Competition and Corporate Law: A Dialogue—The Bangor Punta and Santa Fe Opinions

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In this imaginary dialogue between the economist and the lawyer, both attempt to analyze the recent decisions of the U.S. Supreme Court, applying the norms of their respective disciplines, and seek to derive a principle that would assist in formulating a course of action for the future. To those brought up in the classic tradition of Anglo-American law, the parameters employed to reach a decision in these cases may not be entirely intelligible. However, the determination of the applicable principle in the milieu of the current shift of the frontiers of law needs not only a new perspective, but a judicial calculus of new and complex variables involving critical infinitesimals, and one can discern both in the majority opinion and the dissent a groping for the essentials of the many elements that would count in yielding a just resolution. In the evaluation of such a resolution, the considerations that emerge from the dialogue should be of substantial help both to the judge and the practitioner.

The Bangor Punta Opinion: An Interdisciplinary Conversation

Q: Now that the U.S. Supreme Court has decided Bangor Punta,¹ I trust you legal academics will pay more attention to econo-

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mists' analyses of antitrust opinions. Admittedly, the models we construct may not be very successful in explaining what happens to concepts such as market power in any given opinion. Still, if the general issue is that of statutory interpretation, I fail to see why our analyses of the Sherman and Clayton Acts are not fully as useful as anything you can construct to explain why the Court regarded the tender offers regulated by Section 14(e) of the Securities Exchange Act of 1934 as somehow fundamentally different from the proxy solicitations regulated by Section 14(a) of that same statute.

A: I agree that the parallel you suggest exists, but I think the nuance that separates the majority and dissent in Bangor Punta is also what accounts for your difficulty in analyzing decisions interpreting the Sherman and Clayton Acts. One way of attempting to define that nuance is to distinguish between market concentration, which I would call an economic concept, and market power, which I would designate as political. In this sense, I think that your difficulty with antitrust decisions is that they interpret the Sherman and Clayton Acts in terms of the dangers of market power, rather than concentration.

Q: If you mean simply that economics prefers to deal with concepts defined in mathematical terms, I understand your distinction between economics and politics; otherwise, I fear you are defining a nuance that eludes me.

A: Since we are dealing with the question of ascertaining the meaning of the rules mandated by the legislature, perhaps it will help to point out that what I am calling economics focuses on the creation of general rules. Economic analysis postulates identical individuals and attempts to ascertain the most likely result of their interaction. Politics, on the other hand, because it focuses on the application of rules, rather than on their creation, postulates that a basis for interaction exists and analyzes the ways in which interactions that can be characterized as similar nevertheless impact differently on different individuals.

Politics, in this sense, postulates community and investigates what compromises the individuals comprising that community either make or are conditioned to accept, whereas economics postulates individuals and investigates the nature of the community produced by their interactions. What I think you find confusing in antitrust decisions is that their rationale is based not on the concentration demonstrated by the evidence, but on the likely effect of that degree of economic concentration in the particular factual setting presented. Thus, the significance of a given share is obviously crucially affected by the market shares held by present competitors, and the likelihood of the appearance of more competitors in the future.

Q: I think I understand your analysis but fear I find it rhetorical, rather than analytic. We are indeed dealing with a legal question, but I feel my agreement with the dissent's reading of Section 14 is based on legal, rather than what you designate economic, analysis. In particular, I think that what the dissent demonstrates is that Cort v. Ash,2 in fact, supports its position. What I cannot accept is what I assume your politics/economics distinction forces you to argue; that the precedential significance of Cort v. Ash is vitiated by the fact that the Court, in that case, explicitly noted that "our conclusion ... pretermits any occasion for addressing the question of respondent's standing as a citizen and voter to maintain this action for respondent seeks damages only derivatively as stockholder."3

A: No, I do not think that that statement vitiates the relevance of Cort; it's simply that I read precedent less rigidly than you. As a result, it seems to me important that Cort is not the only precedent about whose meaning the majority and dissent disagree. But I think the more fundamental divergence between legal and economic analysis is that I refuse to assume that the precedent contained in a judicial opinion necessarily has the same significance when applied to a different factual context. For me, in short, law is continually defining its categories by ascertaining whether or not given factual situations fit within them, rather than continually mapping the boundaries of the

3 Id.
categories in terms of which the factual situations being treated are defined.

Q: Even if I accepted the latter procedure as characteristic of economic analysis, I don't understand how what you designate as legal analysis would help us understand the divergent approaches of the majority and dissent to the factual situation adjudicated in the Bangor Punta opinion.

A: What I would focus on is note 21 in the majority opinion:

"The dissent emphasizes that Borak involved a derivative suit brought on behalf of the corporation, in addition to the shareholder's direct cause of action. Since corporations were not the primary beneficiaries of §14(a)—the proxy provision involved in Borak—the dissent concludes that Borak itself fails to meet the 'especial class' requirement articulated by our subsequent decision in Cort v. Ash... But this is a misreading of Borak; there, the Court observed that deceptive proxy solicitations violative of §14(a) injure the corporation in the following sense:

"The damage suffered results not from the deceit practiced on [the individual shareholder] alone but rather from the deceit practiced on the stockholders as a group." 377 U.S., at 432.

