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# FRONT-END LOADED, TWO-TIERED TENDER OFFERS: AN EXAMINATION OF THE COUNTERPRODUCTIVE EFFECTS OF A MIGHTY OFFENSIVE WEAPON

Robert A. Prentice\*

*In the 1980s, front-end loaded, two-tiered tender offers emerged as one of the most potent weapons in the takeover game. This Article describes the development of the front-end loaded, two-tiered offer, its impact on state and federal law, and the reasons for its decline. The author argues that the perceived coerciveness and unfairness of front-end loaded, two-tiered tender offers created a negative backlash that was out of proportion to the true provocation.*

TAKEOVERS CONTINUE to restructure the United States' economy.<sup>1</sup> Like busybodies with a juicy new neighborhood scandal, legal scholars have examined this phenomenon from every conceivable angle, comparing offensive and defensive takeover tactics with the moves in a chess match<sup>2</sup> or the battles in a

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1. Although "Black Monday" slowed the takeover pace briefly in late 1987, merger and acquisition activity, much of it in the form of hostile tender offers, has increased rapidly since then. See generally Smith, *Merger Boom Defies Expectations*, Wall St. J., Jan. 3, 1989, at 8R, col. 1 (despite "fear about the economy's reaction to the stock market crash, 1988 unexpectedly became a boom year for deals"); Celis, *Low Stock Prices Spur Takeover Flurry: Activity for Day Totals Over \$5 Billion*, Wall St. J., Mar. 1, 1988, at 3, col. 1 ("for the foreseeable future, takeover specialists say, the climate remains ripe for acquisition"); Sease, *Takeover Wars, Economic Trends Combine to Push Equities Higher*, Wall St. J., Jan. 29, 1988, at 43, col. 3 ("takeover business seems to be back in vogue"); Burrough, *Companies Take Over The Takeover Game From Flashy Raiders*, Wall St. J., Jan. 25, 1988, at 1, col. 6 ("U.S. companies are staging a comeback on the takeover scene.").

2. See Prentice, *Target Board Abuse of Defensive Tactics: Can Federal Law Be Mobilized to Overcome the Business Judgment Rule?*, 8 J. CORP. L. 337 (1983).

war.<sup>3</sup> These analogies are good ones; however, one contrast stands out. Whereas the rules of chess have not changed for centuries,<sup>4</sup> the rules governing tender offers are constantly evolving. And whereas the rules for warfare are observed mainly in the breach,<sup>5</sup> the tactics of tender offerors and targets are constantly evolving in order to conform to changing state and federal legislative and administrative rules.

Perhaps a better analogy is one to sports. Offensive and defensive tactics form the core of these games, and in many sports the rules are constantly changing. For example, the 1988 major league baseball season began with a rhubarb over the impact of new rules on the size of the strike zone and the definition of a balk.<sup>6</sup> In sports, as in tender offers, contestants are always searching for an edge — a tactic or maneuver to ensure victory. Since the fun is eliminated from sports if one side has a sure victory, the rules are often changed to compensate for a “super weapon.” When George Mikan became the National Basketball Association’s first true big man, the three-second lane was widened to hinder his play.<sup>7</sup> When Bill Russell emerged in college as the greatest defensive player the game had ever known, goal tending was prohibited.<sup>8</sup> And when Lew Alcindor (Kareem Abdul Jabbar) dominated the college ranks, the dunk shot was banned for nine years.<sup>9</sup>

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3. This accounts for the origin of terms such as “pearl harbor file” (a target company’s compilation of contingency plans to be used in the event of a surprise hostile takeover attempt) and “white knight” (a friendly bidder willing to “rescue” a target corporation from a hostile bidder). See J. BROOKS, *THE TAKEOVER GAME* 166-68 (1987).

Brooks even applied the military analogy to this Article’s primary subject: “The two-tier tender offer, in which some of the target company’s stockholders are treated markedly differently than others as a measure of dividing to conquer, calls to mind the similar policy of many military aggressor nations toward their victims.” *Id.* at 167.

4. The current rules have been in place for at least two centuries, and perhaps for more than four. A. HOROWITZ, *THE WORLD CHESS CHAMPIONSHIP* 1 (1973); H. SHONBERG, *GRANDMASTERS OF CHESS* 18 (1973).

5. For example, although numerous treaties and conventions have outlawed the use of poisonous gas in warfare, its use continues. See G. VON GLAHN, *LAW AMONG NATIONS* 588-90 (2d ed. 1970). See also *Iranians Say Iraqis Killed 10 in Poison Gas Raid on Town*, N.Y. Times, June 29, 1987, at A6, col. 1 (U.N. team recently declared Iraq had used chemical weapons).

6. Wulf, *A Squawk About Balks*, *SPORTS ILLUS.*, May 2, 1988, at 98; Gammons, *Inside Baseball*, *SPORTS ILLUS.*, Apr. 4, 1988, at 104.

7. *The Making of a Legend: Towering Lew Alcindor*, *NEWSWEEK*, Feb. 27, 1967, at 60.

8. *Id.*

9. Klein, *High on the Slam Dunk*, *Wall St. J.*, Feb. 8, 1988, at 22, col. 1.

It was a super offensive weapon, the "Saturday Night Special," that helped prompt the initial state and federal regulation of tender offers. When the conglomerate merger wave swept across corporate America in the 1960s, tender offers became the mechanism of choice for effecting takeovers. The "Saturday Night Special"<sup>10</sup> helped ensure the success of a hostile bid. The offer was typically announced on a Friday afternoon, giving target shareholders only a week to ten days to decide whether to tender their shares. The timing of the announcement prevented any effective response from target management until the following Monday, when part of the offering period had already expired. Target shareholders, who were often given little or no information about the offeror or its financing, made their decisions on the basis of inadequate information. They had little choice, however, since a gun was at their collective head.

The patent unfairness of this situation spawned the first tender offer legislation. First Virginia,<sup>11</sup> then the federal government through the Williams Act,<sup>12</sup> and finally many other states<sup>13</sup> enacted tender offer regulations. The Williams Act, which focused federal regulation on disclosure, also contained procedural and substantive provisions for shareholder protection, including withdrawal rights and pro rata purchases for oversubscribed offers.<sup>14</sup> The Securities and Exchange Commission (SEC) supplemented these provisions with various rules, which strengthened or modified the Williams Act's provisions so that shareholders would have at least twenty business days to consider an offer.<sup>15</sup>

Then tender offer strategists, eager to put the pressure back on shareholders, invented a new device which is the subject of this Article — the front-end loaded, two-tiered tender offer. This offer

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Another comparison between sports and tender offer battles that comes immediately to mind is the overcompensation of the gladiators. In the recent 11-week battle between Campeau and Macy for control of Federated Department Stores, Inc., it has been reported that lawyers for the various contestants "earned" \$40 million. Investment bankers did even better, receiving \$200 million for their trouble. See Jensen & Sontag, *Lawyers in Federated Takeover Hit Paydirt*, Nat'l L.J., Apr. 18, 1988, at 2, col. 3.

10. See generally Steinberger, *Corporate Takeovers—Cash Tender Offers, Exchange Offers, and Target Defense*, in I BUSINESS ACQUISITIONS 604 (2d ed. 1981).

11. See VA. CODE ANN. § 13.1-528 to -541 (1978 & Supp. 1982).

12. 15 U.S.C. §§ 781-78n (1986).

13. See Note, *The Tender Offer Regulation Battle Continues: Should States Regulate Only Local Companies*, 60 IND. L.J. 721, 724 n.38 (1985).

14. See *infra* notes 30-32 and accompanying text.

15. See *infra* note 31 and accompanying text.

“typically [consists of] a cash offer that produces control, followed by acquisition of the remaining equity [through a merger] at a lower price for debt or equity securities of the acquiring company.”<sup>16</sup> Proponents thought the front-end loaded, two-tiered tender offer would be to takeovers what the forward pass was to Notre Dame football in the days of Knute Rockne.<sup>17</sup> Critics, on the other hand, perceived it to be as coercive and unfair as the “Saturday Night Special.”<sup>18</sup>

After sketching the history of the front-end loaded, two-tiered tender offer, this Article will demonstrate how the perception of unfairness and coercion surrounding these offers had an impact on every phase of the tender offer game. In response to the front-end loaded, two-tiered tender offer, the SEC adopted more stringent rules governing offensive tactics in tender offers,<sup>19</sup> target corporations and potential target corporations devised more radical defensive tactics,<sup>20</sup> state courts reviewing defensive tactics gave target management more leeway in preventing two-tiered offers,<sup>21</sup> and state legislatures adopted a wide variety of target-oriented takeover regulations, which have been validated by the Supreme Court.<sup>22</sup> To add insult to injury, front-end loaded, two-tiered tender offers became a standard defensive tactic for target corporations.<sup>23</sup>

This Article will assess the true merits of such offers. It will ask whether front-end loaded, two-tiered tender offers are truly coercive and unfair, whether the changes their existence has wrought have been justified, and whether some of the changes should be reversed.<sup>24</sup>

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16. L. LOSS, FUNDAMENTALS OF SECURITIES REGULATION 499 (2d ed. 1988).

17. E.g., Lederman, *Tender Offer Bidding Strategy*, 17 REV. SEC. REG. 917 (1984); Lederman & Vlahakis, *Pricing and Proration in Tender Offers*, 14 REV. SEC. REG. 813, 819 (1981). See also Balotti & Finkelstein, “Coercive” Structures in Tender Offers, 15 REV. SEC. REG. 820 (1982).

18. See *infra* note 77 and accompanying text.

19. See *infra* notes 98, 105, 109, 113-14 and accompanying text.

20. See *infra* notes 123-34 and accompanying text.

21. See *infra* notes 155-94 and accompanying text.

22. See *infra* notes 197-254 and accompanying text.

23. See *infra* notes 284-86 and accompanying text.

24. See *infra* notes 300-65 and accompanying text.

## I. DEVELOPMENT OF FRONT-END LOADED, TWO-TIERED TENDER OFFERS

Although neither Congress nor the SEC has ever defined the term,<sup>25</sup> a "tender offer may be generally defined as: a public offer or solicitation by a company, an individual or a group of persons to purchase during a fixed period of time all or a portion of a class or classes of securities of a publicly held corporation at a specified price or upon specified terms for cash and/or securities."<sup>26</sup> The offer may be approved by the target's board of directors (a "friendly offer") or it may be a self-tender offer made by the target itself. Often, however, it will be a hostile tender offer launched by a third-party and opposed by target management. The hostile offer spawns the most heated litigation and creates the most interesting legal questions.

Target corporations have developed various defensive tactics which prevent the hostile bidder from succeeding, or at the very least, make the bidder pay dearly for success. These colorfully named defensive tactics include: "Shark Repellents," "Golden Parachutes," "Cyanide Capsules," "Poison Pills," "Lock-up Options," sales of "Crown Jewels," "White Knights," "Pac-Man" counter-offers, and even "Corporate Suicide."<sup>27</sup> A hostile bidder,

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25. In the absence of Congressional or SEC definition, most courts have adopted the eight-factor test enunciated in *Wellman v. Dickinson*, 475 F. Supp. 783 (S.D.N.Y. 1979), *aff'd on other grounds*, 682 F.2d 355 (2d Cir. 1982), *cert. denied sub nom.* 460 U.S. 1069 (1983). See Andre, *Unconventional Offers Under the Williams Act: The Case for Judicial Restraint*, 11 J. CORP. L. 499, 541-63 (1986); Note, *Defining "Tender Offer" Under the Williams Act*, 53 BROOKLYN L. REV. 189 (1987). The eight factor test suggested by the commission included:

(1) active and widespread solicitation of public shareholders for the shares of an issuer; (2) solicitation made for a substantial percentage of the issuer's stock; (3) offer to purchase made at a premium over the prevailing market price; (4) terms of the offer are firm rather than negotiable; (5) offer contingent on the tender of a fixed number to be purchased; (6) offer open only a limited period of time; (7) offeree subject to pressure to sell his stock; and (8) public announcement of a purchasing program concerning the target company precede or accompany rapid accumulation of large amounts of the target company's securities.

*Id.* at 203.

26. E. ARANOW & H. EINHORN, *TENDER OFFERS FOR CORPORATE CONTROL* 70 (1973). Although the tender offeror's goal is almost always to gain 100% of the target's shares, an acquisition is typically structured as an initial purchase of fewer than 5% of the target's shares, followed by a tender offer to increase holdings to over 50%, positioning the acquirer for a squeeze-out merger to acquire the remainder. See Freund & Easton, *The Three-Piece Suit: An Alternative Approach to Negotiated Corporate Acquisitions*, 34 BUS. LAW. 1679, 1683-85 (1979).

27. These terms, and those listed in the next paragraph, will be defined in context as

who faces this array of defenses, as well as federal regulation under the Williams Act and state takeover laws (which can be more accurately described as "anti-takeover laws"), needs a few arrows in its own quiver. Ingenious corporate attorneys and investment bankers have risen to the occasion, creating offensive tactics such as "Greenmail,"<sup>28</sup> "Bootstrap Offers," "Group Bids," "Bust-up Takeovers," and "Junk Bonds." The most controversial weapon of the corporate arms race, however, is the front-end loaded, two-tiered offer.

In 1980,<sup>29</sup> front-end loaded, two-tiered tender offers evolved out of the need to counter these potent defensive tactics in a crucible of regulation formed by the Williams Act and its attendant SEC rules. The Williams Act was primarily disclosure-oriented,<sup>30</sup> and the SEC rules required that a tender offer be kept open for at least twenty business days in order to give shareholders an adequate opportunity to study these disclosures.<sup>31</sup> The Williams Act also addressed the consequences of a partial offer that attracted more tendered shares than the offeror wished to purchase. In this situation, the offeror was required to purchase shares on a pro rata basis from all those who tendered them within ten calendar days after the offer began.<sup>32</sup>

If the bidder made an "any and all" offer, agreeing to purchase as many shares as were tendered from one percent to 100%, the pro rata purchasing requirement was irrelevant. Many tender offers, however, were "partial" offers. The bidder generally sought fifty-one percent or more of the target's shares. In a partial offer, there was an incentive for the target shareholder to act quickly and tender his shares within the first ten days in order to capture the tender offer premium<sup>33</sup> for at least a percentage of his

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they arise during the article. See R. PRENTICE, LAW OF BUSINESS ORGANIZATIONS AND SECURITIES REGULATION 715-34 (1987); Comment, *A Review of the Literature on Defensive Tactics to Surprise Cash Tender Offers*, 13 CREIGHTON L. REV. 909 (1980).

28. For a discussion of "greenmail," see Booth, *The Promise of State Takeover Statutes*, 86 MICH. L. REV. 1635, 1662-63 (1988).

29. See *infra* note 40 and accompanying text.

30. See 15 U.S.C. §§ 78m(d) & 78n(d) (1986) (originally enacted as Act of July 29, 1968, §§ 13(d) & 14(d), 82 Stat. 454, 454-56 as an amendment to the Securities Exchange Act of 1934).

31. 17 C.F.R. § 240.14e-1(a) (1988).

32. 15 U.S.C. § 78n(d)(6) (1986).

33. Premiums over market price tend to vary over the years. Although most studies indicate lower numbers, one study of offers over a four-week period in the late 1970s found the average hostile tender offer premium to be 72%. Chatlos, *The SEC v. Investors on Tender Offers*, HARV. BUS. REV., Sept.-Oct. 1978, at 6-7. Professor Lowenstein stated that

holdings. Tendering within the ten day proration period assured some profits to the prompt target shareholder. The bidder, who made a partial offer, might have been satisfied with the purchase of only a portion of the target's shares, but in most cases the partial bidder's ultimate goal was similar to that of the "any and all" bidder — to own 100% of the target. Indeed, from 1981 to 1983 the goal of eighty percent of all tender offers was the acquisition of the entire equity interest of the target.<sup>34</sup>

To gain 100% control, partial bidders usually followed the tender offer with a freeze-out merger. If the target shareholder could be assured of receiving the same value for his shares in the first-step tender offer and second-step merger, then there would be little pressure to tender, unless the target shareholder favored the tender offer price and was concerned that not enough shares would be tendered to reach the bidder's minimum.<sup>35</sup> If the merger price was less than the tender offer price, however, the bid was called a front-end loaded, two-tiered offer. The impact of this tactic was implicit. The bidder did not need to announce the intention to pay less in the second stage of the takeover. The mere possibility of such an intention encouraged alert shareholder's to rush into the proration pool. However, for maximum effect, why not make the front-end loaded, two-tiered bid explicit? Why not announce in advance that the second-stage merger price would be lower than the first-stage tender offer price, putting maximum pressure on the target shareholders?

The unfairness and coercive impact of an explicit front-end loaded, two-tiered tender offer seem apparent. Although this conclusion may not survive close scrutiny, at first blush it is difficult to escape. As one commentator noted:

From the bidder's point of view, a two-tiered pricing structure has the advantage of ensuring a high percentage of tenders during the proration period, since the target shareholders know (or should know) that if they do not tender within the proration pe-

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in the late 1980s the average premium in successful hostile tender offers is 80%. Lowenstein, *Letter to the Editor*, 1987 COLUM. BUS. L. REV. 177, 178. The size of premiums varies with the type of offer. See *infra* note 322 and accompanying text.

34. Leebron, *Games Corporations Play: A Theory of Tender Offers*, 61 N.Y.U. L. REV. 153, 162 n.35 (1986). Another study indicates that takeover mergers follow successful tender offers within five years in 72% of the cases. Dodd & Ruback, *Tender Offers and Stockholder Returns: An Empirical Analysis*, 5 J. FIN. ECON. 351, 352 n.2 (1977).

35. See SEC, Office of the Chief Economist, *The Economics of Partial and Two-Tier Tender Offers*, 49 Fed. Reg. 26, 755 (1984) [hereinafter Office of the Chief Economist].



riod they will almost inevitably be relegated to the "low back end" of the second step merger. Coupled with a ten calendar day proration period (the shortest possible under Section 14(d)(6) of the Exchange Act), the two-tiered pricing structure can, and is intended to, create an atmosphere of stampede among the target company's shareholders.

In addition to forcing target shareholders to act quickly, another, perhaps more important, purpose of the two-tiered pricing structure is to shorten the timetable for, and increase the odds against, a competing tender offer. It is, in short, an attempt to return to the psychology, and as much of the actuality as possible, of the fabled "Saturday Night Special" of bygone days—the ten calendar-day blitzkrieg approach to tender offers.<sup>36</sup>

Although one should not prejudge an issue that will be examined in detail later in this Article, the front-end loaded, two-tiered tender offer appears to be extremely persuasive. The shareholder finds himself in a quandary known as the "prisoner's dilemma."<sup>37</sup> He may believe that the tender offer price for fifty-one percent of his company's stock is too low and wish to hold out for a higher bid. Because of the threat that other shareholders will tender their shares and ensure the offer's success, however, the shareholder is coerced into tendering, so that at least fifty-one percent of his shares will be purchased at the higher tender offer price. Failure to tender initially may mean that all of his shares will be purchased at the lower price of the second-stage merger. Thus, the front-end loaded, two-tiered offer may induce all shareholders to tender, even though no one thinks the offer adequate. As takeover specialist Martin Lipton has observed:

The difference in the prices of the tiers unfairly pressures the target shareholder. A shareholder who would prefer that the tar-

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36. Nathan, *Novel Legal Questions Explored*, Nat'l L.J., Mar. 29, 1982, at 25, col. 6 & at 31, col. 1.

