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Charles M. Yablon
Benjamin N. Cardozo School of Law, yablon@yu.edu

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CORPORATE CULTURE IN TAKEOVERS

*Charles M. Yablon**

There is an intriguing similarity between the longstanding debate over the role played by corporate culture in takeovers and the even longer standing debate over the role played by God in human affairs. By corporate culture, I mean that set of ineffable and hard to quantify variables like compatibility of management styles, strategic fit, and complementary approaches to employee autonomy and decisionmaking structures which some assert are crucial to the success or failure of corporate takeovers, but which others believe involve nothing more than self-justifying obfuscation by incumbent management.

As in other matters of faith, there are three basic positions in the debate. To believers, corporate culture, like the nature of Divinity, is a subject worthy of intense study,[1] and deference is owed to those, like the incumbent boards and their management consultants, who are best able to understand its workings and perceive its effects.[2]

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* Professor of Law, Benjamin N. Cardozo School of Law. I want to thank the Samuel and Ronnie Heyman Center on Corporate Governance for its support, my colleague Larry Cunningham for both conceiving and organizing this symposium, and all of the participants at the conference for laughing at the right places.

1 Among students of management, there is little doubt that integration of corporate culture is a major determinant of the success of an acquisition. *See generally* TERRENCE E. DEAL & ALLAN A. KENNEDY, CORPORATE CULTURES: THE RITES AND RITUALS OF CORPORATE LIFE (1982); PETER J. FROST ET AL., ORGANIZATIONAL CULTURE (1985); GAINING CONTROL OF THE CORPORATE CULTURE (Ralph H. Kilmann et al. eds., 1985); JOHN P. KOTTER & JAMES L. HESKETT, CORPORATE CULTURE AND PERFORMANCE 9 (1992); John Gill & Ian Fouldner, *Managing a Merger: The Acquisition and Aftermath*, PERSONNEL MGMT., Jan. 1978, at 14; Robert H. Hayes, *The Human Side of Acquisitions*, MGMT. REV., Nov. 1979, at 41; Harry Levinson, *A Psychologist Diagnoses Merger Failures*, HARV. BUS. REV., Mar.-Apr. 1970, at 139; Mitchell Lee Marks, *Merging Human Resources*, MERGERS & ACQUISITIONS, Summer 1982, at 38; Marsha Sinetar, *Mergers, Morale and Productivity*, 60 PERSONNEL J. 863 (1981); *see also* Jack Hradesky, TOTAL QUALITY MANAGEMENT HANDBOOK 7, 129-76 (1995).

2 This does not necessarily mean that believers in corporate culture are opposed to hostile takeovers. Not all corporate cultures are worth preserving, and a hostile takeover may be the most effective way to transform a dysfunctional corporate culture. *See, e.g.*, Harvey L. Pitt & Karl A. Groskaufmanis, *When Bad Things Happen to Good Companies: A Crisis Management Primer*, 15 CARDOZO L. REV. 951, 953 (1994) (describing the deleterious effects of the Bhopal incident on Union Carbide's "corporate culture"); Bernie Shellum, *Fruehauf Steers into Trouble: Management Cited in Decline of Truckmaker*, CHI. TRIB., Feb. 27, 1989, at C1 (describing a management that "fostered a culture that prized golf and yachting over attention to business in the early 1980s").

An interesting perspective on this line of argument is provided by Professor Fejfar in Anthony J. Fejfar, *Corporate Voluntarism: Panacea or Plague? A Question of Horizon*, 17

Then there are the atheists, who either deny the ontological reality of corporate culture altogether or claim that it plays no significant role in corporate takeovers. They view corporate culture much the way their counterparts view religion, as a set of artificial constructs created by a priestly caste of incumbent managers to justify and maintain their own positions of power and authority.

In the uncertain middle, of course, are the agnostics. They believe that corporate culture, like God, may very well exist, but given the absence of good empirical evidence on the subject and the extreme difficulty of ascertaining its impact in the individual case, they believe it is better to act and to regulate the market for corporate control, as if such factors as corporate culture were not really there.

