Rev. 937, 968 (1991).

<sup>79</sup> David Cowan Bayne, *Traffic in Corporate Control-Greenmail: The nature of the duty*, University of Detroit Mercy Law Review, 259, 259-263 (1995).

somehow different from the others since he is describing greenmail as a tort by using a four-part technical definition:

“Greenmail consists of (1) the breach, by the incumbent controleur and the Insurgent, of their fiduciary duty to the corporation, (2) effected by the acceptance of a Reverse Premium-Bribe by Insurgent, paid by Incumbent, resulting in (3) the acquiescence by Insurgent in the continued occupancy of the office of control by (4) an unsuitable reverse-premium-briber Incumbent”.<sup>80</sup>

Although the US Courts have different practice regarding greenmail, (Delaware vs. California) no court has ever held greenmail as an independent tort.<sup>81</sup>

Both Karmel and Bayne have a similar approach towards greenmail, based on criticizing and promoting the prohibition of greenmail rather than analyzing the possibility that it can be beneficial to the market economy if it would be precisely regulated. They are excluding the possibility that greenmail can influence some positive effects that can be useful to the shareholders and the market in general.

### ***II.3. Conclusion***

The difficulties in defining greenmail divided US scholars in two groups. One group (Gaughan, Hartnett, Bayne, and Karmel) supports the opinion that greenmail has negative effects as it presents a direct impact on shareholder's welfare by influencing value of their stocks to decrease.<sup>82</sup> The other group reckons that greenmail in fact has a

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<sup>80</sup> David Cowan Bayne, *Traffic in Corporate Control-Greenmail: The nature of the duty*, University of Detroit Mercy Law Review, 259, 262 (1995).

<sup>81</sup> Roberta S. Karmel, *Greenmail the Control Premium and Shareholder Duty*, 48 Wash. & Lee L. Rev. 937, 975 (1991).

<sup>82</sup> David Manry, David Stangeland, *Greenmail-Brief history*, Stanford Journal of Law, 217, 221 (2001).

positive influence on economy because it is a threat to an ineffective Board of directors and it promotes welfare of shareholders.<sup>83</sup>

In our view, greenmail has both good and bad sides and it would be impossible to determine whether to take one or the other position. We have to be objective and to take all the factors into account, focusing carefully on the main features of greenmail and elaborate all the aspects that influence different opinions. The practice has proved that greenmail can be abused in various ways, especially by the directors who tend to pay greenmail only to keep their positions in the company and retain their salaries worth millions of dollars per year.<sup>84</sup>

Although we are more persuaded by the 'negative effects theory' there are also some very good points in what their opponents are suggesting. Exactly because of the positive effects, greenmail should not be prohibited by law: it is a constant threat to an inefficient management<sup>85</sup> and it can also attract a more generous offer<sup>86</sup>. On the other hand, greenmail should be precisely regulated in order to suppress all the negative problems that may occur. These issues will be answered in forthcoming chapters.

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<sup>83</sup> Eric Engle, *Green with Envy? Greenmail is good! Rational Economic Responses to Greenmail in a Competitive Market for Capital and Managers*, DePaul Business & Commercial Law Journal, Vol. 5, 427, 431, (2007).

<sup>84</sup> Note, *Greenmail: Target Stock Repurchases and the Management-Entrenchment Hypothesis*, 98 Harv. L. Rev., 1045, 1048 (1985).

<sup>85</sup> Eric Engle, *Green with Envy? Greenmail is good! Rational Economic Responses to Greenmail in a Competitive Market for Capital and Managers*, DePaul Business & Commercial Law Journal, Vol. 5, 427, 431 (2007).

<sup>86</sup> See page 14

### III. Greenmail Theories and Practice in the US

#### III.1. Motivational theories of greenmail

We will present some of the theories that are explaining directors' social and economic motives when they decide to make greenmail payments to defend the company against a potential hostile takeover.<sup>87</sup> One of the major legal problems in the US regarding greenmail is whether management pays greenmail because it is the best interest of the company or they just want to perpetuate themselves in the office.

##### III.1.a. Management entrenchment theory

Distinction between ownership and control in a company creates a conflict of interests between directors and shareholders. Directors have the privilege to decide between their own interest and shareholders' welfare.<sup>88</sup> The whole idea and function of the company is the shareholders' benefit.<sup>89</sup>

However, directors tend to use their positions and company's assets for their own benefit. Directors have a broad discretion rights to incur high agency costs<sup>90</sup> when managing a company, it is not easy for shareholders to control them, and both proxy fights and shareholder's derivative suits are very expensive and tend to be free-riding<sup>91</sup>

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<sup>87</sup> Christopher J. Bellini, *the Evolution of Greenmail: A Lawyer's Dilemma in Corporate Representation*, 2 Geo. J. Legal Ethics 533, 534 (1988).

<sup>88</sup> Note, *Greenmail: Target Stock Repurchases and the Management- Entrenchment Hypothesis*, 98 Harv. L. Rev. 1045, 1048 (1985).

<sup>89</sup> Christopher J. Bellini, *the Evolution of Greenmail: A Lawyer's Dilemma in Corporate Representation*, 2 Geo. J. Legal Ethics 533, 535 (1988).

<sup>90</sup> "Agency costs are defined as the difference between the hypothetical value of a firm as optimally managed and its value as actually managed." Note, *Greenmail: Target Stock Repurchases and the Management- Entrenchment Hypothesis*, 98 Harv. L. Rev. 1045, 1048 (1985).

<sup>91</sup> *Id.* at 1049.