37. In the classic "prisoner's dilemma," a game invented to illustrate the problems arising from the inability to coordinate decisions in order to gain optimal results, X and Y are arrested for a crime. The prosecutor separates them so that they cannot coordinate their responses. He tells each that he has enough evidence to send them to jail for one year. However, the prosecutor tells X that if he *alone* confesses, he will be given three months in jail and his partner ten years, and that Y is being offered the same deal. If both confess, they will each be given five years. The prosecutor makes the same proposition to Y. The optimal result is for neither to confess. However, because X cannot count on Y to refuse to confess, and vice versa, both will protect themselves by confessing. See generally A. RAPOPORT & A. CHAMMAH, *PRISONER'S DILEMMA* (1965); P. SAMUELSON, *ECONOMICS* 504-05 (9th ed. 1973).

get remain independent will usually tender anyway out of fear that a majority of her fellow shareholders will tender, leaving her squeezed out of her investment at the lower second-tier price.<sup>38</sup>

Credit for the innovative front-end loaded, two-tiered strategy is frequently given to Bruce Wasserstein, formerly of the First Boston investment banking house.<sup>39</sup> McDermott Corporation's fifty-four dollar/front-end, thirty-nine dollar/back-end bid for Pullman, Inc. in 1980 has been cited as the first use of the device.<sup>40</sup> Twenty percent of the tender offers in 1982 and 1983 were front-end loaded, two-tiered offers,<sup>41</sup> including several "mega-deals" such as Martin-Marietta's "Pac-Man" counter tender offer for Bendix Corporation,<sup>42</sup> DuPont's bid for Conoco,<sup>43</sup> Whittaker's bid for Brunswick,<sup>44</sup> and U.S. Steel's "white knight" bid, which snatched Marathon Oil Co. away from Mobil Corporation.<sup>45</sup>

From 1980 to 1982, the front-end loaded, two-tiered tender offer became very popular very quickly. The reasons are easy to discern. In theory, the offer prompts early tendering by otherwise reluctant shareholders.<sup>46</sup> It also reduces the overall cost of an ac-

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38. Lipton, *Corporate Governance in the Age of Finance Corporatism*, 136 U. PA. L. REV. 1, 19 (1987).

39. Metz, *How First Boston Corp. Turned Itself Around Amid a Merger Mania*, Wall St. J., Apr. 21, 1982, at 1, col. 6.

40. McDermott, Inc. v. Wheelabrator-Frye, Inc., 649 F.2d 489 (7th Cir. 1980). McDermott's bid for Pullman, Inc. was worth \$54/share for 54% of Pullman on the front-end, but contemplated a back-end merger at only \$39/share. The bid was unsuccessful, losing to a rival offer by Wheelabrator-Frye, Inc., which, although not front-end loaded, carried a higher overall value of \$594 million versus \$525 million for the McDermott bid. See *Wheelabrator Wins the Battle for Pullman, Inc.*, Wall St. J., Sept. 26, 1980, at 7, col. 2; *McDermott, Inc. Extends Bid for Pullman As Court Ordered: Wheelabrator Appeals*, Wall St. J., Sept. 23, 1980, at 4, col. 1. Fogelson and Kapp suggest that the McDermott bid may have lost simply because of its novelty. Fogelson & Kapp, *The Emergence of Proration Pools and Two-Tier Offers as Desired Structures for Acquisitions*, in FOURTEENTH ANNUAL INSTITUTE ON SECURITIES REGULATION 581, 624 (1982).

41. Grundfest, *Two-Tier Bids Are Now a Defensive Technique*, Nat'l L.J., Nov. 9, 1987, at 26, col. 4.

42. P. HARTZ, MERGER 80-86 (1985).

43. Dallas Morning News, July 30, 1981, at 8D (advertisement by rival bidder, Seagram's).

44. *Brunswick Corp., Whittaker Each Win A Round in Court*, Wall St. J., Feb. 26, 1982, at 18, col. 3.

45. Nag & Rotbart, *U.S. Steel Moves to Rescue Marathon Oil From Mobil: Bid May Just Be Opener of Far Wider Takeover Battle*, Wall St. J., Nov. 20, 1981, at 3, col. 1. For a description of several other early front-end loaded, two-tiered offers, see, Fogelson & Kapp, *supra* note 40, at 613-21.

46. Dennis, *Two-Tiered Tender Offers and Greenmail: Is New Legislation Needed?*, 19 GA. L. REV. 281, 320 (1985); Note, *Front-End Loaded Tender Offers: The Application*

quisition,<sup>47</sup> which allows smaller bidders to stalk larger targets.<sup>48</sup> Also, it arguably allows a lesser bid. For example, an offer of \$100 per share for 50% of the target stock in the front-tier and of \$50 per share for the other 50% in the back-end merger is capable of defeating an offer of \$80 per share for 100% of the stock, even though the front-end loaded, two-tiered offer only has a total blended value of \$75 per share to defeat a higher "any and all" bid. Since a target shareholder will fear being forced to accept the \$50 per share back-end merger offer, because he does not know how many of his fellow shareholders will accept the front-tier offer, he may succumb to the pressure to get as high a percentage of the \$100 per share offer as possible.<sup>49</sup>

One other advantage of the two-tiered offer is demonstrated by the following hypothetical. A hostile bidder makes a tender offer for 50% of a target's stock at \$100 per share with a promised second-step merger price for the other 50% at \$60 per share. On the sixteenth business day of the "hold-open" period, a white knight makes a competing "any and all" offer at \$85 per share. To ensure victory, the hostile bidder may wish to increase the blended value of its bid from its current level of \$80 per share. The hostile bidder, however, also wants to maintain its timing advantage over the white knight, since the ability to purchase first in this situation is very important. A new bid would start the twenty-day "hold-open" period running all over again. Furthermore, raising the price of the tender offer on the front-end (for example, from \$100 per share to \$120 per share in order to raise the blended price to \$90 per share), would trigger SEC Rule 14e-1(b). In 1980, this rule required that a bid be held open for an additional ten days following any price increase.<sup>50</sup> An increase in the number of shares sought in the tender offer, however, did not trigger the extra ten-day hold-open period. Therefore, the hostile bidder could raise the blended price of its bid to \$90 per share, by increasing the percentage of shares to be acquired in the front-end

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of *Federal and State Law to an Innovative Corporate Acquisition Technique*, 131 U. PA. L. REV. 389, 389 (1982).

47. Coffee, *Regulating The Market for Corporate Control: A Critical Assessment of the Tender Offer's Role in Corporate Governance*, 84 COLUM. L. REV. 1145, 1281 (1984); Dennis, *supra* note 46, at 320; Note, *supra* note 46, at 389.

48. Neff, *Takeover Responses—an Update*, CONFERENCE ON SECURITIES REGULATION 24 (Univ. of Tex. School of Law 1986).

49. Lederman, *supra* note 17, at 917.

50. 17 C.F.R. § 240.14e-1(b) (1980).

from 50% to 75%, without losing the timing advantage. Using this technique, Esmark defeated a rival bid by Anderson, Clayton & Co. in a battle for control of Norton Simon.<sup>51</sup>

### A. Challenges Under Federal Law

Although many commentators thought that such a powerful and apparently coercive device must have legal flaws, the front-end loaded, two-tiered tender offer initially survived all legal assaults on its validity.<sup>52</sup> The front-end loaded, two-tiered offer seemed to easily comply with the disclosure provisions of the Williams Act. Section 14(d)<sup>53</sup> of the Securities Exchange Act requires a bidder to file a Schedule 14D-1<sup>54</sup> as soon as possible on the date a tender offer begins. Schedule 14D-1 requires disclosure of any subsequent merger plans of the bidder. These requirements pose no problem for the bidder in a front-end loaded, two-tiered tender offer, because disclosure is desired. The bidder wishes to disclose and even flaunt the lower merger price to maximize the coercive impact of the bid.<sup>55</sup> The same reasoning eliminates any misstatement or omission problem under Section 14(e),<sup>56</sup> which provides a remedy for violation of any of the disclosure provisions and for any other misrepresentation that occurs during the course of a tender offer.

Section 14(e), however, also bans use of "manipulative acts or practices" in connection with a tender offer. The first major legal assault on front-end loaded, two-tiered offers alleged that they were "manipulative" in violation of Section 14(e). This appeared to be a sensible approach in light of the Sixth Circuit's 1981 decision in *Mobil Corp. v. Marathon Oil Co.*<sup>57</sup> The court held that the lock-up options<sup>58</sup> Marathon had granted to white

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51. See Morris & Metz, *Esmark Offers to Buy All Shares of Norton Simon*, Wall St. J., July 22, 1983, at 2, col. 1; Metz, *Anderson Clayton Seeking Foreign Ally to Top Esmark in Bid for Norton Simon*, Wall St. J., July 15, 1983, at 7, col. 1.

52. See generally Comment, *The Front-End Loaded, Two-Tiered Offer*, 78 Nw. U.L. REV. 811 (1984).

53. 15 U.S.C. § 78n(d) (1986).

54. 17 C.F.R. § 240.14d-100 (1988).

55. Brudney and Chirelstein realized this fact before an explicit front-end loaded, two-tiered offer was ever used. Brudney & Chirelstein, *Fair Shares in Corporate Mergers and Takeovers*, 88 HARV. L. REV. 297, 337 (1974).

56. 15 U.S.C. § 78n(e) (1986).

57. 669 F.2d 366, 374 (6th Cir. 1981).

58. A "lock-up" option is an option to purchase shares or assets of a target corporation at a bargain price. It is frequently granted to induce a white knight to enter into a

knight U.S. Steel, which included the sale of its crown jewel<sup>69</sup> should hostile bidder Mobil Corp.'s tender offer succeed, were "manipulative" within the meaning of Section 14(e).<sup>60</sup>

The heavily criticized<sup>61</sup> *Mobil* decision, however, was too flawed to have any persuasive impact on front-end loaded, two-tiered tender offers. For example, in *Radol v. Thomas*,<sup>62</sup> minority shareholders of Marathon challenged the front-end loaded, two-tiered bid of white knight U.S. Steel.<sup>63</sup> U.S. Steel was offering \$125 per share in cash on the front-end and only its own notes with a face value of \$100, and an estimated value of approximately eighty-five dollars at the time of trial, on the back-end.<sup>64</sup> Following the reasoning of *Mobil*, the shareholders claimed that

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bidding contest with a hostile bidder. See Lewkow & Forrest, *The Lock-Up Under Exchange Act Section 14(e)*, Nat'l L.J., Mar. 26, 1984, at 15, col. 1; Fleischer & Raymond, *Lockups Ease Acquisition, May Forestall Bidding War*, Legal Times, Oct. 24, 1983, at 13, col. 1.

Today, such devices must be carefully used to avoid legal difficulties. See *Hanson Trust PLC v. ML SCM Acquisition, Inc.*, 781 F.2d 264 (2d Cir. 1986)(invalidating poorly planned lock-up option that unfairly favored management buyout group); *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986)(invalidating lock-up option that thwarted bidding process for target that board of directors had decided to sell).

59. A "crown jewel" is a prized asset or subsidiary that is the main attraction for a hostile bidder. If that crown jewel is sold to a white knight, it may eliminate the hostile bidder's incentive to continue the battle. See *Whittaker Corp. v. Edgar*, 535 F. Supp. 933 (N.D. Ill. 1982); *Herzel & Schmidt, Shareholders Can Benefit from Sale of "Crown Jewels"*, Legal Times, Oct. 24, 1983, at 33, col. 1.

In the battle for control of Marathon Oil, Marathon granted two lock-up options to white knight U.S. Steel. The first was a present, irrevocable option to purchase 17% of Marathon's common stock at a bargain price, making acquisition of Marathon cheaper for U.S. Steel than for Mobil. More important was the second option to purchase Marathon's 48% interest in the rich Yates Oil Field, which could be exercised only if U.S. Steel's bid failed and control of Marathon changed hands. This latter option meant that if Mobil managed to win the tender offer battle, it would be left holding a half-empty shell, devoid of the asset Mobil coveted most. See *Mobil Corp. v. Marathon Oil Co.*, 669 F.2d 366, 367-70 (6th Cir. 1981).

60. The court held in part:

In our view, it is difficult to conceive of a more effective and manipulative device than the "lock-up" options employed here, options which not only artificially affect, but for all practical purposes completely block, normal healthy market activity and, in fact, could be construed as expressly designed solely for that purpose.

669 F.2d at 374.

61. *E.g.*, Hochman, *The Marathon Case*, 14 REV. SEC. REG. 827 (1981); Prentice, *supra* note 2, at 351-60; Ferrara & Phillips, *Courts Struggle to Define "Manipulative" Practices*, Legal Times, May 3, 1982, at 14, col. 1; Bialkin, *Court Cases Cast Cloud over Option Tactic in Takeovers*, Legal Times, Jan. 11, 1982, at 19, col. 3.

62. 534 F. Supp. 1302 (S.D. Ohio 1982).

63. *Id.* at 1311.

64. *Id.*

the two-tiered approach was manipulative because it "created 'artificial market influences' by coercing Marathon shareholders into tendering their shares to U.S. Steel in order to avoid the risk of a later freeze out."<sup>65</sup>

The *Radol* court rejected this argument. Judge Rubin, after noting that all tender offers are to some extent coercive, concluded that Congress meant to regulate tender offers "primarily through mandatory disclosure provisions . . . ."<sup>66</sup> He noted that "both the case law as well as pertinent SEC Rules and Regulations appear to contemplate such [two-tiered] pricing arrangements."<sup>67</sup> The most pertinent SEC rule, according to the court, was Rule 13e-3,<sup>68</sup> which applies disclosure requirements to a "going private" transaction if it is in the form of a "clean-up" merger occurring within one year after a tender offer has been made. This disclosure requirement applies only if "equal consideration" is not paid in the second step. By implication, as long as disclosures are made, the payment of unequal consideration appears valid.<sup>69</sup>

In a similar case, *Martin-Marietta Corp. v. Bendix Corp.*,<sup>70</sup> Bendix challenged Martin-Marietta's front-end loaded, two-tiered "Pac-Man" counter tender offer as "manipulative" under Section 14(e). Judge Young's analysis stressed two Supreme Court decisions: *Piper v. Chris-Craft Industries* and *Santa Fe Industries, Inc. v. Green*. In *Piper v. Chris-Craft Industries*,<sup>71</sup> the Supreme Court held that Section 14(e) is solely a disclosure provision not meant to regulate the substantive fairness of tender offers. Similarly, in *Santa Fe Industries, Inc. v. Green*,<sup>72</sup> the Court stated that "manipulation" is a term of art in securities law, requiring deception, misrepresentation or nondisclosure; it does not encompass mere unfairness or breach of fiduciary duty. Therefore, Judge Young rejected Bendix's claim that a front-end loaded, two-tiered offer is illegal because it is coercive. Judge Young held that "*Piper* clearly dictates that Section 14(e) is violated only in instances of deception. If the counter offer is in fact 'coercive' [as Bendix claims], it would only be because its two-tier structure is

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65. *Id.* at 1305.

66. *Id.* at 1312.

67. *Id.*

68. 17 C.F.R. § 240.13e-3(g)(1) (1988).

69. 534 F. Supp. at 1312.

70. 549 F. Supp. 623 (D. Md. 1982).

71. 430 U.S. 1, 26-37 (1977).

72. 430 U.S. 462, 476 (1977).

revealed all too well."<sup>73</sup>

The *Radol* and *Martin-Marietta* holdings were later vindicated by the Supreme Court's ruling in *Schreiber v. Burlington Northern, Inc.*<sup>74</sup> The Court held that absent deception, there can be no "manipulation" within the meaning of Section 14(e) and that Congress did not intend to regulate the substantive fairness of tender offers.<sup>75</sup> Thus, in the early 1980s, a properly disclosed front-end loaded, two-tiered tender offer did not create any legal problems at the federal level as long as the second-step merger was accompanied by the proper disclosures under Rule 13e-3.<sup>76</sup>

### B. State Law Challenges

As early as 1974, before the first use of an explicit front-end loaded, two-tiered tender offer, Professors Brudney and Chirelstein were concerned about the fairness of the second step of such a transaction.<sup>77</sup> Would such an offer violate state law under a breach of fiduciary duty analysis? Hostile bidders owe no fiduciary duty to the shareholders of the target corporation.<sup>78</sup> Once the hostile bidder has acquired a majority share of the target's stock through the tender offer, however, can its actions in completing the second-step merger be scrutinized under fiduciary standards? The Supreme Court relegated litigation of this issue to state courts by its ruling in *Santa Fe Industries, Inc. v. Green*.<sup>79</sup> This

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73. 549 F. Supp. at 630.

74. 472 U.S. 1 (1985). In *Schreiber*, Burlington made a hostile tender offer for 25 million shares of El Paso Gas Co. El Paso's board initially opposed the hostile offer. However, in exchange for certain considerations, the El Paso board agreed to support a second offer for only 21 million shares (four million more shares of treasury stock were to be sold directly to Burlington). *Id.* at 3. Shareholders who tendered to the first offer, which was then cancelled, found their tenders to the second offer subject to much greater proration. They sued Burlington and the target board, claiming that the agreement to cancel the first offer and replace it with the second constituted a "manipulative" act within the meaning of Section 14(e). Because the deal was fully disclosed, however, there was no deception and therefore no manipulation. *Id.* at 8-12.

75. *Id.* at 12.

76. See generally Note, *Freezeout Merger Regulation: An SEC Rule Joins State Efforts*, 37 WASH. & LEE L. REV. 964 (1980).

77. Brudney & Chirelstein, *supra* note 55, at 336; Brudney & Chirelstein, *A Restatement of Corporate Freezeouts*, 87 YALE L.J. 1354 (1978) [hereinafter Brudney & Chirelstein II].

78. Brudney & Chirelstein, *supra* note 55, at 337; Greene, *Corporate Freeze-Out Mergers: A Proposed Analysis*, 28 STAN. L. REV. 487, 508 (1976); Note, *Singer v. Magnavox and Cash Take-Out Mergers*, 64 VA. L. REV. 1101, 1113-14 (1978).

79. 430 U.S. 462, 476 (1977) (breach of fiduciary duty does not constitute "fraud" remediable by § 10(b) of the Securities and Exchange Act of 1934).

ruling allowed the "entire fairness" approach, developed by the Delaware Supreme Court in *Singer v. Magnavox Co.*<sup>80</sup> and modified by several subsequent cases,<sup>81</sup> to become the dominant mode of analysis in the 1980s.

*Singer* required a court to examine the "entire fairness" of a challenged second-step merger, concentrating on both fairness of price and fairness of procedure. *Singer* also required that a business purpose justify a freeze-out merger.<sup>82</sup> Although some commentators suggested that the "entire fairness" approach of *Singer* and its progeny be applied to front-end loaded, two-tiered tender offers,<sup>83</sup> no court applied the *Singer* rationale to invalidate a lower second-stage merger price.<sup>84</sup> Thus, in 1982, state fiduciary standards posed little barrier to the front-end loaded, two-tiered tender offer tactic.

Another potential barrier existed in the approximately thirty-seven states that had tender offer laws which could be characterized as antitakeover in tone.<sup>85</sup> Although these laws did not directly address the tactic, several contained provisions for review by state officials of the substantive fairness of tender offers. A reviewing state official had the authority to determine that front-end loaded, two-tiered tender offers were unfair to target shareholders.

This potential barrier was struck down by the Supreme Court in *Edgar v. MITE Corp.*<sup>86</sup> The Court held that an Illinois tender

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80. 380 A.2d 969 (Del. 1977). In *Singer*, North American purchased 84.1% of Magnavox shares through a tender offer. *Id.* at 971. Later, it proposed to acquire the remaining shares by merging Magnavox into a wholly-owned subsidiary, thus cashing out the remaining shareholders at the tender offer price. After the merger was approved, some shareholders sued, alleging that the merger was fraudulent because it did not serve any business purpose other than the forced removal of minority shareholders, and that the price per share was grossly inadequate. *Id.* at 972.

81. *E.g.*, *Roland Int'l Corp. v. Naijar*, 407 A.2d 1032 (Del. 1979)(applying *Singer's* holding to short-form mergers as well as long-form mergers); *Tanzer v. International Gen. Indus., Inc.*, 379 A.2d 1121 (Del. 1977)(holding that "business purpose" of parent will satisfy *Singer's* requirement for a squeeze-out merger).

82. *Singer*, 380 A.2d at 980.

83. *E.g.*, *Mirvis, Two-Tier Pricing: Some Appraisal and "Entire Fairness" Valuation Issues*, 38 BUS. LAW. 485, 501 (1983); *Shay, Current Trends in Takeovers*, in 21ST ANNUAL CORPORATE COUNSEL INSTITUTE 5-1, 5-4 (1982). *See also Chazen, Fairness From A Financial Point of View in Acquisitions of Public Companies: Is "Third-Party Sale Value" the Appropriate Standard?*, 36 BUS. LAW. 1439, 1462-63 (1981)(suggesting front-end loaded, two-tiered tender offers be judged according to their blended value).