At various times and in various takeover cases, the Delaware Supreme Court has seemed to espouse all three positions. Believers, of course, take as their Bible Justice Horsey's decision in *Paramount Communications, Inc. v. Time Inc.*[3] In *Paramount*, Justice Horsey deemed management's efforts to protect Time's culture from the "threat" of Paramount's unwanted takeover as a reasonable exercise of their business judgment entitled to protection under the *Unocal*[4] standard.[5]

For atheists, Justice Moore's decision in *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*,[6] provides the critical countertext. While it does not speak directly to the role of corporate culture as a factor justifying management's efforts to deter a bidder deemed deleterious to corporate culture, it condemns any efforts to play favorites "when bidders make relatively similar of-

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DEL. J. CORP. L. 859, 941 (1992), who argues that socially responsible companies will not become targets of profit maximizing raiders because "once 'irreducible' corporate voluntarism becomes ingrained in a corporate culture, the corporation will tend not to be considered a good target for a takeover because such a 'voluntarist' culture will be viewed as a 'negative' profit factor to potential corporate raiders."

3 571 A.2d 1140 (Del. 1989); *see also* Newell Co. v. Vermont Am. Corp., 725 F. Supp. 351, 373-75 (N.D. Ill. 1989) (upholding defensive tactics where raider's "corporate culture" was "fundamentally at odds" with that of target). *Paramount* and *Newell* are the only cases that expressly cite threats to "corporate culture" as a justification for defensive tactics.

4 Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985).

5 For a strong defense of the deference to managerial decisionmaking inherent in *Paramount*, see Paul E. Burns, *Timing is Paramount: The Impact of* Paramount v. Time *on the Law of Hostile Takeovers*, 19 FLA. ST. U. L. REV. 761, 798 (1991) (management should be able to "select a time frame for the achievement of corporate goals"), and John W. Teague, *Does Corporate Culture Justify Defensive Measures to Takeover Attempts?*, 42 BAYLOR L. REV. 791 (1990).

6 506 A.2d 173 (Del. 1986).

fers."[7] Management's perceptions that one bidder's corporate culture provides a better strategic fit or has a compatible management style means nothing, unless the bidder can be persuaded to translate that perceived cultural advantage into a higher dollar offer.

Finally, the agnostic position is supported by the views of Chief Justice Veasey in *Paramount Communications Inc. v. QVC Network Inc.*[8] He states that in choosing among alternative proposals, target management is "not limited to considering only the amount of cash involved, and is not required to ignore totally its view of the future value of a strategic alliance."[9] He goes on to warn, however, that "[w]here stock or other non-cash consideration is involved, the board should try to quantify its value"[10] and that management should never forget that its "goal is straightforward . . . [to] decide which alternative is most likely to offer the best value reasonably available to the stockholders."[11]

It is possible, of course, to reconcile these views doctrinally by trying to distinguish management's *Revlon* duty to maximize shareholder value in a control contest from management's broader and

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[7] *Id.* at 184.

[8] 637 A.2d 34 (Del. 1993).

[9] *Id.* at 44.

[10] *Id.*

[11] *Id.* at 45. An early proponent of the agnostic position was Professor John Coffee, who warned of the dangers of "excess deterrence" created by an overabundance of hostile takeovers. *See* John C. Coffee, Jr., *Regulating the Market for Corporate Control: A Critical Assessment of the Tender Offer's Role in Corporate Governance*, 84 COLUM. L. REV. 1145 (1984). One of the major concerns he cites is "the more complex reality that corporate cultures are not easily changed, and abrupt efforts to do so may result more in demoralization than increased efficiency." *Id.* at 1159.

Another strong expression of the agnostic position may be found in Chancellor Allen's decision in *Paramount* itself. See Paramount Communications, Inc. v. Time Inc., 1989 Fed. Sec. L. Rep. (CCH) ¶ 94,514, at 93,264 (Del. Ch. July 14, 1989), *aff'd*, 571 A.2d 1140 (Del. 1989), in which the Chancellor, while ultimately accepting the validity of Time's defensive tactics, expressed some trepidation about the far-reaching implications of the claim regarding the preservation of their corporate culture. As he said:

> I note parenthetically that plaintiffs in this suit dismiss this claim of "culture" as being nothing more than a desire to perpetuate or entrench existing management disguised in a pompous, highfalutin' claim. I understand the argument and recognize the risk of cheap deception that would be entailed in a broad and indiscriminate recognition of "corporate culture" as a valid interest that would justify a board in taking steps to defeat a non-coercive tender offer. Every reconfiguration of assets, every fundamental threat to the status quo, represents a threat to an existing corporate culture. But I am not persuaded that there may not be instances in which the law might recognize as valid a perceived threat to a "corporate culture" that is shown to be palpable (for lack of a better word), distinctive and advantageous.