Takeover attempts often happen when external investors analyze the market and find that the agency costs of a target company are excessive<sup>92</sup> and that the company can be more efficient if the management structure changes. That investor can make a tender offer to take control from the present, inefficient Board.<sup>93</sup>

The directors' discretion to pay greenmail can increase agency costs even more. Thus from this perspective, greenmail is coherent with management entrenchment theory, since it is opposite to the shareholders' interests.<sup>94</sup> If the Board of directors offers the bidder a greenmail payment it challenges the idea of increasing shareholders' welfare. The greenmailer is the only one who is receiving a premium payment while rests of the shareholders do not receive anything.<sup>95</sup> Directors tend to approve greenmail payments with the aim to thwart a takeover attempt; they get to keep the control of the company although they were the initial cause of residual loss.<sup>96</sup>

The management entrenchment theory suggests that directors are paying greenmail to keep their positions and maintain the control of the company.<sup>97</sup> This is not unusual since directors have an evident self interest in keeping their jobs. Although it is true that directors want to keep their positions this does not mean that there will be always a conflict of interest between directors and shareholders. Thus, greenmail should not be forbidden because of a potential conflict of interest between directors and

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<sup>92</sup> When agency costs of a company are high it is a clear indicator that the company does not have an efficient Board.

<sup>93</sup> Note, *Greenmail: Target Stock Repurchases and the Management- Entrenchment Hypothesis*, 98 Harv. L. Rev.1045, 1049 (1985).

<sup>94</sup> Id.

<sup>95</sup> Christopher J. Bellini, *the Evolution of Greenmail: A Lawyer's Dilemma in Corporate Representation*, 2 Geo. J. Legal Ethics 533, 535 (1988).

<sup>96</sup> Id.

<sup>97</sup> Note, *Greenmail: Target Stock Repurchases and the Management- Entrenchment Hypothesis*, 98 Harv. L. Rev.1045, 1047 (1985).

shareholders.<sup>98</sup> “Shareholders have internal governance mechanisms, as well as the option of not buying into or selling out of companies with entrenched managers”.<sup>99</sup>

### **III.1.b.Shareholders’ welfare theory**

Second theory is suggesting that directors make greenmail payments to protect the shareholders’ interests.<sup>100</sup> According to this hypothesis directors have an inside information<sup>101</sup> that is not reflected in the price of their company’s stocks, the stocks are undervalued on the market. Directors who have knowledge of publicly unknown (inside) information have an opportunity to evaluate more accurately their company’s actual value.<sup>102</sup> Given that the market price of stocks is falsely low, the bidder’s tender offer undervalues the price of target company shareholders’ stocks. According to this theory, directors make greenmail payments to protect shareholders from receiving insufficient compensation for their shares.<sup>103</sup>

One other, non-greenmail theory explains the link between stock price and available information in the market. Efficient market hypothesis suggests that all the

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<sup>98</sup> Eric Engle, *Green with Envy? Greenmail is good! Rational Economic Responses to Greenmail in a Competitive Market for Capital and Managers*, DePaul Business & Commercial Law Journal, Vol. 5, 427, 429 (2007).

<sup>99</sup> Id.

<sup>100</sup> Note, *Greenmail: Target Stock Repurchases and the Management- Entrenchment Hypothesis*, 98 Harv. L. Rev., 1045, 1050 (1985).

<sup>101</sup> Inside information means that directors know something that is not available to the public for example trade secrets or even some other bidders who are prepared to pay a higher price for shareholders’ shares. Christopher J. Bellini, *the Evolution of Greenmail: A Lawyer’s Dilemma in Corporate Representation*, 2 Geo. J. Legal Ethics 533, 536 (1988).

<sup>102</sup> Note, *Greenmail: Target Stock Repurchases and the Management- Entrenchment Hypothesis*, 98 Harv. L. Rev., 1045, 1049-50 (1985).

<sup>103</sup> Christopher J. Bellini, *the Evolution of Greenmail: A Lawyer’s Dilemma in Corporate Representation*, 2 Geo. J. Legal Ethics 533, 535 (1988).

information about one company that is available to the public is reflected in the stock price. This does not necessarily mean that stocks cannot be undervalued.<sup>104</sup>

The likelihood that stocks can be undervalued indicates that directors can repurchase company's own shares from corporate raider, who is making a tender offer on the basis that directors hold valuable information about the actual value of their company. As well they are aware that bidder's offer is inadequate. Although directors may see that company's stock price is underrated they are simply powerless to transmit this information to the market. If a company has found out some information that is related to its business and the market still does not possess them, directors can actually protect shareholders by making greenmail payments. However, this situation is not likely to happen very often since efficient markets will always anticipate any possible changes and consequently adjust the market price of the stock.<sup>105</sup>

When comparing the two theories, the evident self interest of the directors to preserve control of the company makes management entrenchment theory convincing.<sup>106</sup> As well shareholders' welfare theory has two problems. Firstly, the theory fails to clarify why directors, who consider that their company's stocks are undervalued, do not present their knowledge to the market before a takeover fight starts. (They definitely have the means to do so, they can release crucial information to the press, increase the dividends or by debt issuance) Secondly, it neglects to clarify why directors

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<sup>104</sup> Note, *Greenmail: Target Stock Repurchases and the Management- Entrenchment Hypothesis*, 98 Harv. L. Rev. 1045, 1049 (1985).

<sup>105</sup> Id. at 1050.

<sup>106</sup> Eric Engle, *Green with Envy? Greenmail is good! Rational Economic Responses to Greenmail in a Competitive Market for Capital and Managers*, DePaul Business & Commercial Law Journal, Vol. 5, 427, 430 (2007).

who do present their knowledge to the market are in most cases ineffective.<sup>107</sup>

Therefore, we are also more persuaded by management entrenchment theory.