84. Comment, *supra* note 52, at 829.

85. *See supra* note 13 and accompanying text.

86. 457 U.S. 624 (1982).



offer law<sup>87</sup> containing a provision for substantive review of tender offers by the Illinois Secretary of State was invalid. Although the *MITE* opinion was fragmented and unclear, Justice White's plurality opinion invalidated the Illinois Act on both Commerce Clause and Supremacy Clause grounds.<sup>88</sup> Only one leg of his Commerce Clause analysis, however, was able to muster the support of a majority of the Court.<sup>89</sup> Although the decision might have been unclear, most commentators thought *MITE* sounded the "death knell" for state regulation of tender offers.<sup>90</sup> The lower federal courts agreed, striking down similar laws in litigation arising out of tender offer battles.<sup>91</sup>

Thus, by the end of 1982, the front-end loaded, two-tiered tender offer was flying high, having survived all state and federal challenges to its legality. According to Judge Rubin, the validity of these offers was implicitly recognized by the case law interpret-

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87. *Id.* at 635. The Illinois Act also had an "early warning" provision that required a tender offeror to file a registration statement with the Illinois Secretary of State at least 20 days before commencing the tender offer, thus giving the target time to implement various defenses. ILL. REV. STAT. ch. 121-½, para. 137.51-70 (1979).

88. Justice White found that the Illinois Act, by unduly favoring target management, conflicted with the Williams Act policy of neutrality and was therefore pre-empted by it. He adopted the Seventh Circuit's conclusion that "[t]he state thus offers investor protection at the expense of investor autonomy—an approach quite in conflict with that adopted by Congress." *Edgar*, 457 U.S. at 640 (quoting *MITE Corp. v. Dixon*, 633 F.2d 486, 494 (7th Cir. 1980)).

Under the Commerce Clause, Justice White found the Illinois Act unconstitutional as a direct burden on interstate commerce. The Act applied to corporations that were not formed in Illinois and corporations that had no shareholders in Illinois. If other states enacted such laws, a mass of conflicting regulations could apply to a single tender offer, making its completion virtually impossible. *Id.* at 642.

Finally, White concluded that the Illinois Act was also an unconstitutional indirect burden on interstate commerce. It deprived shareholders of their chance to tender at a premium, hindered efficient allocation of resources, and removed a mechanism for encouraging efficient management. *Id.* at 643.

89. White's conclusion that the Illinois Act was an unconstitutional indirect burden on interstate commerce gained the support of Chief Justice Burger and Justices Powell, Stevens, and O'Connor. Justices Brennan, Marshall, and Rehnquist did not reach the merits of the claim because they felt it was moot. White's conclusion that the Act was also unconstitutional as a direct burden on interstate commerce, however, gained the support of only three other justices, and only two other justices joined his conclusion that the Illinois Act was pre-empted by the Williams Act. *Id.* at 625.

90. *E.g.*, Kreider, *Fortress Without Foundation: Ohio Takeover Act II*, 52 U. CIN. L. REV. 108 (1983); Note, *The Unsung Death of State Takeover Statutes: Edgar v. MITE Corp.*, 24 B.C.L. REV. 1017, 1052 (1983); Note, *A Failed Experiment: State Takeover Regulation After Edgar v. MITE Corp.*, 1983 U. ILL. L. REV. 457, 476.

91. *E.g.*, *Telvest, Inc. v. Bradshaw*, 697 F.2d 576 (4th Cir. 1983); *Martin-Marietta Corp. v. Bendix Corp.*, 690 F.2d 558 (6th Cir. 1982); *National City Lines v. LLC Corp.*, 687 F.2d 1122 (8th Cir. 1982).

ing the Williams Act and by the SEC rules promulgated under the Act.<sup>92</sup> Utilized with quite a bit of success, front-end loaded, two-tiered tender offers constituted over twenty percent of all tender offers, and experts were predicting an even bigger role for them in the future.<sup>93</sup>

Five years later, however, the front-end loaded, two-tiered tender offer had almost disappeared as an offensive weapon in takeover battles.<sup>94</sup> How did this happen? How could a tactic described by its supporters as being as unstoppable as a slam dunk by a 7'2" Lew Alcindor lose popularity so quickly? The bottom line is that the perception that the front-end loaded, two-tiered tender offer was coercive and unfair provided the impetus for sweeping changes in the tender offer realm during this five-year period, as the following sections of this Article will demonstrate.

## II. IMPACT OF THE PERCEPTION OF COERCIVENESS ON FRONT-END LOADED, TWO-TIERED TENDER OFFERS

### A. Impact on SEC Rules

Various changes in SEC Rules can be traced to the impact of the perception that front-end loaded, two-tiered tender offers are coercive and unfair.

#### 1. Rule 13e-3

In *Sante Fe Industries, Inc. v. Green*,<sup>95</sup> the Supreme Court held that a challenge to a second-tier merger price alleging that it was unfair was no concern of federal securities law as long as there was no deception.<sup>96</sup> The SEC was uncomfortable, however, with relegating the protection of minority shareholders to state courts, and began to consider rules to ensure their protection.

The Commission considered rules that would require substantive fairness of price and a viable business purpose for second-tier

92. Radol v. Thomas, 534 F. Supp. 1302, 1312 (S.D. Ohio 1982).

93. Lederman, *supra* note 17, at 917.

94. Grundfest, *supra* note 41, at 26, col. 1.

95. 430 U.S. 462, 476 (1977).

96. Of course, the famous footnote 14 of *Green* left a loophole, which some plaintiffs have been able to exploit. According to some courts, they may still take state law claims into federal court if some deception by defendants prevented them from exercising their state court rights. *E.g.*, Kas v. Financial General Bankshares, Inc., 796 F.2d 508 (D.C. Cir. 1986); Atchley v. Qonaar Corp., 704 F.2d 355, 358 (7th Cir. 1983); Goldberg v. Meridor, 567 F.2d 209, 220 (2d Cir. 1977).

mergers.<sup>97</sup> In the end, however, they merely promulgated a rule requiring more extensive disclosures in a "freeze-out" or "going-private" merger.<sup>98</sup> Although Rule 13e-3<sup>99</sup> is not aimed directly at the explicit front-end loaded, two-tiered tender offer, it is intended to discourage a lower back-end payment by allowing an exception to the filing requirement for a second-step merger price that is equal to the first-step tender offer price.<sup>100</sup> However, the disclosure requirement is not very burdensome and the rule did little to discourage front-end loaded, two-tiered bids.<sup>101</sup> Furthermore, the *Radol* court interpreted the very existence of the Rule 13e-3 exception as authorization of two-tiered bids by negative implication.<sup>102</sup>

## 2. Rule 14d-8

The growth in the use of explicit front-end loaded, two-tiered tender offers was, at least in part, the result of various amendments to the tender offer rules adopted by the SEC in 1979. The Williams Act originally provided for withdrawal rights for shareholders who tendered and then changed their minds. Section 14(e) allowed withdrawal during the first seven calendar days of the tender offer.<sup>103</sup> The SEC decided that this was not enough time for the shareholders to make their decisions. Therefore, the Commission (arguably without authority to contradict the Williams Act)<sup>104</sup> adopted a rule in 1979 to allow withdrawal during the first fifteen business days of an offer and within ten business days following the initiation of any competing tender offer.<sup>105</sup> The Wil-

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97. De Angelo, De Angelo & Rice, *Going Private: Minority Freezeouts and Stockholder Wealth*, 27 J. LAW & ECON. 367, 369 (1984).

98. *Howing Co. v. Nationwide Corp.*, 625 F. Supp. 146, 151 (S.D. Ohio 1985). Rule 13e-3 requires disclosure of such matters as the purpose of the transaction and the reason for its structure, alternatives which were considered and why they were rejected, and effects the transaction will have on all parties, including tax consequences. The disclosure form is codified at 17 C.F.R. § 240.13e-100 (1988).

99. Securities Act Release No. 6100, 17 C.F.R. § 240.13e-3 (1988).

100. Exchange Act Rule 13e-3(g), 17 C.F.R. § 240.13e-3(g) (1988).

101. Lederman & Vlahakis, *supra* note 17, at 819.

102. *See supra* note 66-69 and accompanying text.

103. 15 U.S.C. § 78n(d)(5) (1986). The rule also allows withdrawal after an offer has been effective for more than 60 calendar days if the shares have not yet been purchased. This would be a relatively rare occurrence.

104. Lederman & Vlahakis, *supra* note 17, at 816.

105. *See* Tender Offers, Securities Act Release No. 6158, [1979-1980 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 82,373 (Nov. 29, 1979); Tender Offers, Exchange Act Release No. 16,384, [1979-1980 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 82,373

liams Act also provided for pro rata purchases of any shares tendered during the first ten calendar days of a tender offer.<sup>106</sup> Hostile bidders soon learned how to use these "proration pools" to induce shareholders to tender and to refrain from exercising their extended withdrawal rights under the 1979 amendments.

Two corporate legal strategists used the following hypothetical to demonstrate how the tactic could even be used to defeat higher competing offers.

Bidder 1 offers to purchase up to 1,000,000 shares, out of 2,000,000 outstanding, at a price of \$50.00 per share. Bidder 2 offers to purchase the same number of shares at \$65.00 per share. Bidder 1 subsequently raises its price to \$60.00 per share [which under "best price" rules must be paid even to those shareholders who had tendered at \$50.00], creates two proration pools [one for those who tendered before the price increase and one for those who tendered after] and announces that before the increase in consideration 1,200,000 shares had been tendered.

If a shareholder tendered to Bidder 1 before the increase by Bidder 1, he knows that if Bidder 1 is successful (no matter how many shares are ultimately tendered) he will be subject to a proration factor of at most 2 in 12 and therefor [sic] will receive in cash an amount \$50.00 per share tendered ( $10/12 \times \$60$ ). On the other hand, if the shareholder tenders to Bidder 2, he faces an unknown proration factor if Bidder 2 is successful. The shareholder must then make the same calculations as professional arbitrageurs do on a daily basis, estimating the likelihood of Bidder 2's success, the extent of oversubscription that would be likely, and the effect of such over-subscription on the higher price offered by Bidder 2. If, for example, 1,500,000 shares are ultimately tendered to Bidder 2, the shareholder would receive cash of only \$43.33 per share.<sup>107</sup>

The desire to be in a proration pool, coupled with the pres-

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(Nov. 29, 1979).

106. See *supra* note 32 and accompanying text.

107. Lederman & Vlahakis, *supra* note 17, at 816. See also R. FERRARA, M. BROWN & J. HALL, TAKEOVERS; ATTACK AND SURVIVAL 124-25 (1987); Ferrara, Carroll & Dozier, *Tender Offers: Toughing It Out*, in MERGERS & ACQUISITIONS IN THE 1980s, at 112-17 (1987); Finkelstein, *Antitakeover Protection Against Two-Tier and Partial Tender Offers: The Validity of Fair Price, Mandatory Bids and Flip-Over Provisions Under Delaware Law*, 11 SEC. REG. L.J. 291, 292 (1984) (paraphrasing SEC ADVISORY COMM. ON TENDER OFFERS, REPORT OF RECOMMENDATIONS (July 8, 1983)(recommendation 12)). Rules allowing multiple pools "may have served as a primary factor in the development of two-tier offers by permitting offerors between 1980 and 1982 to structure partial tender offers to place a significant premium upon tendering early." *Id.*

sure created by multiple pools, places very strong pressure on target shareholders to make the decision to tender within ten calendar days, effectively cutting the twenty day "hold-open" period in half. Additionally, because many smaller shareholders will not tender, the value of the front-end for those who do tender is even greater because they will have a higher percentage of their shares purchased at the tender offer price.<sup>108</sup>

The SEC responded directly to the pressure that front-end loaded, two-tiered offers put on shareholders by its promulgation of revised Rule 14d-8 in late 1982.<sup>109</sup> The revised rule eliminated multiple pools and restored effectiveness to the twenty day "hold-open" requirement by extending the proration pool throughout the duration of any partial tender offer. Partial offers were discouraged, in part, because "any-and-all" bidders now had a five-day timing advantage — they could purchase at the end of the fifteen day withdrawal period. Revised Rule 14d-8 was aimed directly at blunting the effect of explicit front-end loaded, two-tiered tender offers,<sup>110</sup> and there is evidence that it has had a small measure of success.<sup>111</sup> Although there is doubt about whether the SEC had the authority to issue Rule 14d-8,<sup>112</sup> it remains on the books. On the other hand, the rule did nothing to protect shareholders on the back-end merger and, in light of the fifteen day withdrawal period, did not significantly aid shareholders in thoroughly considering offers.

In 1986, the SEC extended withdrawal rights to last for the entire duration of the offer.<sup>113</sup> This change gave shareholders

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108. See Lederman, *supra* note 17, at 918-19.

109. Pro Rata Rule, Exchange Act Release No. 19,336, [1982-1983 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,306 (Dec. 15, 1982). See also Masters, *SEC Rule May Not Stop Two-Tier Deals*, Legal Times, Jan. 10, 1983, at 1, col. 2.

110. See Two-Tier Tender Offer Pricing and Non-Tender Offer Purchase Programs, Exchange Act Release No. 21,079 [1984 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,637 (June 21, 1984); Proposed Pro Rata Rule, Exchange Act Release No. 18,761, [1982 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,222 (May 25, 1982); See also Mirvis, *supra* note 83, at 485 n.1.

111. Two-Tier Tender Offer Pricing and Non-Tender Offer Purchase Programs, Exchange Act Release No. 21,079, [1984 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,637 (June 21, 1984).

112. The SEC's rule directly contradicts the Williams Act's provision that proration rights extend for only 10 calendar days, and is therefore of questionable legality. See Dennis, *supra* note 46, at 286-89; Note, *SEC Tender Offer Timing Rules: Upsetting a Congressionally Selected Balance*, 68 CORNELL L. REV. 914, 936 (1983); Pozen, *Extended Proration Time for Tender Offers Proposed*, Legal Times, July 12, 1982, at 15, col. 4.

113. Amendments to Tender Offer Rules: All Holders and Best-Price, Exchange Act

longer to consider a front-end loaded, two-tiered offer, but eliminated the timing advantage of an any-and-all bid. Eliminating this feature had no major impact, however, since by this time many other factors were also discouraging front-end loaded, two-tiered offers.

### 3. Rule 14e-1

An amendment to Rule 14e-1,<sup>114</sup> the minimum "hold-open" requirement, also affected front-end loaded, two-tiered tender offers. When adopted in late 1979, the rule provided that an amendment to the consideration being offered in a tender bid would require that the offer be extended for a period of at least ten business days.<sup>115</sup> Therefore, a change in consideration on the nineteenth day would mean a total minimum hold-open period of at least twenty-nine days. As discussed earlier, however, Esmark was able to evade this rule.<sup>116</sup> Esmark took advantage of the front-end loaded, two-tiered tender offer to capture Norton-Simon. By simply increasing the percentage of shares it intended to purchase in the front-end, it effectively increased the blended price of the announced two-step transaction while maintaining a timing advantage over a competing suitor. The court in *McDermott, Inc. v. Wheelabrator-Frye, Inc.* held that changes in the percentage of shares to be acquired did not constitute an increase in consideration, even though the increase might have an effect on the blended price of a two-step deal.<sup>117</sup> In 1986, however, the SEC amended Rule 14e-1 so that an increase in the percentage of shares sought also triggered the extra ten-day "hold-open" requirement.<sup>118</sup>

### 4. Refusal to Ban the Tactic

Although the SEC has amended its rules in a manner which has had an adverse effect on the use of the front-end loaded, two-tiered tender offer, it has expressly declined to ban the tactic. In

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Release No. 23,421, [1986-1987 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,016 (July 11, 1986).

114. Tender Offers, Exchange Act Release No. 16,384, [1979-1980 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 82,373 (Nov. 29, 1979).

115. *Id.*

116. *See supra* note 51 and accompanying text.

117. *McDermott, Inc. v. Wheelabrator-Frye, Inc.*, 649 F.2d 489 (7th Cir. 1980).

118. Amendments to Tender Offer Rules: All Holders and Best Price, Exchange Act Release No. 23,241, [1986-1987 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,016 (July 11, 1986).

1983, the SEC's Advisory Committee on Tender Offers studied the issue, reported its recommendations, and stated a "concern" about the coercive impact of partial and two-tiered bids.<sup>119</sup> However, the Advisory Committee recommended against prohibition or even substantial regulation of such bids. In Recommendation 16, the Committee suggested that such bids would be sufficiently discouraged if they were subjected to a "hold-open" period which was two weeks longer than the "hold-open" period applicable to "any-and-all" offers.<sup>120</sup> After reviewing the Advisory Committee's recommendations, however, the Commission decided not to follow even this narrow recommendation.<sup>121</sup> The SEC was not satisfied that two-tiered tender offers were unduly coercive. Furthermore, by 1984, when the SEC declined to act, the implementation of Rule 14d-8 had already reduced the appeal of two-tiered pricing.<sup>122</sup> Other developments, which will be discussed, had also reduced the usefulness of the front-end loaded, two-tiered bid.

## B. Impact on Corporate Use of Defensive Tactics

Pre-planning has long been a part of a solid tender offer defensive strategy. Corporate charter amendments, frequently known as "shark repellents" or "porcupine provisions," are

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119. SEC ADVISORY COMM. ON TENDER OFFERS, REPORT OF RECOMMENDATIONS xxi (July 8, 1983) [hereinafter ADVISORY COMM.].

120. *Id.* at 26.

121. Two-Tier Tender Offer Pricing and Non-Tender Offer Purchase Programs, Exchange Act Release No. 21,079, [1984 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,637 (June 21, 1984).

122. *Id.* The SEC also argued that if the front-end loaded, two-tiered tender offer is coercive, a two-week extension of the minimum offering period did not seem to be a very strong response. Also, it was concerned that the regulation did not distinguish between two-tiered bids and other partial bids. Finally, the Commission was concerned that the broader implications for corporate control transactions had not been sufficiently considered. *Id.*

Congress also has failed to outlaw front-end loaded, two-tiered tender offers. However, the alleged unfairness of such offers led Rep. Timothy Wirth to introduce legislation to eliminate partial bids for more than 10% of a target. Dennis, *supra* note 46, at 319-20. Even after front-end loaded, two-tiered bids ceased to be a substantial portion of all tender offers, their existence was still being cited in congressional hearings as justification for passing tender offer legislation. See *Impact of Corporate Takeovers: Hearings Before the Subcomm. on Securities of the Senate Comm. on Banking, Housing, and Urban Affairs*, 99th Cong., 1st Sess. 8-9 (1985) (statement of Martin Lipton, attorney) [hereinafter *Hearings*].

For an update on the progress of various tender offer reform bills, see Goelzer & Quinn, *Recent Developments in Tender Offer Regulation*, in 2 TWENTIETH ANNUAL INSTITUTION ON SECURITIES REGULATION 97-109 (1988).

designed to make takeovers more difficult.<sup>123</sup> For example, a target corporation can insulate its board by eliminating the right of shareholders to call special meetings or to remove directors without cause, or it can stagger the board members' terms and introduce cumulative voting so that a hostile bidder who has purchased fifty-one percent of the shares cannot replace the entire board in one annual meeting. The most popular of the pre-planned defenses, fair price amendments and poison pills, owe much of their popularity to the threat of front-end loaded, two-tiered tender offers.

### 1. Fair Price Provisions

When front-end loaded, two-tiered tender offers became popular, American corporations responded. In 1984, for example, 372 major corporations submitted shark repellent charter amendments for shareholder approval. Only seventeen were defeated.<sup>124</sup> The fair price provision was the most popular shark repellent, accounting for approximately three-fourths of the total number of amendments.<sup>125</sup> Many major American corporations have them in place today.<sup>126</sup>

A fair price charter amendment is intended to insure that all shareholders are treated equally. It requires that shareholders squeezed out in a back-end merger be given the same compensation as those who sold their shares in the front-end tender offer. Fair price provisions are aimed directly at blocking front-end loaded, two-tiered tender offers,<sup>127</sup> which accounts for their popularity with institutional investors.<sup>128</sup> Because they are designed to

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123. See generally 1 M. LIPTON & E. STEINBERGER, TAKEOVERS & FREEZEOUTS § 6.03(2) (1984); Hochman & Folger, *Deflecting Takeovers: Charter and By-Law Techniques*, 34 BUS. LAW. 537 (1978-79); Quinn, *How to Avoid Unwanted Takeovers*, 1 Corp. Guide (P-H) ¶ 26,061, at 26,386 (1981).