Id. at 93, 267; *see also* William T. Allen, *Our Schizophrenic Conception of the Business Corporation*, 14 CARDOZO L. REV. 261, 272-75 (1992).

more generalized obligations under *Unocal* to deter threats to the company and its shareholders. According to this view, corporate culture can be considered in establishing the existence of a "threat" under *Unocal*, but may not provide a basis for favoring one bidder over another in a control contest under *Revlon*. *QVC*, perceived as a sort of watered down version of *Revlon*, provides that corporate culture may be a basis for favoring one bidder over another in theory, but not in practice.

While this account of Delaware law may preserve some level of doctrinal coherence, it does so at a great risk of analytical incoherence. Simply put, if matters of corporate culture are important enough to constitute "threats" justifying anti-takeover tactics under *Unocal*, why must they be ignored in choosing among alternative bidders under *Revlon* and virtually ignored under *QVC*?[12]

One common answer, that *Unocal* permits management to consider other corporate constituencies like employees, creditors, and customers, while *Revlon* requires an exclusive focus on shareholder interests, is not viable if one accepts the doctrine of the believers that corporate culture is a critical factor in determining the future success of the combined entity and therefore its future value to shareholders. If so, it is hard to see why, when seeking to maximize shareholder value among alternative deals, inquiries into strategic fit and compatibility of corporate cultures are not relevant in determining which alternative is best for shareholders. This is particularly so when one or more of the alternatives is anything other than an all cash offer for 100% of the company, so that future earnings and future corporate viability are relevant considerations for the target shareholders.[13]

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[12] It is this analytical dissonance in Delaware takeover law that caused Professor Cunningham and myself to suggest that the *QVC* standard might come to be interpreted by Delaware courts as a unified standard replacing both *Revlon* and *Unocal*. *See* Lawrence A. Cunningham & Charles M. Yablon, *Delaware Fiduciary Duty Law After* QVC *and* Technicolor*: A Unified Standard (and the End of* Revlon *Duties?)*, 49 BUS. LAW. 1593 (1994). It hasn't happened yet. On the conflict between the *Revlon* and the *Unocal* standards, see also Robert A. Ragazzo, *Unifying the Law of Hostile Takeovers: Bridging the* Unocal/Revlon *Gap*, 35 ARIZ. L. REV. 989 (1993).

[13] It is the potential for ideas like "corporate culture" to move corporate law theory beyond the narrow consideration of shareholder profit maximization and toward a more complex and interesting concept of the corporation as an entity from which various individuals (call them "constituencies" if you must) derive meaning and value in their lives that explains the great theoretical interest that followed the *Paramount* decision. *See, e.g.*, Joel Edan Friedlander, *Corporation and* Kulturkampf*: Time Culture as Illegal Fiction*, 29 CONN. L. REV. 31 (1996); Lyman Johnson & David Millon, *The Case Beyond* Time, 45 BUS. LAW. 2105 (1990); Lyman Johnson, *The Delaware Judiciary and the Meaning of Corporate Life and Corporate Law*, 68 TEX. L. REV. 865, 935 (1990); David Millon, *Theories of the Corporation*, 1990 DUKE L.J. 201.

It is possible, of course, to justify the *Revlon-QVC* rule by moving toward an atheistic or agnostic position. One can argue that corporate culture is either an unimportant or unknowable factor easily subject to manipulation by incumbent management for their own self-interested ends, and thus properly ignored in determining the best interests of the shareholders.[14] The problem then lies in explaining why this same questionable factor deserves such deference when invoked by management to justify defensive tactics against an unwanted bidder under *Unocal*.

The purpose of this introductory discussion is not to resolve these murky issues of Delaware takeover law, but to show that their resolution requires consideration of a prior set of murky issues, namely, how real, important, and ascertainable, objectively or otherwise, is the role of corporate culture in the success or failure of takeovers? We have seen that a reliable answer to these questions would substantially illuminate part of the continuing debate over the appropriate regulation of corporate takeovers. But where does one look for reliable answers to such questions?