"The Borak Court was thus focusing on all stockholders—the owners of the corporation—as the beneficiaries of §14(a). Stockholders as a class therefore plainly constituted the 'especial class' for which the proxy provisions were enacted. This reading of Borak compports with the statement of the question presented in that case:

"We consider only the question of whether §27 of the Act authorizes a federal cause of action for rescission or damages to a corporate stockholder with respect to a consummated merger... " Id., at 428. (Emphasis supplied.)"

Q: I don't understand the distinction between stockholders "as a class" and stockholders individually, in the context of the interpretation of Section 14.

A: Perhaps the best way to put it is that the majority views Section 14(a) as protecting shareholders "as a class" in the sense that the concern about misinformation is injury to the corporation. Since the corporation cannot itself be injured, however, what is being protected is the process in terms of which corporate decisions are made, and the individual shareholder recovers damages, not because he is injured in the amount of the damages, but because he participates in the process.

As the majority views 14(e), however, the shareholder is not a participant in a process, but an individual decision-maker benefiting from competition, who is assisted by the provisions of Section 14(e) in the sense that they ensure that he has access to all relevant information.

Q: If what 14(e) relies on to benefit the shareholder is competition, how do you answer the dissent's argument that "once one recognizes that Congress intended to rely heavily on private litigation as a method of implementing the statute, it seems equally clear that Congress would not exclude the persons most interested in effective enforcement from the class authorized to enforce the new law... It is fundamental in our adversary system that the selfish interest of the litigant provides the best guarantee that a claim will be effectively asserted."

A: The general answer is that the competition I was referring to is political, rather than economic, and that the postulation of community in this case entails the assumption that the tender offerors would not both continue to solicit tenders unless the terms of their competition were defined by mutually acceptable rules. The more precise response is that the majority found it "likely... that shareholders may be prejudiced because some tender offers may never be made if there is a possibility of massive damage claims for what courts subsequently hold to be an actionable violation of §14(e)."

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4 See note 1 supra, at 926 at 942: "We are concerned with the investor who today is just a pawn in a form of industrial warfare."

5 Note 1 supra, at 926 at 959, 960 (footnote omitted).

6 Id. at 948 (footnote omitted).
Q: Insofar as I understand your definition of political competition, it seems to me that you are once again substituting rhetoric for analysis, since so far as I can tell, you are defining a situation in which the nature of the governing rules simply could not be ascertained except by the participants. Are you arguing that that is the nature of political competition sanctioned by corporate law?

A: If you accept the proposition that *Rosenfeld v. Fairchild Engine and Airplane Corp.* was a conscious attempt to delineate the common law of corporate political competition, I would argue that, in the absence of legislation, the nature of the rules governing that competition is precisely what the competitors find mutually agreeable. Thus, while the dissent in that case effectively demonstrates the impossibility—in practical terms—of a distinction between “personal power” and “policy” contests, it fails effectively to respond to incumbent management’s claim on corporate resources at least for the purpose of making the contest an equal one in financial terms. As a result, the decision in that case appears to be restricted to a ruling on the technical question of allocating burden of proof in connection with corporate campaign expenditures, although the final comment in the concurring opinion leaves open the possibility that there may indeed exist situations in which campaign expenditures would be found to be “intrinsically unlawful.”

Q: I have two difficulties with the claim that the *Rosenfeld* case is relevant to the situation we are considering. First, what we are concerned about is precisely the fact that the legislature has acted. As a result, I think that any precedent that is relevant to the question of ascertaining legislative intent cannot be read to stand for a proposition as narrow as one involving a failure to meet a burden of proof.

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8 *Id.* at 291, 295, 299.
9 *Id.* at 291, 293.
10 *Id.* at 291, 293, 294.
11 *Id.* at 291, 293, 295.
12 Note 1 *supra*, at 926 at 953.
14 Note 1 *supra*, at 926 at 962 n.18.
15 *Id.* at 948 n.25.
present facts, and political models as descriptions of reality that leave to the future the determination of what it is that the terms used have, in fact, represented.

The Santa Fe Opinion: Concerning the Cost of Corporate Law

Q: If precedent is the basis for law, I do not understand how the Santa Fe opinion\(^{17}\) makes any contribution. The penultimate footnote makes clear that the decision contemplates the possibility that divergent results will be reached depending on which state's law is found to be applicable.\(^{18}\) Yet worse, however, the last citation in the last footnote\(^ {19}\) is to a law-review piece\(^ {20}\) cited for the proposition that "traditional doctrines of substantive corporate law [can be applied to] 'going private' transactions . . . ."\(^ {21}\) What the opinion fails to note is that that piece offered a solution in that it specifically noted that "the misappropriation of the ability to go public again can be easily removed from going private transactions, through the issuance of warrant . . . ."\(^ {22}\)

A: I admit that the possibility of divergent results is a price we pay for living in a federal society. The question, of course, is whether it is a necessary one in corporate law. I would note only that the very law-review piece you cite was careful to point out that the solution it was offering was to a specific problem [the misappropriation of the ability to go public again] and that it was also careful to "contrast [that problem] to [the] fiduciary issues\(^ {23}\) dealt with in the cases surveyed in the Santa Fe opinion.