124. Williams, *Investors Vote on Bids to Fight Hostile Suitors*, Wall St. J., Mar. 28, 1985, at 35, col. 3.

125. Ingersoll, *'Fair Price' Clause is Found Popular to Fight Takeovers*, Wall St. J., Oct. 11, 1985, at 49, col. 2.

126. Grundfest, *supra* note 41, at 28, col. 1.

127. Carney, *Controlling Management Opportunism in the Market for Corporate Control: An Agency Cost Model*, 1988 WIS. L. REV. 385, 393. Gubitosi, *Takeover Defenses May Be Getting More Difficult*, CHEMICAL BUS., Oct. 17, 1983, at 33; Arieff, *Surveys Confirm Popularity of "Shark Repellents"*, Legal Times, May 30, 1983, at 2, col. 1-2; Arieff, *Drafting of "Shark Repellents" Receives Increased Attention*, Legal Times, Feb. 21, 1983, at 1, col. 2.

128. Coffee, *supra* note 47, at 1181 (citing Blustein, *Measures to Discourage Takeovers Stir Controversy at Annual Meetings*, Wall St. J., Apr. 18, 1983, at 29, col. 6).



prevent unequal treatment of shareholders, fair price amendments are "viewed as the most democratic of management proposals and thus most likely to win shareholder approval."<sup>129</sup>

## 2. Poison Pills

Shareholder rights plans, better known as "poison pills," are a related form of pre-planned tender offer defense. A potential target company issues each shareholder a "preferred" share for each common share held. The preferred share remains dormant unless a tender offeror acquires control of the corporation and attempts a second-stage merger. The change of control activates the preferred shares, which entitle the shareholder to purchase shares in the new corporation formed by the second-stage merger at a low price, thus greatly diluting the holdings of the hostile bidder. In some cases, the preferred rights may be triggered before the second-step merger, when the hostile bidder acquires a certain percentage of the target's stock.<sup>130</sup>

One of the main purposes of poison pills, which have been adopted by over 520 American companies,<sup>131</sup> is to deter front-end loaded, two-tiered tender offers.<sup>132</sup> Commentators have argued that such drastic measures can only be justified if they are used to defeat front-end loaded, two-tiered bids.<sup>133</sup>

Although fair price amendments and poison pills are the most lethal counter weapons, "[t]he supposed unfairness of two-tiered [tender] offers is presented as the only justification for a variety of

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129. *Girding for the Proxy Wars: In Takeovers, Management Can No Longer Count Out Big Stockholders*, BUS. WEEK, Apr. 16, 1984, at 46.

130. See generally Dawson, Pence & Stone, *Poison Pill Defensive Measures*, 42 BUS. LAW. 423 (1987); Helman & Junewicz, *A Fresh Look at Poison Pills*, 42 BUS. LAW. 771 (1987).

131. Lee, "Poison Pills" Benefit Shareholders By Forcing Raiders to Pay More for Targets, *Study Says*, WALL ST. J., Mar. 31, 1988, at 55, col. 3. This justification has been challenged by Oesterle, who notes that poison pills are most often used to block any-and-all bids. Oesterle, *The Negotiation Model of Tender Offer Defenses and the Delaware Supreme Court*, 72 CORNELL L. REV. 117, 123 n.30 (1986). This is true, in part, because two-tiered bids are on the way out. One reason is the advent of the poison pill. Another is that it takes a fairer, more attractive bid for a hostile bidder to overcome a poison pill.

132. Richard, Brussard & Williams, *Rights Plans Developments and Recent Litigation*, NAT'L L.J., May 23, 1988, at 28, col. 1; Dawson, Pence & Stone, *supra* note 130, at 425. Masters, "Poison Pill" Takeover Defense Stirs Controversy Uncertainty, *Legal Times*, Aug. 29, 1983, at 1, col. 2.

133. Lewkow & Groll, *Selected Issues in Acquisition Defense*, in ACQUISITIONS & TAKEOVERS 286 (1988); Note, *Protecting Shareholders Against Partial and Two-Tiered Takeovers: The Poison Pill Preferred*, 97 HARV. L. REV. 1964, 1965, 1971 (1984).

[other] defensive techniques."<sup>134</sup>

### C. Impact on the Business Judgment Rule

The fiduciary duty, which a target board of directors owes target shareholders when engaging in various defensive tactics to ward off tender offers, has generally been gauged by the business judgment rule.<sup>135</sup> The rule's presumption, which assumes that the directors' actions are valid, has been used to protect extreme defensive measures.<sup>136</sup> Although a few early cases had derailed excessive defensive tactics,<sup>137</sup> at the time when the front-end loaded, two-tiered tender offer came into vogue, the business judgment rule constituted a "nearly insurmountable obstacle"<sup>138</sup> to any shareholder claim that the board was violating its fiduciary duty. The rule, which in state courts led to "almost complete deference" to target management discretion,<sup>139</sup> became the subject of great

134. Dennis, *supra* note 46, at 319. See also Finkelstein, *supra* note 107, at 294 (listing an entire series of shark repellent amendments that target companies have investigated primarily to respond to two-tiered offers).

135. One formulation of the "business judgment rule" is as follows:

In the absence of a showing of bad faith on the part of the directors or of a gross abuse of discretion the business judgment of the directors will not be interfered with by the courts . . . . The acts of directors are presumptively acts taken in good faith and inspired for the best interests of the corporation, and a minority stockholder who challenges their *bona fides* of purpose has the burden of proof (citation omitted).

Warshaw v. Calhoun, 43 Del. Ch. 148, 157-58, 221 A.2d 487, 492-93 (1966). See generally Arsh, *The Business Judgment Rule Revisited*, 8 HOFSTRA L. REV. 93 (1979) (discussing genesis of the rule); Wander & Lecoque, *Boardroom Jitters: Corporate Control Transactions and Today's Business Judgment Rule*, 42 BUS. LAW. 29 (1986) (discussing purpose and application of the business judgment rule).

136. One of the most extreme instances occurred when Carter Hawley Hale (CHH) was planning a hostile tender offer for control of Marshall Field & Co., whose stock was trading at about \$20/share. Panter v. Marshall Field & Co., 646 F.2d 271 (7th Cir.), *cert. denied*, 454 U.S. 1092 (1981). The contemplated tender offer of \$42/share was called off after Marshall Field's board acquired some retail stores with the major motivation of creating an antitrust problem for CHH if it should proceed with the tender offer. *Id.* at 280. After the offer was aborted, Marshall Field's stock fell to below \$20/share. This obviously upset some Marshall Field shareholders, but the Seventh Circuit overruled their legal objections on the basis of the business judgment rule. *Id.* at 295.

See also Treadway Cos. v. Care Corp., 638 F.2d 357 (2d Cir. 1980) (stock sale to avert takeover upheld); Johnson v. Trueblood, 629 F.2d 287 (3d Cir. 1980) (sale of shares to friendly third party upheld), *cert. denied*, 450 U.S. 999 (1981).

137. Joseph E. Seagram & Sons, Inc. v. Abrams, 510 F. Supp. 860 (S.D.N.Y. 1981) (liquidation of all corporate assets—"corporate suicide"—enjoined).

138. Lynch & Steinberg, *The Legitimacy of Defensive Tactics in Tender Offers*, 64 CORNELL L. REV. 901, 926 (1979).

139. Couric, *Takeover Defense Costs Insured*, Legal Times, Nov. 3, 1980, at 3, col.

debate among commentators. Some defended deference on economic grounds and argued that tender offers should never be impeded.<sup>140</sup> Others could not understand why the business judgment rule's presumption of validity was being applied in the tender offer context at all, and argued that tender offers create an inherent conflict of interest for target management.<sup>141</sup>

A major turning point came in 1984 in *Norlin Corp. v. Rooney, Pace Inc.*<sup>142</sup> The hostile bidder purchased thirty-two percent of Norlin's shares in a series of market transactions. Fearful of an imminent takeover, Norlin's board transferred 28,395 shares of common stock to a wholly-owned subsidiary in exchange for cancellation of a promissory note. It then transferred 800,000 more authorized, but unissued, shares to the same subsidiary in exchange for a promissory note. Finally, it created an employee stock option plan, appointed three board members as trustees of the plan, and then transferred 185,000 shares to the plan in exchange for a promissory note. Within a few days, Norlin's board had transferred forty-nine percent of Norlin's shares to entities controlled by the board itself.<sup>143</sup> The board admitted that the only business purpose behind the maneuvers was to defeat the potential tender offer and that its shenanigans might cause Norlin shares to be delisted by the New York Stock Exchange.<sup>144</sup>

Applying New York law, the Second Circuit became one of the first courts to follow traditional corporate law in the tender offer setting by refusing to apply the business judgment rule when the directors were in a self-serving situation. The court held that when there is a conflict of interest, the burden of proof shifts to

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2 (quoting tender offer expense insurer). See also Blustein, *Courts Give Firms More Power to Fight Takeovers*, Wall St. J., Sept. 26, 1980, at 33, col. 3 (describing how the self-interest of one director cannot be imputed to the remainder of the board).

140. E.g., Easterbrook & Fischel, *The Proper Role of a Target's Management in Responding to a Tender Offer*, 94 HARV. L. REV. 1161 (1981). This article proposes a rule of managerial passivity, whereby management would not be allowed to resist takeovers, resulting in higher share value to holders of the stock.

141. E.g., Gelfond & Sebastian, *Reevaluating the Duties of Target Management in a Hostile Tender Offer*, 60 B.U.L. REV. 403 (1980) ("We believe that the tender offer case and state law must recognize the true role of target management — that of a party with great interest in the outcome of the offer."); Lynch & Steinberg, *supra* note 138, at 915 ("[O]nly a rare individual can affiliate closely with a corporation and still view an offeror's takeover attempt with detachment."); Prentice, *supra* note 2, at 344 (discussing the unavoidable conflict of interest which management faces in a hostile take-over).

142. 744 F.2d 255 (2d Cir. 1984).

143. *Id.* at 259.

144. *Id.* at 259-60.

the directors to demonstrate that their actions are in the best interests of the shareholders.<sup>145</sup> The Norlin directors were unable to satisfy that burden.

After *Norlin* it was no longer taboo for courts to question the *bona fides* of target directors engaged in defensive tactics. The notorious *Smith v. Van Gorkom*<sup>146</sup> decision gave this new thrust a boost by rejecting the business judgment rule as a defense for directors who had not done their homework prior to entering into an agreement to sell the corporation.<sup>147</sup>

Closer judicial scrutiny of defensive tactics is clearly exemplified by *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*,<sup>148</sup> in which Pantry Pride made a hostile bid for Revlon at \$47.50 per share, even after Revlon had enacted a poison pill.<sup>149</sup> Revlon engaged in various defensive tactics, which prompted Pantry Pride to raise its bid to \$53 per share.<sup>150</sup> Two days later, Revlon approved a leveraged buyout by white knight Forstmann at \$56 per share under the condition that Revlon cancel the poison pill. Pantry Pride raised its offer to \$56.25.<sup>151</sup> Forstmann responded by agreeing to raise its bid to \$57.25 contingent upon Revlon: (a) giving it a lock-up option to buy two Revlon divisions for \$100-\$175 million below market value if another acquirer bought Revlon, (b) signing a "no shop" agreement not to seek another bidder, (c) removing the poison pill, and (d) paying a \$25 million "good-bye" fee if another acquirer bought more than 19.9% of Revlon's stock.<sup>152</sup> Revlon's consent to these conditions led Pantry Pride to raise its offer to \$58, contingent on nullification of the pill.<sup>153</sup> Pantry Pride then challenged Revlon's actions in court.

The Delaware Supreme Court ruled against Revlon. The court held that once the Revlon board brought in white knight Forstmann, it had clearly made a decision to sell the company.

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145. *Id.* at 264.

146. 488 A.2d 858 (Del. 1985).

147. *Id.* at 872. See generally Herzel & Katz, *Smith v. Van Gorkom: The Business of Judging Business Judgment*, 41 BUS. LAW. 1187 (1986); Manning, *Reflections and Practical Tips on Life in the Boardroom After Van Gorkom*, 41 BUS. LAW. 1 (1985); Herzel, Davis & Colling, "Smith" Brings Whip Down on Directors' Backs, *Legal Times*, May 13, 1985, at 14, col. 1.

148. 506 A.2d 173 (Del. 1986).

149. *Id.* at 177.

150. *Id.*

151. *Id.* at 178.

152. *Id.*

153. *Id.* at 179.

Once that decision had been made, "[t]he directors' role changed from defenders of the corporate bastion to *auctioneers* charged with getting the best price for the stockholders at a sale of the company."<sup>154</sup> The various advantages the Revlon board had given Forstmann were inconsistent with this role as auctioneer, because they discouraged rather than encouraged competitive bidding.

### The Cases Allowing Greater Leeway in Response to Two-Tiered Tender Offers

Since *Norlin*, the tide of cases has run in favor of closer judicial scrutiny of defensive tactics and against allowing a target board of directors to shield its actions behind the business judgment rule.<sup>155</sup> However, when a front-end loaded, two-tiered tender offer is involved, courts have paid greater deference to the directors' discretion.

*Unocal Corp. v. Mesa Petroleum Co.*<sup>156</sup> involved a selective self-tender offer known as a "lollipop."<sup>157</sup> Mesa, led by T. Boone Pickens, launched a front-end loaded, two-tiered bid for 37% (it already owned 13%) of Unocal Corp.<sup>158</sup> The front-end tender offer price was \$54 per share in cash, the back-end merger price was \$54 per share in the form of highly subordinated junk bonds.<sup>159</sup> After being advised by its investment banker that the

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154. *Id.* at 182 (emphasis added).

155. See generally Herzel & Shepro, *The Changing Fortunes of Takeover Defenses*, 15 SEC. REG. L.J. 116 (1987); Simpson, *The Emerging Role of the Special Committee—Ensuring Business Judgment Rule Protection*, 43 BUS. LAW. 665 (1988); Note, *Corporate Auctions and Directors' Fiduciary Duties: A Third-Generation Business Judgment Rule*, 87 MICH. L. REV. 276 (1988); Mirvis, *Takeover Defense Shaped By Business Judgment Rule*, N.Y.L.J., Dec. 7, 1987, at 33, col. 3 ("The whole range of defensive actions has come under closer, if not close, scrutiny."); Block & Hoff, *Duties of Directors Facing Takeover Offer*, N.Y.L.J., Nov. 12, 1987, at 5, col. 1; Cherno & Gottlieb, *The "Level Playing Field" in Takeover Contests*, N.Y.L.J., July 27, 1987, at 21, col. 1 (Recent "cases reveal a heightened level of judicial review of a target board's actions in bidding contests arising out of hostile takeover attempts."); Lesser, *Directors*, Nat'l L.J., Feb. 24, 1986, at 17, col. 1 ("[T]he courts are scrutinizing the [target board's] decision-making process with increasing rigor.").

156. 493 A.2d 946 (Del. 1985).

157. See Leefeldt, *A Sweet Way to Foil Takeover Bids*, Wall St. J., Sept. 4, 1985, at 24, col. 4.

158. 493 A.2d at 949.

159. A "junk bond" is, by definition, a highly speculative security promising extraordinary returns. These securities were pioneered by the investment banking firm Drexel, Burnham Lambert, Inc. in its salad days before the Boesky scandal and helped finance a good portion of the recent wave in tender offers. See Williams, *How "Junk Financings" Aid Corporate Raiders in Hostile Acquisitions*, Wall St. J., Dec. 6, 1984, at

Mesa bid was inadequate, the Unocal board announced a selective self-tender offer to repurchase a large percentage of its own shares at \$72 per share.<sup>160</sup> The self-tender offer was selective because it was open to all Unocal shareholders except Mesa. Mesa sued, challenging its exclusion from the bid.

Following the *Norlin* line of reasoning, the Delaware Supreme Court stressed that although a target board of directors has a responsibility to protect the interests of its shareholders, it does not have "unbridled discretion to defeat any perceived threat by any Draconian means available."<sup>161</sup> In spite of the inherent conflict of interest, however, the board was entitled to the protection of the business judgment rule because it demonstrated that it had "reasonable grounds for believing that a danger to corporate policy and effectiveness existed because of another person's stock ownership."<sup>162</sup> In *Unocal* the board was able to show that it had acted in good faith, in part, because a board consisting of a majority of outside directors made a reasonable investigation into the adequacy of the offer.<sup>163</sup>

The court also emphasized the importance of balance, stating that "[i]f a defensive measure is to come within the ambit of the business judgment rule, it must be *reasonable in relation to the threat posed*."<sup>164</sup> The court found that a reasonable relationship existed between the defensive tactic and the threat posed for the following reason:

Here, the threat posed was viewed by the Unocal board as a grossly inadequate two-tier coercive tender offer coupled with the threat of greenmail.

Specifically, the Unocal directors had concluded that the value of Unocal was substantially above the \$54 per share offered in cash at the front end. Furthermore, they determined that the subordinated securities to be exchanged in Mesa's announced squeeze out of the remaining shareholders in the "back-end" merger were "junk bonds" worth far less than \$54. *It is now well recognized that such offers are a classic coercive measure designed to stampede shareholders into tendering at the first tier, even if the price is inadequate, out of fear of what*

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1, col. 6.

160. 493 A.2d at 950-51.

161. *Id.* at 955.

162. *Id.*

163. *Id.* at 958.

164. *Id.* at 955 (emphasis added).

they will receive at the back end of the transaction. Wholly beyond the coercive aspect of an inadequate two-tier tender offer, the threat was posed by a corporate raider with a national reputation as a "green-mailer."

In adopting the selective exchange offer, the board stated that its objective was either to defeat the inadequate Mesa offer or, should the offer still succeed, provide the 49% of its stockholders, who would otherwise be forced to accept "junk bonds," with \$72 worth of senior debt. We find that both purposes are valid.

However, such efforts would have been thwarted by Mesa's participation in the exchange offer. First, if Mesa could tender its shares, Unocal would effectively be subsidizing the former's continuing effort to buy Unocal stock at \$54 per share. Second, Mesa could not, by definition, fit within the class of shareholders being protected from its own coercive and inadequate tender offer.<sup>165</sup>

Soon after this decision, the SEC outlawed the "lollipop" selective self-tender offer with its "All Holders Rule,"<sup>166</sup> which requires that a tender offer be open to all shareholders equally, including hostile greenmailers. Nonetheless, *Unocal* clearly made the point that front-end loaded, two-tiered bids are a drastic threat to the interests of target shareholders and justify drastic defensive measures.

Although several cases have struck down poison pills put in place by target management,<sup>167</sup> the leading case upholding the poison pill, not coincidentally, involved a defense against a perceived front-end loaded, two-tiered tender offer. In *Moran v. Household International, Inc.*,<sup>168</sup> the plaintiff, a director of Household, was contemplating a takeover of Household by an-

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165. *Id.* at 956 (emphasis added)(footnotes omitted).

166. Amendments to Tender Offer Rules — All Holders and Best-Price, Exchange Act Release No. 23,421, [1986-1987 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,016 (July 11, 1986).

167. *E.g.*, *Dynamics Corp. of America v. CTS Corp.*, 794 F.2d 250 (7th Cir. 1986), *rev'd on other grounds*, 107 S. Ct. 1637 (1987); *Amalgamated Sugar Co. v. NL Industries, Inc.*, 644 F. Supp. 1229 (S.D.N.Y. 1986), *aff'd*, 825 F.2d 634 (2d Cir. 1987); *R.D. Smith & Co. v. Preway, Inc.*, 644 F. Supp. 868 (W.D. Wis. 1986)(denying a motion to enjoin the implementation of a poison pill because plaintiffs failed to show the requisite irreparable harm, but stating that a challenge to the merits of the poison pill would likely succeed); *Grand Metro. Pub. Co. v. Pillsbury Co.*, Civ. No. 10139, slip op. at 29-30 (Del. Ch. Dec. 16, 1988); *Mills Acquisition Co. v. Macmillan, Inc.*, [Current Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,071 (Del. Ch. Oct. 18, 1988), *rev'd on other grounds*, ¶ 94,072 (Del. Nov. 2, 1988).