I thought it might be interesting to seek the insights of a highly successful investor and businessman, who, while noted for his financial acumen, is generally seen to represent the values of middle America, rather than the fast money ethos of Wall Street; a man who freely expresses opinions on the major financial, economic, and even political issues of the day; a man whose views on business and economic policy are considered unorthodox by many, bizarre by some, yet are looked to by others as a welcome alternative to the narrow views of academic economists; a man whose opinions are frequently invoked in public policy debates, but who has never held and is unlikely ever to hold, elective office. That man, of course, is Ross Perot.

But I couldn't find anything that Perot has written on corporate takeovers, so I looked instead to the far more sensible opinions expressed by Warren Buffett in this collection of his essays.[15]

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14 There have been some attempts to bring some conceptual rigor to corporate culture, generally by trying to give an account of such soft variables as "reputation" in terms of game theory. *See* MASAHIKO AOKI, THE COOPERATIVE GAME THEORY OF THE FIRM (1984); William W. Bratton, *Game Theory and the Restoration of Honor to Corporate Law's Duty of Loyalty*, *in* PROGRESSIVE CORPORATE LAW 139 (Lawrence E. Mitchell ed., 1995); John C. Coffee, Jr., *Unstable Coalitions: Corporate Governance As a Multi-Player Game*, 78 GEO. L.J. 1495 (1990); David M. Kreps, *Corporate Culture and Economic Theory*, *in* PERSPECTIVES ON POSITIVE POLITICAL ECONOMY 90 (James E. Alt & Kenneth A. Shepsle eds., 1990).

15 *See* Lawrence A. Cunningham, Compilation, *The Essays of Warren Buffett: Lessons for Corporate America*, 19 CARDOZO L. REV. 1 (1997) [hereinafter *Buffett Essays*].

My conclusion is that Mr. Buffett is a believer in corporate culture, an exponent of such soft variables as management style as being critical elements of successful acquisitions. But he is not a fundamentalist. Indeed, his faith in corporate culture is tempered by an agnostic humility about the degree to which anyone can know very much about the future prospects of so complex a phenomenon as a modern business enterprise. I hope to consider the implications of these views for takeover regulation at the conclusion of this piece, but first, I want to take a closer look at the views expressed by Mr. Buffett himself.

The most striking thing about Mr. Buffett's approach to takeovers is that he makes no particularly important distinctions between takeovers and other forms of investment in which smaller portions of a business are purchased. As he states, "we are comfortable both with total ownership of businesses and with marketable securities representing small portions of businesses. We continually look for ways to employ large sums in each area."[16]

Unlike much of contemporary takeover jurisprudence and theory, in which purchasing control is seen as an entirely different thing from merely purchasing a small share of a company's earnings or dividend stream, indeed, where the market for corporate control is viewed as conceptually distinct from the mere market for stocks,[17] Mr. Buffett views them both as a part of a larger market for investment opportunities, one where the lowest price purchases are preferred. As he says, "we would rather buy 10% of Wonderful Business T at X per share than 100% of T at 2X per share."[18] As he also notes, "[m]ost corporate managers prefer just the reverse."[19]

Of course, viewed simply as an investment, 10% of Wonderful Business at X is a far better buy than paying twice that, but what about control? Most managers would assert that the higher price for 100% is justified by the extra thing they get for their money, i.e. control. But Mr. Buffett doesn't think that control is worth very much, at least not when you are buying a Wonderful Business.

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[16] *Id.* at 137.

[17] The proto-text in this field is Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305 (1976). These ideas were first explained to lawyers by Frank H. Easterbrook & Daniel R. Fischel, *The Proper Role of a Target's Management in Responding to a Tender Offer*, 94 HARV. L. REV. 1161 (1981). *See generally* KNIGHTS, RAIDERS, AND TARGETS: THE IMPACT OF THE HOSTILE TAKEOVER (John C. Coffee, Jr. et al. eds., 1988).

[18] *Buffett Essays*, *supra* note 15, at 138.