### **III.2. Practice in the US**

The US practice provides us two solutions about the legality of greenmail: the permissive Delaware and prohibitive Californian solutions. The main difference between them is that the courts of these states each developed different concept of the business judgment rule<sup>108</sup>. When there is a dispute regarding a situation when the company repurchases its own stocks, the transaction will be frequently questioned in the court to stop the greenmail payment.<sup>109</sup>

#### **III.2.a. Pro-greenmail in Delaware**

The courts in Delaware developed an improved business judgment rule in stock repurchase matters.<sup>110</sup> The courts allow directors certain protection from the business judgment doctrine in cases of greenmail payments. Directors can prevent a takeover bid with selective stock repurchase. The act of repurchase is absolutely legal if the transaction is acted in good faith. The good faith means that the directors did not perform only or mainly, to keep their positions in the company.<sup>111</sup>

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<sup>107</sup> Note, *Greenmail: Target Stock Repurchases and the Management Entrenchment Hypothesis*, 98 Harv. L. Rev., 1045, 1050-51 (1985).

<sup>108</sup> "The business judgment rule is the standard by which directors of corporations are judged when they exercise their fiduciary duties in the course of an attempted takeover. Under this standard it is presumed that directors acted in a manner that is consistent with their fiduciary obligations to shareholders. Thus, any party contesting this presumption must conclusively demonstrate that their fiduciary duties were violated". Patrick A. Gaughan, *Mergers, Acquisitions and Corporate Restructuring*, p.91 (4<sup>th</sup> ed. 2007).

<sup>109</sup> Christopher J. Bellini, *the Evolution of Greenmail: A Lawyer's Dilemma in Corporate Representation*, 2 Geo. J. Legal Ethics 533, 541 (1988).

<sup>110</sup> Id.

<sup>111</sup> Roberta S. Karmel, *Greenmail the Control Premium and Shareholder Duty*, 48 Wash. & Lee L. Rev. 937, 949 (1991).

In *Kors v. Carey*<sup>112</sup> case, United Corp. was gradually acquiring 16% of Lehn Inc. stocks during a two year period after which they planned to complete a hostile takeover. The chairman of United's board, Mr. Green was famous by his methods of managing the company that were fundamentally different than Lehn's corporate governance strategies and policies.<sup>113</sup> Mr. Green business methods were concentrated to uncompromising marketing and making quick profits regardless the future consequences.<sup>114</sup> This was a clear signal that United was a threat for the future welfare of Lehn and its shareholders.<sup>115</sup> Directors of Lehn organized acquisition of United's shares through a stockbroker at a premium.<sup>116</sup> The court approved the act of directors since they found no evidence that the directors wanted to perpetuate themselves in the company. In addition the court stated that according to Mr. Green's reputation United was a clear threat to the Lehn shareholders' interests.<sup>117</sup>

In *Bennet v. Propp*<sup>118</sup>, the Delaware Supreme Court accepted *Kors v. Carey* decision although they found Noma's Chairman of the Board, Mr. Sadacca liable for repurchasing 22% of company's outstanding shares in order to thwart an expected hostile takeover from Textron.<sup>119</sup> Sadacca was notified about the intent of Textron to purchase 50% of Noma. He approved the repurchase of over 25% of Noma's publicly held stocks, informing the president of the company Mr. Ward but not notifying the rest

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<sup>112</sup> 39 Del. Ch. 47, 158 A.2d 136 (1960).

<sup>113</sup> Christopher J. Bellini, *the Evolution of Greenmail: A Lawyer's Dilemma in Corporate Representation*, 2 Geo. J. Legal Ethics 533, 542 (1988).

<sup>114</sup> Roberta S. Karmel, *Greenmail the Control Premium and Shareholder Duty*, 48 Wash. & Lee L. Rev. 937, 949 (1991).

<sup>115</sup> Christopher J. Bellini, *the Evolution of Greenmail: A Lawyer's Dilemma in Corporate Representation*, 2 Geo. J. Legal Ethics 533, 542 (1988).

<sup>116</sup> *Id.* at 541

<sup>117</sup> Roberta S. Karmel, *Greenmail the Control Premium and Shareholder Duty*, 48 Wash. & Lee L. Rev. 937, 949 (1991).

<sup>118</sup> 41 Del. Ch. 14, 187 A.2d 405 (1962).

<sup>119</sup> Roberta S. Karmel, *Greenmail the Control Premium and Shareholder Duty*, 48 Wash. & Lee L. Rev. 937, 949-50 (1991).

of the board about these repurchases until the company needed funds to close the deal.<sup>120</sup> The Court found that Sadacca's true motivation behind share repurchase was to retain the control of the company and that Textron's intention did not present a danger to Noma and its shareholders.<sup>121</sup> Both Sadacca and Ward were liable for using corporate funds to perpetuate themselves in the office.<sup>122</sup> The rest of directors were excused since they acted reasonably in an emergency situation.<sup>123</sup> Although Bennett case is not a greenmail case it is essential on the basis that it establishes a standard that usage of company's funds for stock repurchases are irregular if the members of the board (or directors) acted only or mainly to keep their positions in the company.<sup>124</sup> Moreover, the courts developed a principle that the directors have a burden of proof in order to validate that the stock repurchase was in the best interest of the company.<sup>125</sup>

In *Cheff v. Mathes*<sup>126</sup> case the Delaware Chancery Court tested "Bennett" standard, this case is regarded as a leading greenmail case in Delaware practice.<sup>127</sup> Holland Company was in business of producing furnaces, the company's sale policy was to employ retail sellers, which was a specific method in the whole industry. President of Motor Product, Mr. Maremont was analyzing the opportunity of merger between his company and Holland. After Maremont purchased 55,000 of Holland's stocks, Holland board started an investigation of Maremont who was considered as a

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<sup>120</sup> Christopher J. Bellini, *the Evolution of Greenmail: A Lawyer's Dilemma in Corporate Representation*, 2 Geo. J. Legal Ethics 533, 543 (1988).