168. 500 A.2d 1346 (Del. 1985).

other corporation which he controlled. In the face of that threat, the Household board adopted a poison pill which entitled Household common stockholders to the issuance of one "right" (redeemable by the board for fifty cents each) per common share under two conditions: the announcement of a tender offer for thirty percent of Household or the acquisition of twenty percent of the corporation by a single bidder. If the first condition occurred, the "rights" were to be issued and could be exercised immediately to purchase 1/100th of a share of new preferred stock for \$100. If the second condition occurred, the "rights" were to be issued, were to become nonredeemable, and could be exercised to purchase 1/100th of a share of preferred. If a "right" was not exercised for a preferred share when it was issued, and a merger or consolidation occurred later, the "rights" holder could then exercise each "right" to buy \$200 of the common stock of the tender offeror for \$100, thus severely diluting the position of any hostile bidder.<sup>169</sup>

The Delaware Supreme Court viewed this poison pill more favorably because it was pre-planned, rather than an after-the-fact response to a bid. It was thus less likely that the poison pill was being instituted solely to entrench management.<sup>170</sup> The court, following its reasoning in *Unocal*, determined that the poison pill, although an extreme measure, was reasonable in relation to the threat posed. And what threat was posed? According to the court: "Household has adequately demonstrated . . . that the adoption of the Rights Plan was in reaction to what it perceived to be the threat in the market place of coercive two-tier tender offers."<sup>171</sup>

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169. *Id.* at 1348-49.

170. *Id.* at 1350.

171. *Id.* at 1356. The Household board was also concerned with the possibility of other offensive tactics such as "bootstrap" and "bust-up" takeovers, especially if they took the form of two-tier bids. *Id.* at 1357. The court cited its own language from *Unocal* regarding the coercive nature of two-tiered bids. *Id.* at 1357 n.14.

*See also* Desert Partners, L.P. v. U. USG Corp., 686 F. Supp. 1289, 1299 (N.D. Ill. 1988)(upholding use of poison pill in light of hostile two-tiered bid); Southdown, Inc. v. Moore McCormick Resources, Inc., 686 F. Supp. 595 (S.D. Tex. 1988)(since all-cash bid was non-coercive, target management's poison pill defensive activities were not fully justified); CRTF Corp. v. Federated Dep't Stores, Inc., [1987-1988 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 93,680 (S.D.N.Y. March 18, 1988)(upholding poison pill used to defend against front-end loaded, two-tiered bid); Facet Enter., Inc. v. Prospect Group, Inc., C.A. No. 9746 (Del. Ch. April 11, 1988)(upholding poison pill even in the midst of an auction because it could still benefit shareholders by deterring street sweeps or front-end loaded offers). *But see* Black & Decker Corp. v. American Standard, Inc., [1987-1988 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 93,685 (D. Del. March 16, 1988)(auction duty not



Another controversial defensive tactic which has been considered in relation to two-tiered bids is the "golden parachute," which typically grants generous (sometimes lavish) severance benefits to target management should a hostile takeover actually occur.<sup>172</sup> Frequently, the hostile bidder need not even fire the managers; they may voluntarily quit and still receive the benefits. As a defensive tactic, the golden parachute has the advantage of making the target corporation more expensive to acquire. When the hostile bidder buys the target, it acquires the target's contractual obligations, including the golden parachutes. Although there is little definitive litigation on the validity of golden parachutes,<sup>173</sup> not surprisingly, the leading case approving the measure involved a threatened front-end loaded, two-tiered tender offer.

In *Buckhorn, Inc. v. Ropak Corporation*,<sup>174</sup> Ropak announced a cash tender offer for any-and-all Buckhorn shares after negotiations for a friendly merger had broken down.<sup>175</sup> The Buckhorn board engaged in a number of defensive tactics. It authorized a fruitless search for acquisition candidates or purchasers for its crown jewels to derail the Ropak offer, it instituted a poison pill, and it granted "golden parachute" severance agreements worth \$750,000 and substantial stock options to six key executives.<sup>176</sup>

The district court generally approved the use of the poison pill, but invalidated the price because the board had not done sufficient homework before setting it.<sup>177</sup> The court's reasoning for ap-

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eliminated by fact that one of the bids is two-tiered); *Minstar Acquiring Corp. v. AMF, Inc.*, 621 F. Supp. 1252 (S.D.N.Y. 1985)(refusing to allow alleged front-end loaded, two-tiered tender offer as justification for "scorched earth" defensive tactics that violated state corporate law, were undertaken primarily to entrench target management, and would have deterred any unfriendly offer).

172. See Moore, *Business Grows Bolder in Giving Lucrative Golden Parachutes*, Legal Times, Mar. 24, 1986, at 1, col. 2; Prokesch, *Too Much Gold in the Parachute?*, N.Y. Times, Jan. 26, 1986, at F1, col. 1.

173. Most analyses of golden parachutes have seriously questioned their practical legitimacy as a hostile takeover defense. E.g., Moore, *Golden Parachutes Appearing Vulnerable*, Legal Times, Sept. 30, 1985, at 1; Riger, *Taking a New Look at the Validity of Golden Parachute Agreements*, Nat'l L.J., Sept. 16, 1985, at 26, col. 1. But see Herzog, *Golden Parachute Contracts: Analysis*, Nat'l L.J., Feb. 15, 1982, at 20, col. 1 (suggesting parachutes perform a useful economic function by equalizing executive compensation with risks they must endure).

174. 656 F. Supp. 209 (S.D. Ohio 1987).

175. *Id.* at 215.

176. *Id.* at 216-18.

177. *Id.* at 231.

proving the poison pill was similar to that of *Moran* and *Revlon*, although the Ropak bid was purportedly an any-and-all cash offer. In determining whether the Buckhorn board's use of the poison pill was reasonable in relation to the threat posed by Ropak, the court held:

There is no question that the directors understood and appreciated the fact that Ropak's offer, on its face, was a cash offer for any and all shares of Buckhorn. However, notwithstanding their understanding of the terms of the offer, the directors believed that the offer was, in fact, a two-tiered tender offer. The basis for this belief was rooted in the fact that Ropak had no cash on hand, but instead had to secure financing for the entire transaction. Furthermore, the directors believed that if Ropak could not secure sufficient financing to purchase all the shares or, alternatively, if some shares were not tendered, Ropak would exchange Ropak securities for the Buckhorn stock held by these shareholders. Given the debt structure of Ropak, which would only be increased by the acquisition of Buckhorn stock, the directors were concerned that the Ropak securities which these shareholders would receive would be of less value than the Buckhorn securities. These concerns were buttressed . . . by Mr. Downen, Buckhorn's investment banker, who was skeptical about Ropak's ability to secure financing for the entire acquisition and about the quality of the Ropak securities exchanged for non-tendering and "back-end" Buckhorn shareholders.

The Court does not believe that the directors' fears about the potential two-tiered nature of the Ropak offer and its impact on back-end or non-tendering shareholders were unreasonable.<sup>178</sup>

The court also validated the golden parachute severance agreements. They were reasonably based on Buckhorn's concern about "losing its key management at a critical time of transition."<sup>179</sup> Although the court did not explicitly tie its approval of the golden parachutes to the threat of a functional two-tiered offer, it stressed that defensive tactics must be reasonable in relation to the threat posed and that two-tiered tender offers justify more radical defensive tactics than "any-and-all" offers.<sup>180</sup>

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178. *Id.* at 228-29.

179. *Id.* at 232-33. However, the court did invalidate certain stock option plans because they greatly diluted the interests of the common shareholders without adding much incentive for the executives to stay on the job beyond those already provided by the golden parachute severance agreements. *Id.* at 233.

180. *Id.* at 229. Clearly, in this case it is the perception that the Ropak offer is two-tiered in nature which creates the threat that some shareholders will be relegated to minor-

In a similar case, *Ivanhoe Partners v. Newmont Mining Corporation*,<sup>181</sup> Newmont had blocked a takeover attempt by Gold Fields, which owned 26% of Newmont. Newmont had signed a three-year "standstill" agreement<sup>182</sup> with Gold Fields, which Gold Fields could cancel if any other party bought more than 9.9% of Gold Fields.<sup>183</sup> Ivanhoe Partners, led by T. Boone Pickens, launched a \$95 per share tender offer for 42% of Newmont's stock. Ivanhoe said that it would seek to obtain the remaining Newmont shares at the same price, but did not commit itself to do so.<sup>184</sup>

Faced with threats from two sides, Newmont engaged in delicate defensive maneuvers. The board installed golden parachutes and signed a \$2.25 billion "cyanide capsule."<sup>185</sup> These maneuvers led Ivanhoe to increase its bid to \$105 per share.<sup>186</sup> Then Newmont announced a \$33 per share nondiscriminatory dividend,<sup>187</sup> which Gold Fields could use in a "street sweep"<sup>188</sup> to purchase up to 49% of Newmont.<sup>189</sup> In exchange for the dividend, Gold Fields entered into a ten-year standstill agreement which

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ity or back-end status. It is in the protection of this potential class of shareholders that the court finds justification for the Buckhorn directors' poison pill plan. If the offer were perceived as merely an "any-and-all" shares offer, no such class of shareholders would exist and the poison pill would lack justification.

181. 533 A.2d 585 (Del. Ch.), *aff'd*, 535 A.2d 1334 (Del. 1987).

182. In a "standstill" agreement, a potential bidder, in exchange for consideration, agrees not to pursue certain aggressive takeover measures, such as starting a proxy fight or a tender offer. *See generally* Bartlett & Andrews, *The Standstill Agreement: Legal and Business Considerations Underlying a Corporate Peace Treaty*, 62 B.U.L. REV. 143 (1982); Note, *The Standstill Agreement: A Case of Illegal Vote Selling and a Breach of Fiduciary Duty*, 93 YALE L.J. 1093 (1984).

183. 533 A.2d at 591.

184. *Id.* at 595-96.

185. *Id.* at 595. A "cyanide capsule" is a provision in a contract that calls for renegotiation or immediate payment upon a change of control. In this case, Newmont had lined up a \$2.25 billion line of credit which could be deemed in default if any entity other than Gold Fields acquired control of Newmont. A cyanide capsule is a non-stock related version of a poison pill. For a discussion of poison pills, see Gerlits & Barnard, *Poison Pill Takeover Defense Lays Open Corporate Boards*, Nat'l L.J., May 27, 1985, at 15, col. 1.

186. 533 A.2d at 597.

187. *Id.*

188. In a "street sweep" a buyer goes into the market during or immediately after a tender offer and buys large amounts of shares, usually from arbitrageurs at a premium over market. The SEC is not at all fond of street sweeps, which normally are a disadvantage to the small investor. *See* Blanc, *Commission Proposes to Outlaw Market Sweeps*, Nat'l L.J., Nov. 9, 1987, at 28, col. 1; Bagley & Chuh, *Takeover Defense in the Wake of "Carter Hawley"*, Nat'l L.J., Nov. 12, 1984, at 15, col. 1. While these articles use the term "market sweeps," the term "street sweeps" is used in *Ivanhoe*. 533 A.2d at 597.

189. 533 A.2d at 597.

bound Gold Fields to vote its shares with Newmont management for director nominees and restricted Gold Field's ability to sell its shares.<sup>190</sup> In response, Ivanhoe reduced its bid to \$78 per share, in order to account for the money paid out in the dividend, and joined a class of Newmont shareholders in suing to enjoin the street sweep and the Newmont defensive tactics.<sup>191</sup>

The trial court denied almost all aspects of the requested relief.<sup>192</sup> The court's discussion of whether the defensive tactics were reasonable in relation to the threat posed by the Ivanhoe offer echoed its reasoning in *Buckhorn*:

[The board's] conclusion that the Ivanhoe offer — a two-tier offer having no assured “back end” merger at the same (\$105) price — was inadequate, was supported by the *Unocal* decision, which recognized the inherently coercive nature of a two-tier offer that one of the same offerors (Mesa Petroleum) had made two years before.<sup>193</sup>

These cases demonstrate that when an explicit or implicit two-tiered tender offer is involved, courts are more likely to go against the current trend of more stringent judicial scrutiny and restraint of defensive tactics<sup>194</sup> and allow target management

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190. *Id.* at 597-98.

191. *Id.* at 598.

192. The trial court refused to enjoin the golden parachutes, the cyanide capsule, the dividend, or the street sweep. It did conclude that the ten-year standstill agreement went too far in entrenching Newmont's management. The Gold Fields' 49.9% share which would be controlled by Newmont's board went too far in “locking up” control and making any tender offer for as long as ten years an impossibility. *Id.* at 608. Newmont and Gold Fields then amended the standstill agreement to meet the trial judge's objections. The Delaware Supreme Court then affirmed all aspects. *Ivanhoe Partners v. Newport Mineral Corp.*, 535 A.2d 1334, 1334 (Del. 1987).

193. 533 A.2d at 607 (quoting *Unocal Corp. v. Mesa Petroleum*, 493 A.2d 946, 956 (Del. 1985)).

194. The causal relationship between the presence of front-end loaded, two-tiered tender offers and the decisions of courts should not be overstated. One can detect a strong correlation in the cases cited above, but two authors have recently taken the position that although courts are carefully scrutinizing how boards fulfill their “auctioneer” role, once they have decided to sell the company, the directors are still given great discretion to battle a hostile offer in an attempt to keep the company independent. Johnson & Siegel, *Corporate Mergers: Redefining the Role of Target Directors*, 136 U. PA. L. REV. 315, 334 (1987). Although they make a valid point, their argument fails to account for all the cases, including the following: *Dynamics Corp. v. CTS Corp.*, 794 F.2d 250 (7th Cir. 1986), *rev'd on other grounds*, 107 S. Ct. 1637 (1987); *Norlin Corp. v. Rooney, Pace Inc.*, 744 F.2d 255 (2d Cir. 1984); *Mills Acquisition Co. v. Macmillan, Inc.*, [Current Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,072 (Del. Nov. 2, 1988); *AC Acquisitions Corp. v. Anderson, Clayton & Co.*, 519 A.2d 103 (Del. 1986); *Grand Metro. Pub. Co. v. Pillsbury Co.*, Civ. No. 10319 (Del. Ch. Dec. 16, 1988); *City Capital Assocs. v. Interco, Inc.*, [Current Binder] Fed. Sec.

greater discretion in fending off the takeover.

#### D. Impact on State Tender Offer Laws

As noted earlier, in the wake of the Supreme Court's decision in *Edgar v. MITE Corporation*,<sup>195</sup> the lower federal courts invalidated a host of state tender offer statutes (statutes drafted before *MITE* are called "first generation" statutes) on Supremacy Clause and Commerce Clause grounds.<sup>196</sup> Undaunted, approximately thirty states passed "second generation" statutes designed to avoid these constitutional problems.<sup>197</sup> These statutes can be grouped into five rough categories:<sup>198</sup>

First, there are the "fair price" or "second-tier" statutes. This type of regulation was pioneered in Maryland<sup>199</sup> and quickly became the most popular form of second generation statute.<sup>200</sup> The statute typically requires that a tender offeror either pay a "fair price" (a price that is as high or higher than the tender offer price) in the second-step merger, or obtain a supermajority approval of the other shareholders, before completing the second-step merger.

A second category consists of "shareholder redemption" stat-

L. Rep. (CCH) ¶ 94,084 (Del. Ch. Nov. 1, 1988); *Robert M. Bass Group, Inc. v. Evans*, Civ. No. 9953 (Del. Ch. July 14, 1988). Of course, judicial reaction to front-end loaded, two-tiered tender offers does not account for all major recent decisions, and this Article does not advance that claim.

195. 457 U.S. 624 (1982).

196. See *supra* note 91 and accompanying text.

197. See Prentice, *The Role of States in Tender Offer Regulations: An Analysis of CTS*, 1988 COLUM. BUS. L. REV. 1, 3 n.6. Fifteen states had tender offer laws on the books before *CTS* was decided: Connecticut, Georgia, Hawaii, Illinois, Indiana, Kentucky, Maine, Maryland, Michigan, Mississippi, New Jersey, New York, Ohio, Pennsylvania, and Virginia. Fourteen states have passed tender offer laws since *CTS*: Arizona, Delaware, Florida, Louisiana, Massachusetts, Minnesota, Missouri, Nevada, North Carolina, Oklahoma, Oregon, Utah, Washington, and Wisconsin.

198. I borrow these categories, with some relabeling, from Professor Pinto, who also discussed two other categories: the Fiduciary Duty Model and the Full Disclosure Model. Pinto, *Takeover Statutes: The Dormant Commerce Clause and State Corporate Law*, 41 U. MIAMI L. REV. 473, 478-83 (1987). The Fiduciary Duty Model was pioneered in Pennsylvania and authorizes a target board to consider the interests of constituencies other than its shareholders (such as employees and communities) in planning tender offer responses. 42 PA. CONS. STAT. ANN. § 8363 (Purdon Supp. 1988). The Full Disclosure Model, exemplified in Minnesota, supplements Williams Act disclosure requirements. MINN. STAT. ANN. § 80B.03 (West 1986).

199. MD. CORPS. & ASS'NS CODE ANN. §§ 3-601 to -603 (1985).

200. Hanks, *State Takeover Laws: The Second Generation*, Nat'l L.J., Nov. 3, 1986, at 34, col. 1.

utes. The "shareholder redemption" statute was pioneered in Pennsylvania<sup>201</sup> and patterned after British tender offer regulations.<sup>202</sup> It requires any shareholder who acquires a certain percentage of shares, for example, thirty percent, to buy out the remaining shareholders at "fair value" if they so demand. "Fair value" normally requires payment of at least as high a price as was paid in the tender offer.<sup>203</sup>

"Control share acquisition" statutes comprise a third category of these second generation statutes. Pioneered in Ohio,<sup>204</sup> these statutes typically will not allow a potential acquirer of shares to complete a purchase that would put him over certain thresholds of ownership without first obtaining the approval of the other shareholders.

A fourth category of these statutes, the "voting rights" statutes, was first adopted in Indiana,<sup>205</sup> and is similar to a control share acquisition statute. It allows the offeror to acquire the shares that give him control of the corporation, but does not allow him to vote them without receiving the approval of the other shareholders.

Finally, there are the "business combination" statutes which were originated in New York<sup>206</sup> and modified in Delaware.<sup>207</sup> These statutes allow an acquirer to purchase shares and to vote them. However, he cannot complete the normally-desired second-stage merger for a period of three to five years without receiving director approval or the approval of the other shareholders. Even after the specified waiting period, the second-step merger can occur only if the other shareholders approve or the acquirer pays a "fair price" as determined by statutory formula.<sup>208</sup>

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201. 15 PA. CONS. STAT. ANN. §§ 1409.1(C)(1)-(3)(Purdon Supp. 1988); 42 PA. CONS. STAT. ANN. § 8363 (Purdon Supp. 1988).

202. See DeMott, *Current Issues in Tender Offer Regulation: Lessons from the British*, 58 N.Y.U. L. REV. 945, 960-62 (1983).

203. Pinto, *supra* note 198, at 480 n.39; Booth, *supra* note 28, at 1679.

204. OHIO REV. CODE ANN. §§ 1701.01, .831 (Anderson 1985).

205. IND. CODE ANN. §§ 23-1-42-1 to -11 (West Supp. 1986).

206. N.Y. BUS. CORP. LAW § 912 (McKinney 1986).

207. See Veasey, *A Statute Was Needed To Stop Abuses*, N.Y. Times, Feb. 7, 1988, at F2, col. 1.

208. *Id.* See also Bandow, *Curbing Raiders is Bad for Business*, N.Y. Times, Feb. 7, 1988, at F2, col. 1; Pinto & McGrath, *Problems and Issues Raised in State's New Takeover Law*, N.Y.L.J., Mar. 17, 1986, at 20, col. 1.