Q: If your point is that any particular solution to a problem does not necessarily cover all the ways in which that problem may be manifested in the future, I, of course, agree with you. In terms of our argument about law, however, I fail to see what effect this agreement has on the issue of the choice between the economic and political models of precedent. Naturally, I agree that a statute enacting such a solution would not eliminate the need for litigation but want to point out that the same footnote citing the law-review piece we have been discussing also cites an article by William Cary\(^ {24}\) that explicitly argues that the inadequacies of the Delaware statute are not compensated for by the "relative ease of entry into Delaware courts for suits against corporate directors."\(^ {25}\)

A: As usual, our disagreement seems to me more fundamental than the one to which you are responding. Thus, the question that separates us is not, I think, the difference between rules contained in statutes or enunciated by courts, but rather the extent to which the articulation of any solution to a given problem can serve as a precedent for future situations. Specifically in terms of federalism and corporate law, it seems to me significant that in Essex Universal Corp. v. Yates,\(^ {26}\) where the issue is precisely the percentage of stock ownership necessary to bring into play the fiduciary standards delineated in Perlman v. Feldmann,\(^ {27}\) Judge Friendly, after noting that "there is hardly enough New York authority for a really informed prediction what the New York Court of Appeals would decide on the facts here presented . . . yet too much for us to have the freedom used to good effect in Perlman v. Feldmann,"\(^ {28}\) concludes that "the development of doctrine\(^ {29}\) concerning "a question of New York law, of enormous importance to all New York corporations and their stockholders,"\(^ {30}\) should be "[left] . . . to the

\(^{17}\) Santa Fe Indus. v. Green, 97 S. Ct. 1292 (1977).
\(^{18}\) Id. at 1303-1304 n.16.
\(^{19}\) Id. at 1304 n.17.
\(^{21}\) Note 17 supra, at 1304 n.17.
\(^{22}\) 84 Yale L.J. 893, 931 (1974).
\(^{23}\) Id.
\(^{25}\) Id. at 686.
\(^{26}\) 305 F.2d 572 (2d Cir. 1962).
\(^{27}\) 219 F.2d 173 (2d Cir. 1955).
\(^{28}\) 305 F.2d 572, 580 (2d Cir. 1962).
\(^{29}\) Id. at 582.
\(^{30}\) Id. at 580.
State, which has primary concern for it." 31 Strikingly, moreover, even where a state does develop doctrine in connection with fiduciary standards as in Diamond v. Oreamuno, 32 it is by no means certain that a federal court attempting to apply that doctrine may not itself underestimate the likelihood of a divergent result being reached in another jurisdiction.22

Q: Accepting what you have described as a price necessarily exacted by the diversity made possible by a federal system, I fail to see why that argues against the possibility of solving a corporate law problem by means of promulgation of a rule whose initial formulation is both detailed and comprehensive and that also contains the procedures necessary to keep it up to date.

A: Even assuming, though I think it is an assumption contrary to fact, that our society would be willing to bear the costs required by such a rule, I think it impossible to draft the type of rule you describe when the subject to which it applies is United States corporations.

Q: I, of course, agree with you that no such rule could be drafted if it were applicable to the corner grocery store, as well as to General Motors, but assuming it were restricted to that relatively small group of corporations whose power is causing a good deal of public concern, what are the costs whose burden you believe society would be unwilling to shoulder?

A: In the absence of an adversary system of litigation, the bureaucratic costs of keeping a complex and detailed set of rules up to date, and I cite the Internal Revenue Code as an example of the phenomenon I am attempting to avoid. If we assume litigation, the cost, of course, would be borne primarily by the corporations to which the rule was applied, but I think our experience under the Public Utility Holding Company Act is persuasive that any such process would be both expensive and time-consuming.

31 Id. at 582.
33 See Schein v. Chasen, 519 F.2d 453 (2d Cir. 1975).

Q: Granted that the process would not be cheap, if you grant only that the problem is regarded as sufficiently serious, and that the costs involved in the initial formulation of the rule are ones that the society is willing to bear, what are your objections to imposing even substantial additional costs on a small group of United States corporations?

A: I think the easiest way to answer that question is to indicate that there is a good deal about the operation of the Federal Elections Commission and the statute under which it operates that I find disturbing, and it is precisely those phenomena that make me prefer that we attempt to continue to regulate conduct by following a political, rather than economic, model, and bear the costs entailed in living with the uncertainty resulting from accepting as law the rule embodied in Rosenfeld v. Fairchild Engine and Airplane Corp.34

34 Note 7 supra.