<sup>121</sup> Id.

<sup>122</sup> 41 Del. Ch. 14, 187 A.2d 405,411 (1962).

<sup>123</sup> Christopher J. Bellini, *the Evolution of Greenmail: A Lawyer's Dilemma in Corporate Representation*, 2 Geo. J. Legal Ethics 533, 543 (1988).

<sup>124</sup> Roberta S. Karmel, *Greenmail the Control Premium and Shareholder Duty*, 48 Wash. & Lee L. Rev. 937, 950 (1991).

<sup>125</sup> Christopher J. Bellini, *the Evolution of Greenmail: A Lawyer's Dilemma in Corporate Representation*, 2 Geo. J. Legal Ethics 533, 543 (1988).

<sup>126</sup> 41 Del. Ch. 494,199 A.2d 548 (1964).

<sup>127</sup> Roberta S. Karmel, *Greenmail the Control Premium and Shareholder Duty*, 48 Wash. & Lee L. Rev. 937, 950 (1991).

liquidator of companies in the furnace industry. Only a month later Maremont requested a board position which was declined. As a result he started criticizing Holland's management policy and made threats to liquidate the company. As a procedure of the investigation Holland got an expert opinion from an independent legal consultant who advised the company to repurchase Maremont's shares at a premium price. Investigation showed Maremont's record of making quick profits by either selling or liquidating companies. Besides, financial reports of Motor Product Company revealed major net loss. Based on these facts, Holland's board granted the acquisition of Maremont's shares. They obtained a sum of 155,000 stocks from Maremont at a price above market. The court identified Board's conflict of interests and the directors had to prove that their actions were made in good faith. They satisfied the test by proving good faith and independent investigation. The court stated that the investigation had a crucial role by showing Maremont's reputation as a liquidator and his willingness to change Holland's retail sales policy which was considered as an important aspect of the company's corporate governance. The court decided that directors had reasonable grounds to consider Maremont was a danger to the company on the basis of a direct investigation and consultation with professional advisors.<sup>128</sup>

The disputes about premium price payments for stock repurchases mostly occur when there is a tender offer; *Unocal v. Mesa*<sup>129</sup> case proves this statement. In this case, Unocal had to make a self-tender offer for its own shares to beat a two-tier tender offer made by Mesa. If Mesa succeeded it would have taken the control of Unocal. Unocal excluded Mesa from the tender offer since they considered that Mesa offer was coercive

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<sup>128</sup> Christopher J. Bellini, *the Evolution of Greenmail: A Lawyer's Dilemma in Corporate Representation*, 2 Geo. J. Legal Ethics 533, 543-45 (1988).

<sup>129</sup> Del. Supr. 493 A. 2d 946 (1985).

and insufficient comparing the market price of the stocks. The Board of Unocal consisted of 6 inside and 8 outside directors. After Mesa made a tender offer for Unocal's outstanding stocks, Unocal's financial consultants concluded that Mesa offer was not adequate since it was lower than the market price; as well outside directors gave an advice to the Board to refuse the offer. The Board of Directors decided to continue with \$72 per share self-tender offer for 49 % of its outstanding shares against Mesa<sup>130</sup> two-tier tender offer for 37 % at \$54 per share. Under the previous practice, Delaware Supreme Court stated that a company can respond to a threat by repurchasing its own stocks selectively from its shareholders only if directors' primary goal was not to perpetuate themselves in the office. The board had to prove good faith investigation and reasonable grounds for the decisions they made. When the court decided that directors were performing in the best interest of shareholders, the next step was to see whether the directors' actions were reasonable comparing the threat. In Unocal case, Mesa coercive and inadequate two-tier tender offer, along with greenmail threat was a clear danger to the company and its shareholders. T. Boone Pickens, who was a famous greenmailer, was a creator of Mesa offer. To facilitate shareholder's protection Unocal's exclusion of Mesa from self tender was appropriate and required step. The court found that acts of Unocal board met Delaware developed business judgment rule. As a result court passed burden of proof to Mesa to demonstrate that the aim of the transaction was to keep directors in the office. Finally, Delaware Supreme

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<sup>130</sup> Mesa was already an owner of 13% of Unocal's shares.



Court decided that directors were not acting in self interest when deciding to make a self-tender offer since all friendly shareholders benefited from the transaction.<sup>131</sup>

### **III.2.b. Anti-greenmail in California**

Unlike Delaware rich history of greenmail, practice in California possesses only one essential case; Disney case that clarified the position of its courts about greenmail phenomenon. In Disney (*Heckmann v. Ahmanson*<sup>132</sup>) case, Steinberg Group purchased 12% of publicly held stocks of Walt Disney. The Disney board was informed by Steinberg that he is planning to make a tender offer. Directors of Disney made a decision to repurchase their own stocks from Steinberg at a premium. This transaction was a clear greenmail transaction where Steinberg made profits around \$60 million; in return Steinberg agreed to sign a standstill agreement under which he obliged himself not to acquire Disney shares anymore. Disney had to take a loan in order to get the money to finance the greenmail payment. When the Board announced the decision publicly it influenced the price of the stocks to fall. The court decided that directors could not make a decision about acquisition of their own shares, with company's funds, to keep the control of the company. Since directors were engaged in a transaction that was in their interest, they have to demonstrate that their actions were made in good faith from the perspective of the company and its shareholders. The statement of Disney attorneys that directors paid greenmail fee to prevent any damage to the company and its shareholders, from the Steinberg's two-tier tender offer, was the only fact that could prove directors' actual motives. However, the court did not found the statement justified

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<sup>131</sup> Christopher J. Bellini, *the Evolution of Greenmail: A Lawyer's Dilemma in Corporate Representation*, 2 Geo. J. Legal Ethics 533, 546-47 (1988).