### 1. Purpose and Effect of Second Generation Statutes

All five of the most popular second generation statutes discourage front-end loaded, two-tiered tender offers.<sup>209</sup> The fair price statute protects the shareholders who did not tender in the first tier from a lower second-tier price by requiring that they receive as much compensation in the second-step merger as the shareholders who tendered in the first step received.<sup>210</sup> The shareholder redemption statute has an identical effect. The shareholder who did not tender can decide to sell later and be assured of receiving as high a price as those who did tender.<sup>211</sup> Obviously both the fair price and the shareholder redemption statutes reduce the "stampede" effect of front-end loaded, two-tiered tender offers by protecting the interests of minority shareholders in the second-step freeze-out merger. The shareholder redemption statute clearly encourages any-and-all offers, because a hostile bidder who commences a front-end loaded, two-tiered offer may be forced to redeem 100% of the target's shares.<sup>212</sup>

The control share acquisition law also discourages front-end loaded, two-tiered tender offers by allowing the target shareholders to vote as a group to determine their own destiny. Instead of being trapped in the "prisoner's dilemma" and being forced to act individually out of fear of what other shareholders will do, the shareholders democratically determine their own fate as a group.<sup>213</sup> The voting rights model has the same effect, because most offerors will not wish to acquire non-voting shares.<sup>214</sup> Under both statutes, shareholders can tender to protect their interests, yet vote against bids they consider inadequate. Risk aversion no longer forces them to tender to an offer they oppose.

The business combination statute also encourages "any-and-all" offers. A bidder who attempts a front-end loaded, two-tiered tender offer finds himself waiting three to five years before he can effect the planned second-step merger, and even then he probably will have to pay at least as much as the original tender offer

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209. See, Note, *The Constitutionality of Second Generation Takeover Statutes*, 73 VA. L. REV. 203, 222-25 (1987).

210. See *supra* note 200 and accompanying text.

211. See *supra* note 203 and accompanying text.

212. *Id.*

213. See *supra* note 204 and accompanying text.

214. See *supra* note 205 and accompanying text.

price.<sup>215</sup>

There is evidence that these statutes were purposely designed to blunt the impact of two-tiered tender offers. The legislative history of the first fair price statute in Maryland clearly indicates this purpose.<sup>216</sup> Commentators agree that the Pennsylvania shareholder redemption provisions were aimed directly at stopping two-tiered offers.<sup>217</sup> The legislative history of the original control share acquisition statute in Ohio contains a finding of fact that tender offers are coercive,<sup>218</sup> and the Missouri version is clearly aimed at protecting shareholders from front-end loaded, two-tiered offers.<sup>219</sup> The Indiana version of a voting rights statute has been justified on the basis of its deterrent effect on front-end loaded, two-tiered offers.<sup>220</sup> Although the New York business combination statute has been justified as deterring front-end loaded, two-tiered offers,<sup>221</sup> it is more directly aimed at discouraging highly leveraged offers.<sup>222</sup> On the other hand, the Delaware legislature focused directly on the prisoner's dilemma created by front-end loaded, two-tiered tender offers when passing its antitakeover legislation.<sup>223</sup>

One can conclude that the bad reputation<sup>224</sup> of front-end

215. See *supra* note 208 and accompanying text.

216. Hanks, *Maryland-Type Takeover Statutes: Are They "Fair Price" or Foul Ball?*, Nat'l L.J., Sept. 8, 1986, at 32, col. 2., (cited in DEPARTMENT OF LEGISLATIVE REFERENCE OF MARYLAND, STAFF REPORT TO THE GENERAL ASSEMBLY OF 1983, at 9, 14, 50 (1983)). See also Block, Barton & Roth, *State Takeover Statutes: The "Second Generation"*, 13 SEC. REG. L.J. 332, 352 (1986); Garrity, *Post-MITE State Takeover Statutes: Constitutional Issues and Recent Cases*, 42 BUS. LAW. 586, 589 (1987); Warren, *Developments in State Takeover Regulation: MITE and Its Aftermath*, 40 BUS. LAW. 670, 697 (1985).

217. Bainbridge, *State Takeover and Tender Offer Regulations Post-MITE: The Maryland, Ohio and Pennsylvania Attempts*, 90 DICK. L. REV. 731, 748 (1986); Newlin & Gilmer, *The Pennsylvania Shareholder Protection Act: A New State Approach to Deflecting Corporate Takeover Bids*, 40 BUS. LAW. 111, 113 (1984); Sargent, *Do the Second-Generation State Takeover Statutes Violate the Commerce Clause?*, 8 CORP. L. REV. 3, 11 (1985).

218. See Sargent, *supra* note 217, at 31 n.85 (1985) (citing Ohio Substitute House Bill No. 822 §§ 3(A)(3), 3(A)(4)). This act is clearly a form of "back-end tender offer regulation." *Id.* at 30.

219. Note, *Missouri Takeover Regulation: Solving the Shareholder Coordination Problem*, 63 WASH. U.L.Q. 491, 501-02 (1985).

220. Booth, *supra* note 28, at 1179; Pinto, *supra* note 198, at 499.

221. J. BROOKS, *supra* note 3, at 261; Note, *supra* note 209, at 236.

222. See Danilow & Bentley, 20 REV. SEC. & COMMODITIES REG. 13, 18 (1987).

223. Veasey, Finkelstein & Shaughnessy, *The Delaware Takeover Law: Some Issues, Strategies, and Comparisons*, 43 BUS. LAW. 865, 871 (1988); Goldman, *Delaware Anti-Takeover Legislation is Needed*, Nat'l L.J., Feb. 8, 1988, at 31, col. 1.

224. The front-end loaded, two-tiered tender offer is the Sean Penn of takeover tactics.



loaded, two-tiered tender offers has had a significant impact on state tender offer legislation. However, two-tiered bids are not the only impetus. State interest, legitimate or not, in protecting local target companies from sharks in other states is a major motivating force behind many state tender offer laws.<sup>225</sup> The distasteful scenario of target companies making a trip to the state legislature as their first defensive tactic has occurred altogether too often.<sup>226</sup>

Professor Roberta Romano has developed a theory based on political power structures to explain why state tender offer laws are passed. Using Connecticut as her primary example, she explained how the political influence of a major local corporation, in this case Aetna Life and Casualty Insurance Company, can override potential conflicting interests.<sup>227</sup> Although Professor Romano's theories have much validity, in my opinion politicians require a rationale for legislation other than pressure from major corporations, a rationale that will appeal to the voters' sense of fairness. The bogey man in the guise of the front-end loaded, two-tiered tender offer provides such a rationale. As Romano noted, fair price statutes are the most popular form of second generation statute because they are easy to justify in terms of the best interests of all shareholders. "Recognition of a need for equal treatment among shareholders makes a fair price statute appealing; the concern for preventing allegedly coercive tenders is ammunition for refuting the contention that [tender offer] legislation is principally a device to entrench poorly performing managers by discouraging takeovers."<sup>228</sup> In a similar manner, the other major types of

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225. See Danilow & Bentley, *supra* note 222, at 19 ("The New York statute enables target boards to hinder or block many (although not all) nationwide tender offers — including offers by bidders who plan to effect a second-step merger . . .").

226. See, e.g., White, *Washington State Legislative Leaders Meet with Boeing*, Wall St. J., July 30, 1987, at 12, col. 1 ("Boeing Co., anticipating a possible unfriendly takeover bid from investor T. Boone Pickens, met with leaders of the Washington State Legislature to discuss modifications of the state's existing anti-takeover laws."); Miller, *How Indiana Shielded a Firm and Changed the Takeover Business*, Wall St. J., July 1, 1987, at 1, col. 6 (the Chairman of Arvin Industries immediately contacted state senate leaders after being threatened with a tender offer and effectuated "emergency legislation," resulting in Indiana's second anti-takeover statute within two months); Kilman & Schwadel, *Minnesota Passes Anti-Takeover Bill Sought to Thwart Dayton Hudson Suitor*, Wall St. J., June 26, 1987, at 6, col. 1 ("The Minnesota Legislature passed a strong anti-takeover bill aimed at thwarting Dart Group Corp.'s interest in acquiring Dayton Hudson Corp., the big Minneapolis-based retailer.").

227. Romano, *The Political Economy of Takeover Statutes*, 73 VA. L. REV. 111, 122-41 (1987).

228. *Id.* at 119.

second generation state takeover statutes no doubt owe some of the support necessary for their passage to the deterrent effect which they have on the alleged coercion and inequity generated by front-end loaded, two-tiered tender offers.<sup>229</sup>

## 2. Supreme Court Validation

Following the Supreme Court's decision in *Edgar v. MITE Corp.*, a cloud hung over all the second generation statutes, and some were struck down in the lower federal courts.<sup>230</sup> Most legal scholars were predicting a similar fate for second generation statutes<sup>231</sup> in the Supreme Court. Therefore, when the issue came before the Court in *CTS Corp. v. Dynamics Corp. of America*,<sup>232</sup> the result was surprising.

*CTS* addressed the validity of the Indiana Control Share Acquisition Act<sup>233</sup> (a voting rights statute in my system of categori-

229. See *supra* notes 216-23 and accompanying text.

230. E.g., *Dynamics Corp. of America v. CTS Corp.*, 794 F.2d 250 (7th Cir. 1986)(Indiana's second generation statute violated the Supremacy and Commerce Clauses and was preempted by the Williams Act.), *rev'd on other grounds*, 107 S. Ct. 1637 (1987); *Fleet Aerospace Corp. v. Holderman*, 796 F.2d 135 (6th Cir. 1986)(concluding that Ohio Rev. Stat. § 1701.831 is unconstitutional); *APL Ltd. Partnership v. Van Dusen Air, Inc.*, 622 F. Supp. 1216 (D. Minn. 1985)(Minnesota's statute "is a different statute from the Illinois Act under consideration in *Edgar v. MITE Corp.*, yet it suffers from the same constitutional infirmities.").

231. E.g., *Siamas, Can States Curb Tender Offers?*, 73 A.B.A. J. 80, 85 (1987)(predicting that the Supreme Court might invalidate the Indiana law, leaving "domestic corporations to take their takeover concerns to Congress, not their state legislatures").

232. 107 S. Ct. 1637 (1987). See generally Langevoort, *The Supreme Court and the Politics of Corporate Takeovers: A Comment on CTS Corp. v. Dynamics Corp. of America*, 101 HARV. L. REV. 96 (1987)(Langevoort compares the impact and significance of the Supreme Court's Commerce Clause and preemption analysis in *CTS Corp. v. Dynamics Corp. of America*, with their decision in *Edgar v. MITE Corp.*); Regan, *Siamese Essays: (I) CTS Corp. v. Dynamics Corp. of America and Dormant Commerce Clause Doctrine; (II) Extraterritorial State Legislation*, 85 MICH. L. REV. 1865 (1987) (addresses the Supreme Court's dormant Commerce Clause analysis); Tannon & Stewart, *Did the Indiana Decision Buoy Takeover Regulation?*, MERGERS & ACQUISITIONS, Sept.-Oct. 1987, at 22, 43 ("In upholding Indiana's control share acquisition law, the United States Supreme Court apparently strengthened the power of states to regulate takeovers if shareholders are given a voice in the process. Bolder legislative initiatives could lead to judicial rejection, which was the fate of most earlier statutes."); Brown, Paley & Richman, *Does CTS Mean New Life for State Takeover Statutes?*, N.Y.L.J., July 27, 1987, at 21, col. 2 ("The CTS ruling appears to legitimate various types of 'second' and 'third' generation statutes enacted in the wake of MITE that (a) apply only to corporations incorporated in the regulating state and that have other substantial contracts with the state . . . and (b) do not bar transactions in shares but regulate corporate governance . . .").

233. IND. CODE ANN. §§ 23-1-42-1 to -11 (West Supp. 1986).

zation). The district court<sup>234</sup> and the Seventh Circuit<sup>235</sup> followed what they believed to be the *MITE* line of reasoning and invalidated the statute on both Commerce Clause and Supremacy Clause grounds.

Judge Posner, writing for the Seventh Circuit, emphasized that tender offers are beneficial and that “[f]or the sake of trivial or even negative benefits to its residents Indiana is depriving non-residents of the valued opportunity to accept tender offers from other nonresidents.”<sup>236</sup> This “market approach” was consistent with Justice White’s plurality opinion in *MITE*, which carried the implicit message that tender offers are “good” and any impediments to them are “bad.”<sup>237</sup> In *CTS*, however, Justice White found himself in the minority. Justice Powell’s majority opinion carries a very different tone than that of the *MITE* decision.

#### a. Supremacy Clause Analysis

Three main issues were discussed in the Court’s Supremacy Clause analysis. First, the Court concluded that Congress had not explicitly pre-empted state regulation of tender offers.<sup>238</sup> Secondly, the Court held that it was possible to simultaneously comply with both the Williams Act and the Indiana Act.<sup>239</sup> The third and key issue, however, was whether the Indiana Act frustrated the main purpose of the Williams Act,<sup>240</sup> which is shareholder protection.<sup>241</sup> *MITE* had invalidated an Illinois takeover law, in part, because it favored target management and operated to defeat legitimate tender offers to the detriment of target shareholders.<sup>242</sup> By contrast, Powell noted, the Indiana law was not unduly pro-manage-

234. 637 F. Supp. 389 (N.D. Ill.), *aff’d*, 794 F.2d 250 (7th Cir. 1986), *rev’d*, 107 S. Ct. 1637 (1987).

235. 794 F.2d 250 (7th Cir. 1986), *rev’d*, 107 S. Ct. 1637 (1987).

236. *Id.* at 264.

237. Prentice, *supra* note 197, at 20.

238. 107 S. Ct. at 1644.

239. *Id.* (citing *Florida Lime & Avocado Growers, Inc. v. Paul*, 373 U.S. 132, 142-43 (1963)).

240. *Id.* (citing *Hines v. Davidowitz*, 312 U.S. 52, 67 (1941)); *Ray v. Atlantic Richfield Co.*, 435 U.S. 151, 158 (1978).

241. There is a debate over whether creating a “level playing field,” which favors neither management nor takeover bidder, was a Williams Act goal of independent significance or whether the level playing field was simply a means to the Act’s primary goal—shareholder protection. *Piper v. Chris-Craft Indus.*, 430 U.S. 1, 28 (1977) indicated that both goals were important. *MITE* intimated the same thing, though *CTS* seems to subordinate the “neutrality” goal.

242. *Edgar v. MITE Corp.*, 457 U.S. 624, 633 (1982).

ment; instead, it “protects the independent shareholder against both of the contending parties.”<sup>243</sup> By placing the investors on an “equal footing” with the bidder,<sup>244</sup> it furthered the basic purpose of the Williams Act. Target shareholders who must act independently, Powell reasoned, are often at a disadvantage when facing the coercive aspects of a tender offer. By allowing shareholders to vote as a group,<sup>245</sup> the Indiana Act helped to provide protection.

To illustrate his point, Powell used the two-tiered tender offer as an example:

If, for example, shareholders believe that a successful tender offer will be followed by a purchase of nontendering shares at a depressed price, individual shareholders may tender their shares — even if they doubt the tender offer is in the corporation’s best interest — to protect themselves from being forced to sell their shares at a depressed price. As the SEC explains: “The alternative of not accepting the tender offer is virtual assurance that, if the offer is successful, the shares will have to be sold in the lower priced, second step . . .” In such a situation under the Indiana Act, the shareholders as a group, acting in the corporations’ best interest, could reject the offer, although individual shareholders might be inclined to accept it. The desire of the Indiana Legislature to protect shareholders of Indiana corporations from this type of coercive offer does not conflict with the Williams Act. Rather, it furthers the federal policy of investor protection.<sup>246</sup>

Justice Powell distinguished the Court’s decision in *MITE* on other grounds as well. The Indiana Act did not have the lengthy hold-open requirement and the state approval requirement which were at issue in *MITE*.<sup>247</sup> He also pointed out how difficult it would be to strike down the Indiana law and yet preserve traditional state dominion over internal corporate matters.<sup>248</sup> Many state provisions of unquestioned validity, such as the requirement of shareholder approval for mergers and the provisions for cumu-

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243. 107 S. Ct. at 1645.

244. *Id.* at 1645-46 (quoting *Piper v. Chris-Craft Indus.*, 430 U.S. 1, 30 (1977), quoting, in turn, the Senate Report accompanying the Williams Act, S. REP. No. 550, 90th Cong., 1st Sess. 4 (1967)).

245. 107 S. Ct. at 1646.

246. *Id.* (quoting Two-Tier Tender Offer Pricing and Non-Tender Offer Purchase Programs, Exchange Act Release No. 21,079, [1984 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,637 (June 21, 1984)).

247. *Id.* at 1647.

248. *Id.* at 1647-48.

lative voting, deter tender offers to some extent.<sup>249</sup>

b. Commerce Clause Analysis

Justice Powell absolved the Indiana Act of the allegation that it violated the Commerce Clause by discriminating against interstate commerce. He pointed out that the Act regulated all tender offers for corporations formed in Indiana, whether those offers originated in-state or out-of-state.<sup>250</sup> Unlike the Illinois Act in *MITE* and most first generation takeover laws, the Indiana Act limited its regulation to tender offers for corporations formed in Indiana, thereby eliminating the risk of subjecting bidders to inconsistent state regulation.<sup>251</sup>

Justice Powell then addressed the issue which the Seventh Circuit had found to be determinative — whether the Indiana Act might hinder the successful completion of tender offers. Justice Powell rejected the implication of *MITE* that tender offers have a beneficial effect and should not be impeded. He noted that every state has enacted regulations that to some extent might hinder tender offers. For example, regulations prescribing the rights and powers of shareholders to acquire and vote shares can have this effect. He reiterated that the Indiana Act protects shareholders by allowing them to vote collectively.<sup>252</sup> Powell rejected the claim that tender offers should generally be favored because they enhance the efficient allocation of capital assets and again noted the coercive effect of two-tiered tender offers.

Indiana's concern with tender offers is not groundless. Indeed, the potentially coercive aspects of tender offers have been recognized by the Securities and Exchange Commission . . . and by a number of scholarly commentators . . . . The Constitution does not require the States to subscribe to any particular economic theory . . . . In our view, the possibility of coercion in some takeover bids offers additional justification for Indiana's decision to promote the autonomy of independent shareholders.<sup>253</sup>

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249. *Id.* at 1647-48, 1650.

250. *Id.* at 1648-49.

251. *Id.* at 1649.

252. *Id.* at 1650-51.

253. *Id.* at 1651 (citing Two-Tier Tender Offer Pricing and Non-Tender Offer Purchase Programs, Exchange Act Release No. 21,079, [1984 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,637 at 86,916 (June 21, 1984)). See also Bradley & Rosenzweig, *Defensive Stock Repurchases*, 99 HARV. L. REV. 1377, 1412-13 (1986); Lowenstein, *Pruning Deadwood in Hostile Takeovers: A Proposal for Legislation*, 83 COLUM. L. REV. 249,

Thus, the perceived coercive nature of front-end loaded, two-tiered tender offers played a critical role in the Supreme Court's *CTS* decision, which cast *MITE* aside and gave state tender offer regulation a green light. Since *CTS* was decided, at least fourteen states have passed tender offer legislation.<sup>254</sup>

### E. Impact on State Fiduciary Law

As noted earlier, the Supreme Court's decision in *Santa Fe Industries, Inc. v. Green* relegated the issue of whether a majority shareholder owes a fiduciary duty to minority shareholders in a freeze-out merger to the states.<sup>255</sup> "Going private" transactions became especially popular in the early 1970s,<sup>256</sup> and Delaware law naturally became a focal point of litigation by minority shareholders who were being cashed out in such transactions. *Singer v. Magnavox Co.*,<sup>257</sup> the leading Delaware case, was viewed as a very pro-minority shareholder decision. The court held that a majority shareholder could not freeze out minority shareholders without a good "business purpose" for the transaction.<sup>258</sup> Although the use of front-end loaded, two-tiered tender offers appeared inconsistent with *Singer*,<sup>259</sup> no court used *Singer* to invalidate such an offer.