[19] *Id.*

When you buy 10% of such a business, you are investing in current management as much as anything else, and Mr. Buffett sees no reason why that should be any different when you buy 100%. Indeed, Mr. Buffett is quite famous for not interfering with managements he admires, even when his ownership interests would entitle him to do so. He has taken this principle so far as to actually cede his voting rights in companies like Cap Cities to incumbent management for extended periods of time. His justification for such actions clearly indicates that Mr. Buffett believes in maintaining and fostering the compatibility of corporate cultures. As he says:

> The human side is just as important. We don't want managers we like and admire—and who have welcomed a major financial commitment by us—to ever lose any sleep wondering whether surprises might occur because of our large ownership. I have told them there will be no surprises, and these agreements put Berkshire's signature where my mouth is.[20]

Of course, a reputation for not interfering with incumbent management is not a bad thing for a major investor to have, particularly an investor who wishes to be offered future opportunities to make friendly deals with incumbent management to purchase all or substantial parts of public companies at attractive prices. But this does not in any way show that Mr. Buffett does not believe the acquisition philosophy he espouses in his essays. It merely shows that he is very adept at implementing it.

One might argue, however, that Mr. Buffett's relative inattention to the importance of control, and his reluctance to pay control premia, is due to his focus on the purchase of Wonderful Businesses. An investor specializing in Terrible Businesses, the standard argument goes, is much better off paying two times the market price for control and the right to replace Terrible management, than paying market price for 10% of a business that is being run into the ground by its current executives.[21]

Mr. Buffett, however, believes that there are relatively few businesses whose value can be substantially increased by simply replacing top management, and relatively few managers talented enough to substantially increase the value of an otherwise bad business. As he says, "when a management with a reputation for

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[20] *Id.* at 89.

[21] For a general analysis of replacement of inefficient management as a motive for takeovers, see RONALD J. GILSON & BERNARD S. BLACK, THE LAW AND FINANCE OF CORPORATE ACQUISITIONS 363-97 (2d ed. 1995).

brilliance tackles a business with a reputation for bad economics, it is the reputation of the business that remains intact."[22]

But aren't there some cases where businesses with potentially good economics are underperforming due to bad managers? Mr. Buffett answers with a slightly fractured fairy tale. He says:

> Many managements apparently were overexposed in impressionable childhood years to the story in which the imprisoned handsome prince is released from a toad's body by a kiss from a beautiful princess. Consequently, they are certain their managerial kiss will do wonders for the profitability of Company T(arget).
>
> . . . .
>
> . . . We've observed many kisses but very few miracles. Nevertheless, many managerial princesses remain serenely confident about the future potency of their kisses—even after their corporate backyards are knee-deep in unresponsive toads.[23]

Mr. Buffett does acknowledge that there are some "managerial superstars" who can "recognize that rare prince who is disguised as a toad, and who have managerial abilities that enable them to peel away the disguise."[24] Mr. Buffett does not consider himself one of them. As he says, "[w]e have tried occasionally to buy toads at bargain prices with results that have been chronicled in past reports. Clearly our kisses fell flat."[25]

Mr. Buffett's acquisition philosophy can be quickly summarized: buy only good businesses with managements you believe are performing well, and then leave them alone; don't expect a better management to substantially improve a bad business; and don't go looking for businesses you think can be substantially improved by better management.

Underlying these rules, I submit, is an interesting theory about the relationship between managers and the businesses they run. Mr. Buffett rejects the notion that there are generically "bad" managers whose removal will automatically improve corporate performance or "good" ones whose acquisition of control will predictably improve performance. Rather, he seems to assume a complex, somewhat ineffable and fundamentally organic relationship between managers and their businesses. The excellence of a management does not exist in the abstract (except perhaps for a few superstars), but rather in their ability to effectively manage the

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22 *Buffett Essays*, *supra* note 15, at 95.
23 *Id.* at 138-39.
24 *Id.* at 139.
25 *Id.* at 139-40.

specific businesses they actually are managing. That is why it is much easier to recognize good management when it is occurring, and to foster it by leaving incumbent management alone, than it is to determine that a bad business performance is due to bad management, or to predict how a new management will affect an existing business. The point is that good management not only takes a certain indefinable knack, but that it may well be highly firm-specific.