<sup>132</sup> 168 Cal. App. 3d 119, 214 Cal. Rptr. 177 (1985).

to excuse them from liability.<sup>133</sup> The California Court of Appeal found that directors breached their fiduciary duty by paying greenmail to Steinberg, who was held by the court as an aider and abettor in the matter.<sup>134</sup>

### **III.3. Conclusion**

During the mid -1980s directors spent billions of company's money to acquire shares from corporate raiders and greenmailers who were a potential threat to their wellbeing in the company.<sup>135</sup> Their goal was to keep the control of the company and maintain getting high paychecks. Enhanced business judgment doctrine allowed them to pay greenmail, regardless the initial purpose of the doctrine to protect the shareholders.<sup>136</sup> However, the consequences of these events were that the US Congress passed a federal law that imposed 50% tax on greenmail gains which was a direct basis why greenmail almost totally disappeared from the US practice.<sup>137</sup>

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<sup>133</sup> Christopher J. Bellini, *the Evolution of Greenmail: A Lawyer's Dilemma in Corporate Representation*, 2 Geo. J. Legal Ethics 533, 551-52 (1988).

<sup>134</sup> Roberta S. Karmel, *Greenmail the Control Premium and Shareholder Duty*, 48 Wash. & Lee L. Rev. 937, 954 (1991).

<sup>135</sup> Note, *Greenmail: Target Stock Repurchases and the Management Entrenchment Hypothesis*, 98 Harv. L. Rev., 1045, 1065 (1985).

<sup>136</sup> Id.

<sup>137</sup> Patrick A. Gaughan, *Mergers, Acquisitions and Corporate Restructuring*, p.202 (4<sup>th</sup> ed. 2007).

## Chapter IV. Analysis and recommendations for Serbian Emerging Capital Market

### ***IV.1. Analysis-Is greenmail possible in Serbia?***

Before evaluating possible recommendations for the Serbian legal system concerning greenmail we need to look into Serbian legislation and see whether the US greenmail phenomenon is possible or not under the new company law<sup>138</sup>.

Greenmail is a consideration paid for repurchase of company's own shares at a premium by the Board of directors in order to defend itself against hostile takeover from "anyone who makes or threatens to make a tender offer"<sup>139</sup>. Payment is considered greenmail only if the offer is not available to all shareholders.<sup>140</sup> In return greenmailer agrees not to use the same tactic again.<sup>141</sup>

We have to look at the main characteristics of greenmail in order to determine whether it is possible in Serbia or not. The key features of greenmail are: 1) Company's acquisition of its own shares; can a company repurchase its own shares and if so under what conditions? 2) Premium price; can a company pay a price, above the market to obtain its own shares from the shareholders? 3) Target share repurchase; is it possible to acquire shares only from certain shareholder and not to make a general offer to every shareholder? We will examine and answer these uncertainties:

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<sup>138</sup> *Company Law (Zakon o privrednim drustvima)*, Official Gazette of the Republic of Serbia No. 36/2011 and 99/2011.

<sup>139</sup> Patrick A. Gaughan, *Mergers, Acquisitions and Corporate Restructuring*, p.202 (4<sup>th</sup> ed. 2007).

<sup>140</sup> Id.

<sup>141</sup> Christopher J. Bellini, *The Evolution of Greenmail: A Lawyer's Dilemma in Corporate Representation*, 2 Geo. J. Legal Ethics, 533, 539 (1988).

#### IV.1.a. Company's acquisition of its own shares

In Serbia, according to the Article 282 of the new company law<sup>142</sup>, a company may acquire its own shares from their shareholders, directly or indirectly through a third person. Naturally, there are certain conditions that should be satisfied: 1) The shareholders' assembly has to approve the repurchase; 2) the acquisition of its own shares cannot render the company insolvent; 3) shares that the company is obtaining have to be paid in full; 4) a joint-stock company cannot acquire more than 10% of all its shares including the shares that they have already repurchased.<sup>143</sup>

The shareholders assembly has to determine: 1) the maximum number of shares that the company is acquiring; 2) the time limit until the company can repurchase its own shares (cannot be more than 2 years); 3) minimum and maximum price that the company is prepared to pay.<sup>144</sup> In some special cases the Board of directors (one tier system)<sup>145</sup> or if the company is established as a two tier system the Supervisory Board can approve the acquisition of the company's own shares without the shareholders' assembly.<sup>146</sup>

#### IV.1.b. Premium price

The Serbian Company Law did not specifically state how the price should be determined when a company decides to repurchase its own shares; the company is free to decide the price they are prepared to offer to the shareholders or they can establish a

<sup>142</sup> In May 2011, the Serbian parliament adopted a new company law, which took effect on 1 February 2012.

<sup>143</sup> *Company Law (Zakon o privrednim društvima)*, art. 282 (2), Official Gazette of the Republic of Serbia No. 36/2011 and 99/2011.

<sup>144</sup> Id. in art. 282 (3).

<sup>145</sup> The new Serbian Company law provides an option; companies can choose the corporate governance structure, either one-tier system or two-tier system. *Company Law (Zakon o privrednim društvima)*, art. 198, Official Gazette of the Republic of Serbia, No. 36/2011 and 99/2011.