In 1983, *Singer*, which had been the leading Delaware case for approximately six years, was replaced by another case with implications for front-end loaded, two-tiered tender offers — *Weinberger v. UOP, Inc.*<sup>260</sup> *Weinberger* eliminated *Singer's* requirement of a "business purpose" in order for a majority shareholder to freeze out minority shareholders through a long-form or

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307-09 (1983); Macey & McChesney, *A Theoretical Analysis of Corporate Greenmail*, 95 YALE L.J. 13, 20-22 (1985).

254. See *supra* note 197.

255. See *supra* note 79 and accompanying text.

256. Booth, *The New Law of Freeze-Out Mergers*, 49 MO. L. REV. 518 (1984).

257. 380 A.2d 969 (Del. 1977).

258. *Id.* at 980.

259. See *supra* notes 82-84 and accompanying text.

260. 457 A.2d 701 (Del. 1983). See generally Prickett & Hanrahan, *Weinberger v. UOP: Delaware's Effort to Preserve a Level Playing Field for Cash-Out Mergers*, 8 DEL. J. CORP. L. 59 (1983); Weiss, *The Law of Take-Out Mergers: Weinberger v. UOP, Inc. Ushers in Phase Six*, 4 CARDOZO L. REV. 245 (1983); Richards & Williams, *Compliance with Delaware Law Problems in Parent-Subsidiary Acquisitions*, N.Y.L.J., Dec. 7, 1987, at 40, col. 2; Mallenbaum, *Helping a Company "Go Private,"* Nat'l L.J., Jan. 6, 1984, at 15, col. 1.

short-form merger.<sup>261</sup> Although this aspect of the decision appeared to smooth the way for the use of "back door" mergers, other portions of the opinion set up new barriers. The court replaced the "Delaware block" method<sup>262</sup> of calculating the "fair price" of minority shares with a comprehensive approach more favorable to minority shareholders. The court stressed that determination of whether the minority was being offered a "[f]air price obviously requires consideration of all relevant factors involving the value of a company . . . [The] more liberal approach must include proof of value by any techniques or methods which are generally considered acceptable in the financial community and otherwise admissible in court,"<sup>263</sup> subject to interpretation under the Delaware appraisal statute.<sup>264</sup>

This new, more liberal approach for calculating the "fair price" aspect of the "entire fairness" requirement for freezeout mergers had obvious implications for the use of front-end loaded, two-tiered tender offers. It created a stronger position for shareholders who had not tendered, yet wished to challenge the price they were being offered in the second-step cash-out merger. Commentators asked whether the higher front-end tender offer price should be taken into account in valuing the shares being purchased in the second-step cash-out merger.<sup>265</sup>

The *Singer and Weinberger* line of cases echoed the same concerns about front-end loaded, two-tiered tender offers which Brudney and Chirelstein had expressed in 1974.<sup>266</sup> Some scholars argue that the *Weinberger* holding, coupled with the SEC's promulgation of Rule 14d-8, accounts for the decline in the use of front-end loaded, two-tiered tender offers between 1982 and

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261. 457 A.2d at 715.

262. Under the Delaware Block method of calculating share value, fair value is determined by weighing a share's market value, asset value, dividend value, and earning value. See Application of Delaware Racing Ass'n, 42 Del. Ch. 406, 213 A.2d 203 (1965); *Brown v. Hedahl's-Q B & R, Inc.*, 185 N.W.2d 249 (N.D. 1971); *Blasingame v. American Materials, Inc.*, 654 S.W.2d 659 (Tenn. 1983).

263. 457 A.2d at 713.

264. DEL. CODE ANN. tit. 8, § 262(h) (1987).

265. E.g., Chazen, *Weinberger v. UOP, Inc.: Implications for Planning Corporate Transactions*, in II FIFTEENTH ANNUAL INSTITUTE ON SECURITIES REGULATION 265, 279 (1983) ("There is nothing in *UOP* which suggests that judicial review of [front-end loaded, two-tiered tender offers] would be any less rigorous than in a going private transaction, except that if the back-end price is announced at the time of the tender offer the courts may view the two steps as a unitary transaction."); Mirvis, *supra* note 83.

266. Booth, *supra* note 256, at 518 n.5.

1984.<sup>267</sup> This conclusion has some validity, perhaps, but it probably overstates the case because it fails to account for the passage of state antitakeover legislation. States would not have felt obliged to pass as many antitakeover laws aimed specifically at front-end loaded, two-tiered tender offers if the *Weinberger* holding had truly offered full protection for non-tendering shareholders trapped in the back-end merger. In spite of the more liberal appraisal formula it sets forth, *Weinberger* is of little avail to shareholders given the cumbersome, expensive, and "last resort" nature of appraisal proceedings in general.<sup>268</sup> Although appraisal proceedings are not a shareholder's exclusive remedy if he can prove exceptional circumstances such as fraud, misrepresentation, self-dealing, or deliberate waste of corporate assets,<sup>269</sup> courts do not often find such circumstances. Therefore, the inadequate appraisal proceedings remain the shareholder's main remedy.<sup>270</sup>

More importantly, no court has applied *Weinberger* to invalidate a front-end loaded, two-tiered tender offer. *Joseph v. Shell Oil Co.*<sup>271</sup> is the only case which has even considered this issue. Royal Dutch Petroleum Company attempted to cash-out the minority shareholders of Shell Oil. Royal Dutch had controlled a majority of Shell shares for over sixty years when it decided to purchase the remaining shares.<sup>272</sup> Rather than act through the long-form Delaware merger statute, Royal Dutch made a cash tender offer of fifty-eight dollars per share for the remaining Shell shares.<sup>273</sup> The bid was structured in order to coerce minority shareholders into tendering.<sup>274</sup> Royal Dutch expressly stated that it would not purchase any untendered shares through another tender offer or a merger for a price higher than fifty-eight dollars for at least eighteen months.<sup>275</sup> Thus, unless a shareholder ten-

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267. Note, *supra* note 209, at 224-25 n.130.

268. Eisenberg, *The Legal Roles of Shareholders and Management in Modern Corporate Decisionmaking*, 57 CALIF. L. REV. 1, 85 (1969)(calling appraisal "remedy of desperation"); Lipton, *supra* note 32, at 18; Strauch, *Regulating Two-Tier Tender Offers: A Compromise Proposal with Negligible Disruption*, 22 WILLAMETTE L. REV. 41, 63 (1986).

269. *Weinberger v. UOP, Inc.*, 457 A.2d 701, 714 (Del. 1983).

270. R. FERRARA, M. BROWN & J. HALL, *supra* note 107, at 127.

271. 482 A.2d 335 (Del. Ch. 1984).

272. *Id.* at 338-39.

273. *Id.* at 340.

274. Herzal & Finkelstein, *Fairness: Majority vs. Minority*, Nat'l L.J., July 16, 1984, at 15, col. 1.

275. 482 A.2d at 340.



dered, he would have to wait at least eighteen months before getting the same price. Given the time value of money, this offer was clearly the equivalent of a front-end loaded, two-tiered tender offer.

The court, however, did not even address the coercive nature of the offer. Instead, it held that a majority shareholder does not generally have a fiduciary duty to offer the minority a fair price in a tender offer.<sup>276</sup> However, because the tendering shareholders in *Joseph* were unlikely to discover the unfairness of the tender price due to the inadequate disclosures accompanying the bid, the court held that the offer was invalid.<sup>277</sup> Because it uses a different line of reasoning, this case illustrates that *Weinberger* has had only a slight impact, if any, on two-tiered bids.

### III. REASONS FOR DECLINE AS AN OFFENSIVE WEAPON

In 1982, 20% of all tender offers were front-end loaded, two-tiered offers. By 1985 through 1986 its use as an offensive weapon had declined to 3%, and by 1987 it had disappeared altogether.<sup>278</sup>

What caused this decline? The demise of the front-end loaded, two-tiered tender offer can be traced to the various changes in the law discussed in the preceding sections of this paper: new SEC rules,<sup>279</sup> new state antitakeover laws,<sup>280</sup> new corporate "shark repellents,"<sup>281</sup> and discretion granted under the business judgment rule for directors to fight allegedly coercive offensive maneuvers with extreme defensive tactics.<sup>282</sup> Additionally, the rise in junk bond financing made it easier to finance "any-and-all" offers, thus decreasing the motivation for use of front-end loaded, two-tiered tender offers.<sup>283</sup>

### IV. USE AS A DEFENSIVE TACTIC

Today the dominant use of front-end loaded, two-tiered

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276. *Id.* at 341.

277. *Id.*

278. Grundfest, *supra* note 41, at 26, col. 4 & at 27, col. 1. For an interesting comparison, see also Ruback, *Coercive Dual-Class Exchange Offers*, 20 J. FIN. ECON. 153, 171 (1988) (showing coercive nature of management-sponsored, dual-class exchange offers which shareholders often must accept although their economic interests are injured).

279. *See supra* note 98, 105, 109, 113-14 and accompanying text.

280. *See supra* note 197-254 and accompanying text.

281. *See supra* note 123-34 and accompanying text.

282. *See supra* note 155-94 and accompanying text.

283. Grundfest, *supra* note 41, at 27, col. 1; Sommer, *supra* note 122, at 24, col. 1.

tender offers is defensive.<sup>284</sup> It may take the form of a white knight's competing offer or of a target's defensive self-tender offer.<sup>285</sup> There has been such a complete reversal in use of the tactic that SEC Commissioner Grundfest wrote an article expressing concern about the coercive effects of a *defensive* front-end loaded, two-tiered tender offer on shareholders.<sup>286</sup> Use of a defensive front-end loaded, two-tiered tender offer can, however, spark an offensive use of the same weapon, as a recent case illustrates.

### Campeau/Macy's/Federated

In the spring of 1988, one of the more hard-fought tender offer battles of recent years was played out.<sup>287</sup> It involved two front-end loaded, two-tiered offers. The target was Federated Department Stores, which had a poison pill in place.<sup>288</sup> On January 25, 1988, Campeau, through its wholly-owned subsidiary CRTF, made a hostile "any-and-all" cash offer for Federated shares at \$47 per share.<sup>289</sup> At the same time, CRTF filed suit seeking to enjoin Federated from invoking the poison pill. As jockeying for position occurred, CRTF gradually raised its "any-and-all" cash bid to \$68 per share.<sup>290</sup>

For a time it appeared that CRTF would reach a negotiated agreement with Federated's management, but at the eleventh hour R.H. Macy & Co. intervened with a white knight front-end

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284. Grundfest, *supra* note 41, at 27, col. 1.

285. *Id.*

286. *Id.* at 26, col. 2-4. Although Commissioner Grundfest was not convinced that any form of tender offer is truly coercive, he argued that if front-end loaded, two-tiered tender offers are coercive when used offensively, they must be equally coercive when used defensively.

Lipton, *supra* note 38, at 20 n.90, disagrees, noting that target management, unlike the hostile bidder, is constrained by a fiduciary duty owed to the target shareholders. A few courts have held such an offer to be impermissibly coercive. See *Edelman v. Fruehauf Corp.*, 798 F.2d 882, 887 (6th Cir. 1986)(target board did not fulfill its role as auctioneer because it improperly favored management's front-end loaded, two-tiered, self-tender offer over hostile bidder's any-and-all bid); *AC Acquisitions v. Anderson, Clayton & Co.*, 519 A.2d 103, 114 (Del. Ch. 1986). Interestingly, the front-end loaded, two-tiered self-tender offer in *Anderson, Clayton* was deemed not only "coercive," but also not "reasonable in relation to the threat posed," because the hostile offer it responded to was explicitly held to be non-coercive since it was an any-and-all cash offer for \$56/share which promised a second-stage merger for any untendered shares, also at \$56/share cash. *Id.* at 112-13.

287. See *CRTF Corp. v. Federated Dep't Stores*, [1987-1988 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 93,680 (S.D.N.Y. March 18, 1988).

288. *Id.* at 98,115.

289. *Id.*

290. *Id.* at 98,116.

loaded, two-tiered bid for Federated. The front-end offer was \$73.80 cash for 80% of Federated. In exchange for the final 20% of Federated, Macy offered a 40% interest in the combined Macy/Federated entity.<sup>291</sup> Macy soon raised its front-end bid to \$74.50 per share. According to Federated's investment bankers, the blended value of the Macy bid was \$70 to \$80 per share.<sup>292</sup>

The persistent CRTF responded with its own front-end loaded, two-tiered bid. It was an all-cash bid, offering \$75 per share for 80% of Federated shares and promising \$40 per share in the back-end merger, for a blended value of \$68 per share.<sup>293</sup> Macy increased the pressure by raising its front-end tender offer price to \$77.35 per share and reducing its offer for the back-end merger to 36%, rather than 40%, of the post-merger entity.<sup>294</sup> As befits a white knight, Macy was granted many benefits by Federated's management, including the following promises if its bid failed: (1) a breakup fee of up to \$45 million for expenses, (2) a topping fee of 25% of consideration received in excess of \$77.35 per share from another acquiror, and (3) a lockup of two divisions of Federated which would be sold to Macy's at market value.<sup>295</sup>

The case was in this posture when, on March 18, 1988, Judge Sand of the Southern District of New York ruled on CRTF's challenge to the Federated poison pill in *CRTF Corporation v. Federated Department Stores*. He ruled that a poison pill, while questionable, is valid if used to promote an auction or to protect a target from coercive offers.

CRTF claims that its two-tiered offer is not intended to be coercive but was required in order to make the CRTF offer as comparable as possible to the Macy's offer. It asserts that the danger was that investors would tender into a \$74.50 offer for 80 percent of the shares rather than into a \$68 offer for 100 percent of the shares, even if the latter was overall a more beneficial offer.

. . . .

. . . It is the opinion of the court that regardless of the motivation, the principal consequence of the change to a two-tiered, front-end loaded, all-cash offer is to coerce shareholders into tender into [sic] the first stage offer at \$75 to avoid being

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291. *Id.*

292. *Id.*

293. *Id.* at 98,117.

294. *Id.*

295. *Id.*

left with shares worth only \$44 in a subsequent merger.

. . . .  
 . . . [I]f we were to enjoin Federated from the exercise of the [poison pill], . . . we would be making it vulnerable to a street sweep; to this and other coercive, two-tiered, front-end loaded tender offers; to a decrease in existing offers; and possibly to other dangers.<sup>296</sup>

CRTF responded to the ruling by simply increasing the pressure of its offer. It raised its front-end tender offer price from \$75 per share to \$82 per share, while at the same time lowering its back-end merger price from \$44 per share to \$37 per share.<sup>297</sup> Aware of the appearance of such tactics, Robert Campeau, Chief Executive Officer of CRTF's parent corporation, placed an open letter to the Federated board in the *Wall Street Journal* stating that he opposed two-tiered offers, but felt that he had no choice, given the structure of the Macy bid.<sup>298</sup> The bloody battle ended when CRTF and Macy agreed that CRTF would buy Federated and then sell \$1.1 billion of prime Federated assets to Macy.<sup>299</sup>

#### V. ASSESSMENT OF FRONT-END LOADED, TWO-TIERED TENDER OFFERS

Does the front-end loaded, two-tiered tender offer deserve its reputation as the most infamous of takeover tactics? Does its existence justify the various changes in tender offer law that it has caused? This Article's tentative answer is yes. This answer will be explained by examining two facets of the front-end loaded, two-tiered tender offer: coerciveness and unfairness.

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296. *Id.* at 98,120-21 (emphasis added).

297. Burrough, *Campeau Raises Federated Bid To \$6.54 Billion*, *Wall St. J.*, Mar. 23, 1988, at 3, col. 1.

298. *Wall St. J.*, Mar. 18, 1988, at 31. In part, Campeau said:

I do not like a two-tier offer. That's playing the arbitrageur game.

Monday, Macy's played this game again. However, I want you and the world to know that this is not my game—that I am responding to Federated and Macy's game—and I think it should be stopped. We want to appeal to your sense of justice. I would like an opportunity to sit down with you immediately to conclude a merger agreement. Under such agreement, we would be prepared and able to pay \$68 a share across the board, if you prefer, not favoring anyone, and we would be able to pay this promptly. However, since you have endorsed a two-tier offer, our offer remains two-tier.

*Id.*

299. *Betting the Store: Campeau at Last Gets Federated — Now Can He Make A Go Of It?*, *Wall St. J.*, Apr. 4, 1988, at 1, col. 6.

### A. Coercive Effect

Most commentators have concluded that front-end loaded, two-tiered tender offers are unduly coercive in their effect on target shareholders,<sup>300</sup> and virtually all courts addressing the matter have agreed.<sup>301</sup> Professor Ronald Gilson has intimated that only two-tiered tender offers which are front-end loaded are coercive. He reasoned that in the case of most partial bids, if a second step merger follows then the bidder almost always pays more than the original market price, and if no merger follows then there is a fiduciary duty placed upon the new majority owner that will protect the minority shareholders' interests.<sup>302</sup> However, Gilson's argument ignores the fact that even though the second-step price may exceed the pre-tender offer market price, it may be below the first-step tender offer price. In this scenario, pressure is still placed on the shareholders to tender.

Perhaps the real issue is whether a lost chance to profit constitutes a loss. The shareholder will think that he has suffered a loss whenever the market price of the target has fallen below the tender offer price whether or not there is a back-end merger.<sup>303</sup> If securities are offered in the back end, what appears to be an equal

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300. 1 F. O'NEAL & R. THOMPSON, O'NEAL'S OPPRESSION OF MINORITY SHAREHOLDERS § 5:26(A) (2d ed. 1986); DeMott, *supra* note 202, at 991; Harrington, *If It Ain't Broke, Don't Fix It: The Legal Propriety of Defenses Against Hostile Takeover Bids*, 34 SYRACUSE L. REV. 977, 1004 (1983); Macey & McChesney, *supra* note 253, at 20; Note, *supra* note 134, at 1966; Note, *Virginia's Affiliating Transactions Article: The Death of Two-Tiered Takeovers in Virginia?*, 44 WASH. & LEE L. REV. 1103, 1106 n.16 (1987); Marinaccio, *Bidder, Target Balance Ought to Be Re-Evaluated*, Legal Times, Mar. 25, 1985, at 20, col. 1; Nathan, *supra* note 36, at 31, col. 1; Fleischer, *Sun Shines on Bidders in Corporate Takeover World*, Legal Times, Jan. 25, 1982, at 15, col. 1. *But see* Bradley, Desai & Kim, *Synergistic Gains from Corporate Acquisitions and Their Division Between Stockholders of Target and Acquiring Firms*, 21 J. FIN. ECON. 3, 30 (1988) ("two-tier, front-end loaded tender offers are not coercive and do not impede the (optimal) allocation of the target resources").

301. Desert Partners, L.P. v. USG Corp., 686 F. Supp. 1289, 1298-99 (N.D. Ill. 1988); CRTF Corp. v. Federated Dep't Stores, [1987-1988 Current Binder] Fed. Sec. L. Rep. (CCH) ¶ 93,680 (S.D.N.Y. March 18, 1988); Buckhorn, Inc. v. Ropak Corp., 656 F. Supp. 209 (S.D. Ohio 1987); Ivanhoe Partners v. Newmont Mining Corp., 535 A.2d 1332, 1342 (Del. 1987); Moran v. Household Int'l, Inc., 500 A.2d 1346, 1357 (Del. 1985); Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 956 n.12 (Del. 1985); Facet Enter., Inc. v. The Prospect Group, Inc., Civ. No. 9746 (Del. Ch. Apr. 15, 1988); AC Acquisitions v. Anderson, Clayton & Co., 519 A.2d 103, 113 (Del. Ch. 1986)(self tender).

302. Gilson, *A Structural Approach to Corporations: The Case Against Defensive Tactics in Tender Offers*, 33 STAN. L. REV. 819, 861 (1981).