This, apparently, is at least one part of what Mr. Buffett means when he speaks of the "overwhelming importance in business of an unseen force that we might call the 'institutional imperative.'"[26] The institutional imperative is something which causes "decent, intelligent, and experienced managers"[27] to act irrationally and even stupidly when placed in bad institutional settings. The causes of such irrationality may include institutional inertia, peer pressure, a perceived need to score brownie points with the boss, empire-building, or the mindless imitation of competitor companies. Once such an institutional imperative is created, competent managers may make "misguided" decisions that nonetheless seem sensible given the skewed corporate culture in which they are operating.

Mr. Buffett seems less interested in fixing such flawed institutional cultures than in simply avoiding them. These institutional imperatives tend to be self-perpetuating, because even competent and well meaning managers in such corporate cultures find themselves encouraged to act in ways that create such managerial sins as sloth, greed, and administrative gluttony. Perhaps this is why Mr. Buffett's acquisition and investment philosophy also places so much emphasis on the character of the managers with whom he does business. Mr. Buffett does not suggest investing with the smartest people you can find, or the richest, or the most experienced. His advice is to deal with people you "like, trust, and admire."[28] One often quoted test is whether the business managers are "men that you would be pleased to see your daughter marry."[29]

Since I happen to be the father of eighteen and fifteen year-old daughters, this son-in-law standard has particular resonance for me. I have given this matter careful consideration, and I believe that the kind of men I would be most pleased to see my daughters marry would be people with whom Warren Buffett intends to go

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[26] *Id.* at 95.

[27] *Id.*

[28] *Id.* at 96.

[29] *Id.*

into business. Unfortunately, my standard, when conjoined with Mr. Buffett's standard, creates an impenetrable circularity. I therefore tried a different approach, and asked, what kind of people do fathers generally want their daughters to marry? There is much anthropological data available on this very question, studies of kinship and marriage relationships throughout the world. The consensus of such studies seems to be that fathers want sons-in-law who are pretty much like them, but a little bit different, usually second cousins once removed.[30]

I'm not sure this is helpful as a guide to selecting business associates, except insofar as it once again shows Mr. Buffett's emphasis on maintaining compatibility with the incumbent management of companies he invests in or acquires. If the son-in-law standard means anything, it means: don't acquire interests in companies whose managers you would not want to have over for Thanksgiving dinner to watch a few football games with. I submit that when target management rejects a potential corporate suitor as being a threat to management's strategic plans or corporate culture, they probably have a similar standard in mind.

But Mr. Buffett's emphasis on character is significant for another reason. It constitutes an important independent variable in judging whether to invest in a company. Mr. Buffett is well aware that the features that most characterize the business world are ignorance and uncertainty. The things you would most like to know about any business—its likely future prospects and performance—are those that are the hardest, indeed, often impossible to ascertain. Mr. Buffett does not claim greater knowledge of such matters than his fellow investors, except to suggest, on occasion, that he is more acutely aware of the limits of his knowledge than most of his compatriots.[31] This appreciation of his own ignorance (which, of

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[30] *See, e.g.*, Daniel Goleman, *After Kinship and Marriage, Anthropology Discovers Love*, N.Y. TIMES, Nov. 24, 1992, at C1 (quoting Dr. Victoria Burbank, an anthropologist at the University of California at Davis, who described arranged marriages among Australian aborigines as follows: "[Y]ou can't choose just any son-in-law . . . . Ideally, the mother wants to find a boy who is her maternal grandmother's brother's son . . . .").

[31] In this sense, he is simply following in the tradition of Socrates, who is said to have stated:

> Well, I am certainly wiser than this man. It is only too likely that neither of us has any knowledge to boast of, but he thinks that he knows something which he does not know, whereas I am quite conscious of my ignorance. At any rate it seems that I am wiser than he is to this small extent, that I do not think that I know what I do not know.

Plato, *Socrates' Defense (Apology)*, THE LAST DAYS OF SOCRATES (Hugh Tredennick trans., Penguin Classics 1954), *reprinted in* THE COLLECTED DIALOGUES OF PLATO 3, 7-8 (Edith Hamilton & Huntington Cairns eds., 1961).

course, is everyone else's ignorance as well) underlies many of Mr. Buffett's investment rules, such as stick to businesses you understand, don't arbitrage deals that don't make economic sense to you, and don't look for toads that can be kissed. These rules may be viewed as efforts at error minimization, which, in Mr. Buffett's investment philosophy, seems to be the surest road to profit maximization.