<sup>146</sup> Id. in art. 282 (4).

system that will determine the price.<sup>147</sup> Firstly, the shareholders' assembly has to decide whether they are going to approve the acquisition or not.<sup>148</sup> If they do, they have to make a decision stating the lowest-guaranteed and the highest price that they are willing to pay.<sup>149</sup> This is just a preliminary procedure, under the shareholders' decision the Board of Directors (one-tier system) or Executive Board (two-tier system) is obliged to make an official offer to the shareholders that will contain the exact price for shares that the company wants to repurchase.<sup>150</sup> Thus, we can conclude that the company is allowed to pay a premium price to the shareholders when acquiring its own shares.

#### **IV.1.c. Target share repurchase**

Greenmail payment is a type of target share repurchase since the offer is not available to all shareholders.<sup>151</sup> Payment is regarded as greenmail only if the repurchase offer is not available to every shareholder.<sup>152</sup>

According to Serbian Company Law when a company decides to repurchase its own shares it has to make a general offer to all shareholders without any discrimination.<sup>153</sup> Thus it seems to us, that greenmail payments are not likely to occur in Serbia as a defense mechanism against hostile takeovers. The conditions that the Law prescribes for companies (that want to repurchase their own shares from a shareholder who is making or threatening to make a tender offer) make greenmail simply legally impossible.

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<sup>147</sup> Id. in art. 285 (2) (2).

<sup>148</sup> Id. in art. 282 (2) (1).

<sup>149</sup> Id. in art. 282 (3) (3).

<sup>150</sup> Id. in art. 285 (2) (2).

<sup>151</sup> Bhagat and Jefferis, *The Causes and Consequences of Takeover Defense: Evidence from Greenmail*, *Journal of Corporate Finance* 1, 201, 202, (1994).

<sup>152</sup> Patrick A. Gaughan; *Mergers, Acquisitions and Corporate Restructuring*; p.202 (4<sup>th</sup> ed. 2007).

<sup>153</sup> *Company Law (Zakon o privrednim drustvima)*, art. 285 (1), Official Gazette of the Republic of Serbia No. 36/2011 and 99/2011.

If the Law changes in the future, allowing companies target share repurchases, it would definitely lead to a birth of greenmail phenomenon in Serbian capital market. In that case we have to be ready to confront any problems that greenmail phenomenon can provoke.

#### ***IV.2. Recommendations for future Serbian legislation***

Since Serbian law restricts target share repurchases it is hard to believe that nowadays greenmail can pop out in Serbian practice. However, in our opinion it is important to suggest a model law solution for the future Serbian legislation that will recommend how greenmail could be regulated. Our goal is to suggest what lessons should be taken into account from the US if the time comes for greenmail to be regulated in Serbia. We will clarify main legal questions:

##### **IV.2.a. Legality of greenmail**

First question is regarding legality of greenmail. Whether greenmail payments should be prohibited by law or not? The US practice provides us two solutions: the permissive Delaware and prohibitive Californian solutions. As far as the first is concerned, in 1984 the Delaware Chancery Court<sup>154</sup> ruled that Texaco payment of 1.3 billion \$ to Bass Brothers was a reasonable price for eliminating possible future threat.<sup>155</sup> As mentioned, in California greenmail is illegal. In Disney case<sup>156</sup>, shareholders of Disney sued the company on the basis of greenmail payment to Steinberg. The California Court of Appeal found that directors breached their fiduciary duty by

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<sup>154</sup> See *Good v. Texaco, Inc.*, No. 7501 (Del. Ch. February 19, 1985), aff'd sub nom. *Polk v. Good*, 507 A.2d 531 (Del.1986).

<sup>155</sup> Patrick A. Gaughan, *Mergers, Acquisitions and Corporate Restructuring*, p.199 (4<sup>th</sup> ed. 2007).

<sup>156</sup> *Heckmann v. Ahmanson*, 168 Cal. App. 3d 119, 214 Cal. Rptr. 177(1985).

paying greenmail to Steinberg, who was held by the court as an aider and abettor in the matter.<sup>157</sup>

We reckon that if the time comes for Serbia to regulate greenmail, it should be definitely allowed since it is a constant threat to an inefficient management<sup>158</sup>, it reallocates capital from inefficient to efficient companies<sup>159</sup> and it can also attract a more generous offer<sup>160</sup>. However, greenmail should be strictly regulated in order to prevent any negative effect that may affect the Serbian capital market. Greenmail presents a direct impact on shareholder's welfare by influencing value of their stocks to decrease.<sup>161</sup> Besides, sometimes there is a conflict of interests when directors tend to pay greenmail only to keep their positions in the company not considering the best interest of the company.<sup>162</sup>

Nowadays in Serbia, according to the 2012 Company Law, greenmail payments are impossible since the share repurchases are allowed though only if the offer is available to every shareholder.<sup>163</sup> Nevertheless, it does not change the fact that maybe one day greenmail will be a reality in the Serbian capital market thus we have to be ready for the possible changes.

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<sup>157</sup> Roberta S. Karmel, *Greenmail the Control Premium and Shareholder Duty*, 48 Wash. & Lee L. Rev. 937, 954 (1991).

<sup>158</sup> Eric Engle, *Green with Envy? Greenmail is good! Rational Economic Responses to Greenmail in a Competitive Market for Capital and Managers*, DePaul Business & Commercial Law Journal, Vol. 5, 427, 431 (2007).

<sup>159</sup> Id. at 435

<sup>160</sup> See page 14

<sup>161</sup> David Manry, David Stangeland, *Greenmail-Brief history*, Stanford Journal of Law, 217, 221 (2001).

<sup>162</sup> Note, *Greenmail: Target Stock Repurchases and the Management-Entrenchment Hypothesis*, 98 Harv. L. Rev., 1045, 1048 (1985).

<sup>163</sup> *Company Law (Zakon o privrednim drustvima)*, art. 285 (1), Official Gazette of the Republic of Serbia, No. 36/2011 and 99/2011.

#### **IV.2.b. Taxation for greenmail payments**

Second question is whether gains by greenmail payments should be taxed or not? And if they are taxed; what is the rate? In the US federal tax law (Excise Tax on Greenmail) imposed a 50% tax on greenmail gains.<sup>164</sup> This was one of the reasons which resulted that greenmail practically disappeared from the US takeover scene.<sup>165</sup>

There is no doubt that greenmail should be taxed. Everything depends on what aims the legislators pursue. If they think that greenmail have negative effects on the market they will impose a high tax and thus make greenmail payments unattractive. Or if there is a general opinion that greenmail is good the legislator just need to impose low taxes.

Eric Engle suggested that it is better to reduce greenmail tax and allow greenmail payments to be considered as a necessary business expense and allow greenmail payments as a regular income. In his view this would be a positive reform that would ensure efficient market and good economic performance.<sup>166</sup> Our opinion is that greenmail should be taxed separately, but unlike in the US it should be increasingly less than 50%; still the percentage should be high enough to prevent any misuses. Everything depends on what legislators want to achieve.

#### **IV.2.c. Shareholders' approval for greenmail payments**

The third question concerns approval of nonparticipating shareholders for the greenmail payments. In the US, the Board of Directors makes the decision whether they

<sup>164</sup> 26 U.S.C. § 5881(b) (1988).

<sup>165</sup> Patrick A. Gaughan; *Mergers, Acquisitions and Corporate Restructuring*; p.202 (4<sup>th</sup> ed. 2007).

<sup>166</sup> Eric Engle, Green with Envy? Greenmail is good! Rational Economic Responses to Greenmail in a Competitive Market for Capital and Managers, *DePaul Business & Commercial Law Journal*, Vol. 5, 427, 436 (2007).



are going to pay greenmail or not, they do not need a shareholder's approval.<sup>167</sup> This is one of the reasons why greenmail is so controversial. In 1983 Securities and Exchange Commission (SEC) made a recommendation that prohibited company's acquisition of its own shares at a premium price held by the shareholder less than two years without shareholders' approval.<sup>168</sup> However, this recommendation never became legally binding since the corporation started adopting antigreenmail charter amendments and the Congress already discouraged greenmail via federal tax law.<sup>169</sup> Thus there was no need to discourage greenmail anymore.

In Serbia, company's major decisions are made by shareholder's assembly and the certain percentage of shareholders is required for the decision to be authorized. Our problem is whether approval of greenmail payments should be regulated by law (stating the exact percentage of shareholders' votes required) or it should be left for every company to freely regulate these situations by charter. "Within the logic of capitalist competition and freedom of contract it is clear that the principal response to greenmail should be made by the company and not the state".<sup>170</sup>

There are a couple of solutions. A corporate charter can prohibit greenmail payments without approval of nonparticipating shareholders;<sup>171</sup> by simple majority or by one of the qualified majorities. Antigreenmail charter amendments limit the possibility of a target company to repurchase its own shares from a greenmailer at a premium

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<sup>167</sup> See Roberta S. Karmel, *Greenmail the Control Premium and Shareholder Duty*, 48 Wash. & Lee L. Rev. 937, 938 (1991).

<sup>168</sup> *Id.* at 940-41.

<sup>169</sup> *Id.* at 942.

<sup>170</sup> Eric Engle, *Green with Envy? Greenmail is good! Rational Economic Responses to Greenmail in a Competitive Market for Capital and Managers*, DePaul Business & Commercial Law Journal, Vol. 5, 427, 433 (2007).

<sup>171</sup> Patrick A. Gaughan; *Mergers, Acquisitions and Corporate Restructuring*, p.191 (4<sup>th</sup> ed. 2007).

price.<sup>172</sup> Some corporate charters can state that there is no need for the shareholders' approval if the payment is in the amount of the market price.<sup>173</sup> (Although that means that those payments are not greenmail payments, since the price paid is not at a premium.)

Nonetheless, greenmail can pose a lot of danger to an emerging market since the mechanism is new and the market is not familiar with its negative effects. Our opinion is that for the first period the law should impose a super majority vote required to allow greenmail payments.

#### **IV.2.d. Conflict of interest**

One of the biggest legal questions concerning greenmail payments is what the true interests of the target company are. Whether directors of the company when paying greenmail are looking for the best interest of the company or they just want to perpetuate themselves in the office.<sup>174</sup> Although there is a general opinion that corporate raiders and hostile takeovers have negative effects it does not necessarily mean that they have always a bad impact on the target company. Sometimes an acquirer can invest in a target company and make it more financially stable. So what happens in the case when the management is paying greenmail saying that it is in the best interest of the company but in fact they are protecting themselves by keeping their jobs and retaining millions of dollars salaries?

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<sup>172</sup> Id.

<sup>173</sup> Id.

<sup>174</sup> See *Polk v. Good*, 507 A.2d 531, 536-37 (Del. 1986); *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 955 (Del. 1985).

As we previously mentioned in Chapter III, Management entrenchment theory<sup>175</sup> is the most convincing one since there is an evident self interest of management to keep their jobs.<sup>176</sup> Our opinion is that this theory should be also governing in the future Serbian law (if greenmail occurs at all) when courts have to decide whether greenmail payments are allowed or not. They have to take into consideration all the facts and details that lead to a greenmail payment. Unlike in the US where Board of Directors decides whether they are going to pay greenmail in Serbia shareholder's assembly has that privilege. Therefore in Serbia we would not have a management entrenchment problem since management does not have any power to decide whether they will protect their own interest by paying greenmail.