Rather than trying to guess the unknowable, Mr. Buffett concentrates on ascertaining the ascertainable: the economic characteristics of the business, the purchase price, likely inflation and tax effects, and, perhaps somewhat surprisingly, the trustworthiness of management. Mr. Buffett lists as one of the risks to be evaluated with respect to any investment, "[t]he certainty with which management can be counted on to channel the reward from the business to the shareholders rather than to itself."[32] Notice that Mr. Buffett does not consider this a mere agency cost characteristic of all public companies, nor as an unknowable risk best dealt with through diversification. Rather, he views it as an independent variable which, unlike many aspects of business performance, can be reasonably investigated and ascertained. I, for one, would start such an investigation by looking at the compensation of senior management.

It is this concern for management's character and trustworthiness, I suggest, that would inject an agnostic element into Mr. Buffett's view of corporate culture in takeovers. "Of course, the compatibility of corporate cultures is important to takeover success," I expect he would say, "but you can't always expect target management to give you a straight answer when you ask them about it."

Let's conclude this Article then, with a thought experiment. Let's appoint Warren Buffett to the Delaware Supreme Court and present him with the following hypothetical: Target Company management has previously negotiated a friendly acquisition by White Knight Inc. It is a two-step deal with cash on the front-end and equity in the combined entity on the back end, such equity to be worth, in the view of White Knight's investment banker, "not less than the cash offered on the front-end." White Knight has agreed to leave incumbent management in place and will support them with its votes. Red Knight Co. makes a competing offer, and discloses its intention to replace the current board. At the end of an informal bidding contest, Red Knight's bid is 5% higher than

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[32] *Buffett Essays, supra* note 15, at 77.

White Knight's cash component, and contemplates a cash freeze-out at the same price on the back-end. Target management rejects Red Knight's bid on the ground that it believes, due to the "compatibility of their corporate cultures," that White Knight's bid actually offers more value to shareholders in the long run. How does one determine whether this is a violation of target management's fiduciary duty under Delaware law?

I have been astonished during this symposium at the number of speakers who, while sitting directly in front of Warren Buffett, have proceeded to tell him what they think he thinks. I am even more astonished that I am about to do precisely the same thing.

Based on the prior discussion of Mr. Buffett's approach to acquisitions, I believe he would not reject out of hand the board's justification for favoring the ostensibly lower bid on the basis of compatibility of corporate cultures. He would, however, subject the target board's decision to the most intense and searching scrutiny. He would seek to know as much as he could about those aspects of the board's decision that are in fact presently ascertainable. I believe his inquiry would focus on three basic questions: (1) Did target management engage in a reasonable deliberative process?; (2) Does their conclusion that White Knight's deal offers more long-term value for shareholders make economic sense in light of known and reasonably anticipated business conditions?; and (3) Have the people on Target's board shown themselves to be trustworthy in the way they have comported themselves in this and prior business situations? Only if all three of these criteria are shown to be satisfied by a preponderance of the evidence, I submit, will Judge Buffett be likely to uphold management's decision to resist the higher cash offer. These are also not a bad set of criteria to apply in such situations. Who knows, they might even be the current law of Delaware.[33]

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[33] In designing my hypothetical, I purposely made the differential between the competing bids 5%, because I found it hard to imagine Mr. Buffett endorsing the lower bid if the differential were any greater. I gave the low bid an equity back end because I wanted target shareholders to have the chance to participate in any stock appreciation if management claims about the compatible corporate cultures turned out to be valid. As the response I received from Mr. Buffett indicates, however, my hypothetical apparently defines a choice where, in Mr. Buffett's view, tax effects swamp other considerations. Whereas I was trying to define a choice between deference to management or a strict principle of shareholder wealth maximization, Mr. Buffett's response reminds us that there are potential conflicts within the shareholder group as well. I suspect that the discussion, if it had continued, would have led to a tentative endorsement of shareholder voting as the best way of ascertaining shareholder preferences ameliorating conflicts among the shareholder group, but time, as it has a tendency to do, ran out.