However, if in the future management would be in a position to decide on their own about making greenmail payments, the law should establish a test (similar to Unocal standard<sup>177</sup>) that the courts will use to determine the motives for payments (best interest of the company or self interest).

### **IV.3. Conclusion**

Different corporate policy choice in the US and Serbian system resulted that greenmail phenomenon is not likely to occur in Serbia.<sup>178</sup> In the US, Board of directors can make greenmail payments for stock repurchases, since they have the freedom of

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<sup>175</sup> The management entrenchment hypothesis holds that directors make greenmail payments to keep their jobs. Eric Engle, *Green with Envy? Greenmail is good! Rational Economic Responses to Greenmail in a Competitive Market for Capital and Managers*, DePaul Business & Commercial Law Journal, Vol. 5, 427, 429 (2007).

<sup>176</sup> *Id.* at 430.

<sup>177</sup> Unocal standard is a two part test that determines whether the decision made by the directors was in a good faith and in the best interest of the company: 1) Reasonableness test: The directors have to prove that their actions were reasonable comparing the danger to the company. 2) Proportionality test. The directors must also prove that their defensive actions were in proportion to the perceived danger to the company. Patrick A. Gaughan, *Mergers, Acquisitions and Corporate Restructuring*, p.91 (4<sup>th</sup> ed. 2007).

<sup>178</sup> See Vuk Radovic, *Mere Odbrane Akcionarskog Drustva od Preuzimanja Kontrole*, p. 485 (2008).

decision making.<sup>179</sup> Unlike in Serbia, where management has the duty to stay neutral during the takeover procedure, directors in America can take necessary actions to prevent a hostile takeover.<sup>180</sup> Serbian neutrality principle forbids the management to defend the company against hostile takeovers by repurchasing stocks.<sup>181</sup> In Serbia, shareholders assembly is on the top of decision making pyramid, and there is no tendency of possible corporate policy change. The only tendency is developing already existing defense measures. The shareholders assembly can defend the company by repurchasing shares but the law prohibits target share repurchases so even in that case greenmail is not likely to occur.<sup>182</sup> However some questions still remain open, although directors have the obligation to stay neutral during the takeover procedure, they have a direct influence on shareholders assembly since they are the ones who are scheduling meetings of shareholders assembly.<sup>183</sup> Since on a takeover scene participants have to react very fast, directors can have a direct impact on the final outcome of the takeover.

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<sup>179</sup> Id. at 133.

<sup>180</sup> Id. at 199.

<sup>181</sup> Id. at 485.

<sup>182</sup> Id. at 486-87.

<sup>183</sup> *Company Law (Zakon o privrednim drustvima)*, art. 202 Official Gazette of the Republic of Serbia, No. 36/2011 and 99/2011.

## Conclusion

Greenmail became popular in the US in the 1980's, when investors found out that it is a fast and easy way to make profits without taking control of the company.<sup>184</sup> The US scholars who analyzed greenmail divided in two opposing groups. One group supports the opinion that greenmail has a positive influence on economy because it is a threat to an ineffective management.<sup>185</sup> The other group states that greenmail has negative effects as it presents a direct impact on shareholder's welfare.<sup>186</sup> From our point of view, greenmail has both good and bad elements and it would be impossible to determine whether to take one or the other position. Practice in the US has proved that greenmail can be abused in various ways, usually by the directors who spent billions of company's money for greenmail payments to retain their positions.<sup>187</sup> Even though 'negative effects theory' seems more persuasive there are also some very good arguments that their opponents are suggesting. Therefore, greenmail should be allowed but precisely regulated since it has both positive and negative aspects. In the US after years of greenmail practice, the government realized that it should do something since there was a public believe that greenmail is negative for the entire US economy, the results of these events were that the US Congress passed a federal law that imposed

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<sup>184</sup> Eric Engle, *Green with Envy? Greenmail is good! Rational Economic Responses to Greenmail in a Competitive Market for Capital and Managers*, DePaul Business & Commercial Law Journal, Vol. 5, 427, 428 (2007).

<sup>185</sup> Id. at 431.

<sup>186</sup> David Manry, David Stangeland, *Greenmail-Brief history*, Stanford Journal of Law, 217, 221 (2001).

<sup>187</sup> Note, *Greenmail: Target Stock Repurchases and the Management-Entrenchment Hypothesis*, 98 Harv. L. Rev., 1045, 1048 (1985).

50% tax on greenmail gains which was a one of the reasons why greenmail almost totally disappeared from the US takeover scene.<sup>188</sup>

Different corporate policy choices between the US and Serbia and prohibitive Serbian legislation resulted that greenmail concept is not likely to occur in Serbia.<sup>189</sup> In Serbia, management has the duty to stay neutral during the takeover procedure and there is no tendency of possible corporate policy change.<sup>190</sup> As well the law is pretty clear about the prohibition of target share repurchases, but the practice is always more inventive than the regulations so there is a question what can happen in forthcoming years? However, if the law changes in the future allowing companies target share repurchases, it would definitely lead to a birth of greenmail phenomenon in Serbian capital market.

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<sup>188</sup> Patrick A. Gaughan, *Mergers, Acquisitions and Corporate Restructuring*, p.202 (4<sup>th</sup> ed. 2007).

<sup>189</sup> See Vuk Radovic, *Mere Odbrane Akcionarskog Drustva od Preuzimanja Kontrole*, p.485 (2008).

<sup>190</sup> Id. at 199.

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