303. Bebchuk, *Toward Undistorted Choice and Equal Treatment in Corporate Takeovers*, 98 HARV. L. REV. 1693, 1713 (1985).

bid may become front-end loaded because of the impact of market forces on the value of the securities.<sup>304</sup>

Gilson's second argument, that minority shareholders are protected by the fiduciary duty owed them by the new majority owners, ignores the perils of being a minority shareholder under a new regime. This protection may prove illusory. The new owner may be incompetent or the minority shareholder may have to rely on the less than desirable derivative lawsuit for protection.<sup>305</sup>

In defense of the front-end loaded, two-tiered tender offer, one can argue that any type of tender offer is coercive to an extent.<sup>306</sup> As one court has noted, "pressure on stockholders to decide whether to sell is the primary characteristic of a tender offer."<sup>307</sup> Even an "any-and-all" bid is somewhat coercive if there is no promise that those who do not tender will receive at least the same price at a later date.<sup>308</sup>

Professors Brudney and Chirelstein argue that the front-end loaded, two-tiered tender offer was designed to be and is more coercive than other types of tender offers.

Given the inability of [a target's] dispersed stockholders to com-

304. Fogelson & Kapp, *supra* note 40, at 656.

305. One problem is that careless mismanagement as well as self-dealing may be difficult to detect. Bebchuk, *The Pressure to Tender: An Analysis and a Proposed Remedy*, 12 DEL. J. CORP. L. 911, 918-19 (1987). Another problem is the limited effectiveness of derivative suits. See Greene & Junewicz, *A Reappraisal of Current Regulation of Mergers and Acquisitions*, 132 U. PA. L. REV. 647, 676 n.134 (1984). See also Dent, *The Power of Directors to Terminate Shareholder Litigation: Death of the Derivative Suit?*, 75 Nw. U.L. REV. 96, 109 (1980) (increased use of special litigation committees limits usefulness of derivative litigation); Deutsch, *Regulation and the United States Corporation: An Alternative to Law-and-Economics*, 9 CARDOZO L. REV. 1463, 1481-82 (1988) (derivative suits have limited usefulness as monitor of directors in takeover phenomenon).

306. Greene & Junewicz, *supra* note 305, at 679 ("Any offer to purchase stock that involves payment of a premium over the market price results in pressure on shareholders to tender their shares."); Note, *supra* note 134, at 1966 ("Any tender offer undeniably contains an element of coercion.").

307. Crane Co. v. Harsco Corp., 511 F. Supp. 294, 302 (D. Del. 1981). See also BNS, Inc. v. Koppers Co., [1988 Current Binder] Fed. Sec. L. Rep. (CCH) ¶ 93,730 (D. Del. 1988) (even an all-cash offer can be a "threat" to the target shareholders for Unocal purposes); Radol v. Thomas, 534 F. Supp. 1302, 1312 (S.D. Ohio 1981) ("Any tender offer is likely to be coercive to some degree.").

308. According to Professor Lowenstein, there is pressure in any bid because: (1) the shareholder may never see as high a price again, (2) he may receive as high a price only after a delay, or (3) he may see his or her liquidity impaired for a time. Lowenstein, *supra* note 253, at 267.

Bebchuk, *supra* note 305, at 924-25 argues that the prisoner's dilemma forces shareholders to tender during any offer in which they attach a sufficiently significant chance of success to the bid, no matter how inadequate they think it is.

municate with one another during the tender, the act of offering a higher price on tender than would be paid on merger would have a "whipsaw" effect on [the target's] stockholders. Individual stockholders would find it difficult or impossible to refuse a tender price of \$40 when they are also made aware that if the tender succeeds, the remaining shares will be merged out at \$30. In effect, an announced disparity between the tender and the merger figure would deprive [the target's] stockholders of their ability to make an unforced, independent judgment on whether an average of \$35 per share is an acceptable overall price for the assets of the firm. Hence, although the presence of a concealed disparity must be regarded as unfair, the presence of an announced differential is plainly coercive.<sup>309</sup>

The effect of front-end loaded, two-tiered tender offers is to "stampede" target shareholders into a decision to tender.<sup>310</sup> The "whipsaw" effect is created by the "prisoner's dilemma."<sup>311</sup> Although every shareholder may believe that the bid is too low and the wiser course would be to hold out for a higher bid, an inability to act cooperatively forces each shareholder to tender out of fear that if he does not tender, his fellow shareholders will, leaving him stuck with the lower back-end merger price.<sup>312</sup> The more extreme the differential between the front-end tender offer price and the back-end merger price, the greater the coercive effect.<sup>313</sup>

The logic of the "prisoner's dilemma" argument is difficult to challenge. But the argument has been challenged on the basis of several statistical studies. A study by Comment and Jarrell found that two-tiered bids are not coercive, because more persons tender in an "any-and-all" bid (74.7%) than in a two-tiered bid

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309. Brudney & Chirelstein, *supra* note 55, at 337. See also Brudney & Chirelstein, *A Restatement of Corporate Freezeouts*, 87 YALE L.J. 1354 (1978).

310. Greene & Junewicz, *supra* note 305, at 677, 679; Oesterle, *Target Managers as Negotiating Agents for Target Shareholders in Tender Offers: A Reply to the Passivity Thesis*, 71 CORNELL L. REV. 53, 61-63 (1985); Note, *supra* note 46, at 409.

311. See *supra* note 37. See also Booth, *supra* note 256, at 551 n.174; Carney, *Shareholder Coordination Costs, Shark Repellents, and Takeout Mergers: The Case Against Fiduciary Duties*, 1983 AM. B. FOUND. RES. J. 341, 349 n.39, 351 n.47, 366; Herzl & Finkelstein, *supra* note 274, at 15, col. 1.

312. Bebchuk, *The Case for Facilitating Competing Bids*, 95 HARV. L. REV. 1028, 1040 (1982) (noting that the stampede effect may be minimized if large accumulations of shares are held by institutional investors or if a competing bid arises); Finkelstein, *supra* note 107, at 293; Gordon & Kornhauser, *Takeover Defense Tactics: A Comment on Two Models*, 96 YALE L.J. 295, 301 (1986) (tendering "dominates" non-tendering because optimal shareholder response cannot be obtained due to inability to coordinate action); Lipton, *supra* note 38, at 19; Oesterle, *supra* note 310, at 60-64;

313. See Bradley & Rosenzweig, *supra* note 253 at 1418.

(61.8%), while an even lower percentage (35.5%) tender in a pure partial bid.<sup>314</sup> These figures, however, immediately indicate that a two-tiered, front-end loaded offer puts substantially more pressure on target shareholders than does a pure partial bid. Professor Oesterle has pointed out that these statistics also ignore the fact that two-tiered offers tend to be made for the larger companies with more dispersed ownership, where it is natural that the percentage of shares tendered would be lower.<sup>315</sup>

Another study argues that front-end loaded, two-tiered tender offers are not coercive because they are almost always beaten by "any-and-all" bids with a higher overall value.<sup>316</sup> Although this is somewhat comforting, Oesterle points out that it begs the question by failing to examine what target management did to cause the result.<sup>317</sup> For example, an "any-and-all" white knight bid with endorsements from target management and the support of lock-up options would, naturally, prevail over a hostile front-end loaded bid in most cases.<sup>318</sup>

These points also respond to the claim that front-end loaded, two-tiered tender offers are not coercive because they normally succeed only if they are ultimately negotiated with target management.<sup>319</sup> The act of negotiation carries no unusual significance given the fact that eighty percent of all successful tender offers are negotiated.<sup>320</sup> In addition, negotiation may have come about because management saw the handwriting on the wall and was

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314. Comment & Jarrell, *Two-Tier Tender Offers: The Imprisonment of the Free-Riding Shareholders*, 19 J. FIN. ECON. 283, 301-02 (1987). Note that an earlier, fuller version of this paper was discussed in Oesterle, *supra* note 131.

315. Oesterle, *supra* note 131, at 127 n.46.

316. Two-Tier Tender Offer and Non-Tender Offer Purchase Programs — Advance Notice of Possible Commission Action, Exchange Act Release No. 21,079, [1984 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,367, at 1119 (June 21, 1984) [hereinafter SEC Request].

317. Oesterle, *supra* note 131, at 127-28 n.46.

318. Indeed, a major thrust of the Comment & Jarrell article is that "[t]he bargaining power of target management apparent in these results suggests that their action is one reason for the absence, on average, of an adverse shareholder wealth effect from front-end takeovers." Comment & Jarrell, *supra* note 314, at 285. Thus, while some would cite these statistics in order to claim that front-end loaded bids are not coercive and, therefore, shareholders do not need any protection, these statistics in fact may show just the opposite. As Oesterle points out, the numbers support the conclusions that "target boards negotiate better offers in response to two-tier tender offers than their shareholders would otherwise receive." Oesterle, *supra* note 131, at 122 n.26.

319. Comment & Jarrell, *supra* note 314, at 302-03.

320. Office of the Chief Economist, *supra* note 35, at 368.



willing to go to the table.<sup>321</sup>

These statistical arguments are interesting; however, they are misleading to some degree. I believe that they minimize the "coercion differential" between front-end loaded, two-tiered tender offers and other types of offers, but they do not eliminate it. The intuitive appeal of the prisoner's dilemma argument is too strong. Furthermore, these arguments overlook the fact that when front-end loaded, two-tiered tender offers succeed, they do so by paying less of a premium, on average, than it takes to prevail in an "any-and-all" bid.<sup>322</sup>

In assessing the coercive nature of two-tiered offers, one must finally consider the point of view of the participants in the takeover game. For example, Robert Campeau believed that although his "any-and-all" offer had a higher blended value, it could not defeat a front-end loaded, two-tiered offer, and he thus restructured his bid.<sup>323</sup> Target managements now gear a large number of their defensive tactics toward providing equal treatment between shareholders in the back-end and those in the front.

## B. Unfairness

Brudney and Chirelstein believe that front-end loaded, two-tiered tender offers are unfair because shareholders in the back-end do not receive as much compensation as those who tender in the front-end.<sup>324</sup> They point out that a shareholder can vote

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321. Also, there is no way for studies to consider the role of target management in unnegotiated transactions. Because the final takeover was not negotiated does not mean that target management, through defensive tactics, did not have a role to play in shaping the final premium offered.

322. SEC Request, *supra* note 316, at 1123. However, Comment & Jarrell, *supra* note 314, at 298, found no statistically significant difference between blended premiums paid in any-or-all offers and those paid in two-tiered bids. This can be explained by the defensive tactics used by target management to obstruct a two-tiered bids, which force an offeror to pay a higher price. Additionally, Comment and Jarrell admit that:

[P]otential premiums available to target shareholders may, however, exceed our reported realized premiums. If so, and if any-or-all or negotiated offers can yield a greater part of the potential premium, target shareholders might realize a net benefit from a regulation-induced switch to any-or-all or negotiated offers, if not too many offers are thereby deterred.

*Id.* at 285. In other words, sharks may use the two-tiered, front-end loaded approach primarily in cases where they fear that they will have to pay a larger than average premium. By use of modest coercion, they bring the premium down into the "normal" range. This is plausible, because we know that two-tiered tender offers tend to be used in cases involving larger targets than any-or-all bids. See *supra* note 315 and accompanying text.

323. See *supra* note 298 and accompanying text.

324. Brudney & Chirelstein, *supra* note 55, at 336-37. They suggest a requirement

against a merger, yet still receive the same amount of compensation as other shareholders if the merger succeeds. The shareholder, who in effect votes against a front-end loaded, two-tiered tender offer by not tendering, however, will lose the chance to receive as high a price for his shares as other shareholders do if the front-end offer is not defeated.<sup>325</sup>

Easterbrook and Fischel, the leading proponents of unrestrained tender offers, responded directly to Brudney and Chirelstein.<sup>326</sup> Rather than claiming that front-end loaded, two-tiered offers are not coercive, they attempt to justify the price differential. They believe that an unequal sharing of benefits is necessary to give incentives to bidders to buy and target shareholders to sell. They suggest that non-tendering shareholders are "free riders" who deserve no better than the back-end merger price. They argue that if an equal price is required on the back-end, tender offers will fail because shareholders will have no reason to tender.<sup>327</sup> This argument is fallacious, however, because shareholders have every reason to tender when an attractive premium is offered.<sup>328</sup> Moreover, two-tiered tender offers that are not loaded on the front-end commonly succeed.

Others argue that unfairness is an invalid objection because the blended price of front-end loaded, two-tiered offers will be higher than the pre-tender offer market price, and usually the back-end price will be higher as well.<sup>329</sup> However, one can argue that from another perspective the back-end price is still unfair, because it is lower than the price received by front-end tendering shareholders and it is lower than the price the shareholders might have bargained for had they not been coerced into tendering by the prisoner's dilemma.<sup>330</sup>

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that as much be paid in the back-end as in the front-end.

325. *Id.* For a strong criticism of their position, see Toms, *Compensating Shareholders Frozen Out in Two-Step Mergers*, 78 COLUM. L. REV. 548, 550-64 (1978) (their proposal would "create market and administration problems, while leaving unresolved many inequities of the present standard").

326. Easterbrook & Fischel, *supra* note 141, at 1170-74.

327. *Id.* Oesterle asks how far this argument can be taken. Does it justify, for instance, paying greater dividends to the new shareholders than to the hold-over shareholders? Oesterle, *supra* note 312, at 61 n.29.

328. Leebron, *supra* note 34, at 185 n.115.

329. Coffee, *supra* note 47, at 1169; Gilson, *supra* note 302, at 861.

330. This effect is exacerbated by the fact that two-tiered offers tend to discourage competing bids, impairing the target's chances to "auction" the firm. R. GILSON, *THE LAW AND FINANCE OF CORPORATE ACQUISITIONS* 853 (1986).

In many instances where shareholders have managed to reject a premium bid, the

Finally, some argue that equal *opportunity* is all that is required, not equal *treatment*.<sup>331</sup> In other words, those shareholders who do not tender have only themselves to blame because they could have tendered and received the front-end price for a prorated portion of their shares. This argument assumes that the offer is not oversubscribed. If it is oversubscribed, even shareholders who sought to tender will be relegated to the back-end for a portion of their shares. This argument also ignores the prisoner's dilemma; those shareholders who did not tender might have made a different decision if they had been able to coordinate their actions with their fellow shareholders.

The equal opportunity argument also ignores the difference in resources and abilities between institutional investors and arbitrageurs, on the one hand, and individual investors, on the other.<sup>332</sup> Although one can argue that "inattentive" individual investors should not be protected,<sup>333</sup> even attentive individual investors can never match the resources of the arbitrageurs and institutional investors who use "runners" to tender at the very last minute, delaying so that they can take advantage of all possible information.<sup>334</sup> Furthermore, individual shareholders are not contacted directly during the bid by the contesting parties and never will be able to sell in a "street sweep" as do the arbitrageurs.<sup>335</sup> Individual shareholders are thus inevitably going to be relegated to the back-end in greater proportion than institutional investors.

### CONCLUSION

Front-end loaded, two-tiered tender offers are a bit more unfair and coercive than other partial offers. However, the negative backlash has been out of proportion to the true provocation. Perceptions play an important role. One of the first moves by any

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decision turned out to be a wise one for they were ultimately able to sell at an even higher price. See Bradley, Desai & Kim, *The Rationale Behind Interfirm Tender Offers: Information or Synergy?*, 11 J. FIN. ECON. 183, 204-05 (1983).

331. Note, *supra* note 46, at 404.

332. DeMott, *supra* note 202, at 991; Goldberg, *Regulation of Hostile Tender Offers: A Dissenting View and Recommended Reforms*, 43 MD. L. REV. 225, 229 (1984); Lipton, *supra* note 38, at 19; Scriggins & Clarke, *Takeovers and the 1983 Maryland Fair Price Legislation*, 43 MD. L. REV. 266, 271 n.22 (1984); Note, *Second Step Transactions in Two-Tiered Takeovers: The Case for State Regulation*, 19 GA. L. REV. 343, 353 (1985).

333. E.g., Dennis, *supra* note 46, at 329.

334. Note, *supra* note 46, at 409.

335. Romano, *supra* note 227, at 173.

participant in a hostile takeover battle is the hiring of a good public relations firm to put the right "spin" on press coverage and perhaps in the halls of Congress and the state legislatures.<sup>336</sup> T. Boone Pickens realizes the importance of image, which accounts for much of his work with the United Shareholders Association, a group formed to advocate both reforms in management practices and legislation that will facilitate takeovers.<sup>337</sup>

Those who play the tender offer game should remember that in American political battles, concerns for equity generally win out over concerns for efficiency.<sup>338</sup> Victories won with weapons perceived as coercive and unfair may turn out to be pyrrhic in nature. If hostile tender offerors had paid less attention to securing sure victory and more attention to paying a fair price to all target shareholders, the legal and regulatory environment today would probably be much more conducive to the takeover process.

Does the overreaction, even if slight, to front-end loaded, two-tiered tender offers warrant turning back the clock? Should the SEC repeal some of its rules, particularly Rule 14d-8, which lengthens the proration period? I do not think that repeal is called for. The Williams Act is aimed at protecting all target shareholders, including those who choose not to tender.<sup>339</sup> The Act's provisions for hold-open requirements, withdrawal rights, and proration rights all encourage equal treatment of target shareholders.<sup>340</sup> Rules 13e-3, and the "Best Price" and "All Holders" rules also advance that interest.<sup>341</sup> If it were decided that the SEC had exceeded its authority in promulgating these rules, Congress could step in and make the changes itself. Presently there are bills pend-

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336. See H. LAMPERT, *TILL DEATH DO US PART* 109-11 (1983)(explaining public relations efforts of combatants in classic Bendix/Martin-Marietta struggle); Lipton, *A Checklist for Defending Against Takeovers*, Nat'l L.J., Sept. 21, 1987, at 21, col. 1 (listing public relations firms as a key part of team to defeat hostile tender offer).

337. See Victor, *Pickens' Plan Gets Mixed Reviews From Bar*, Nat'l L.J., Aug. 11, 1986, at 9, col. 1. Public relations consciousness reportedly accounts for Pickens having withdrawn his name from the Committee's letterhead after his star had become somewhat tarnished. See Getschow & Burrough, *Pickens, Acting Bitter, Finds Takeover Game Isn't Much Fun Now*, Wall St. J., Apr. 5, 1988, at 1, col. 6.

338. T. McCRAW, *PROPHETS OF REGULATION* 302 (1984).

339. *Hundahl v. United Benefit Life Ins. Co.*, 465 F. Supp. 1349, 1368 (N.D. Tex. 1979); *In re Commonwealth Oil/Tesoro Petroleum Corp. Sec. Litig.*, 467 F. Supp. 227, 241-42 (W.D. Tex. 1979).

340. *S-G Sec., Inc. v. Fuqua Inv. Co.*, 466 F. Supp. 1114, 1124 (D. Mass. 1978). See generally Note, *SEC Takeover Regulation's Under the Williams Act*, 62 N.Y.U. L. REV. 580 (1987).

341. See *supra* notes 99, 166 and accompanying text.

ing before Congress which would increase the "hold-open" period beyond twenty business days.<sup>342</sup> Thus, it appears that Congress will, if anything, broaden protection.

Only the most extreme advocates of the Chicago School desire the elimination of the SEC rules on efficiency grounds.<sup>343</sup> After its passage, the Williams Act did slow tender offers for a while, but not for long.<sup>344</sup> The trade-off between higher premiums and more equal opportunity for target shareholders, on one hand, and optimum efficiency, on the other,<sup>345</sup> seems to represent a sensible policy choice.

Should fair price amendments, poison pills, and other defensive tactics be prohibited? Again, I believe that few persons other than strict disciples of Easterbrook and Fischel would answer "yes."<sup>346</sup> It would violate the basic tenets of corporation law to say that target management cannot use defensive tactics to protect minority shareholders' interests. There is evidence that defensive

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342. Smith, *Is 20-Day Period the Right Length?*, N.Y.L.J., May 28, 1987, at 5, col. 1 (several bills pending in Congress to lengthen hold-open period to as long as 45 business days).

343. See *supra* notes 326-27 and accompanying text.

344. ADVISORY COMM., *supra* note 119, at 11.

345. If we accept economists' assumptions that market price indicates an increase in efficiency, and I do not wholly, we must note that premiums rose after passage of the Williams Act. Jarrell & Bradley, *The Economic Effects of Federal and State Regulation of Cash Tender Offers*, 23 J. L. & ECON., 371, 396 (1986). This means, functionally, that before passage of the Williams Act, 71% of the gain in takeovers went to offerors, but after passage only 47% went to offerors. Bradley, Desai & Kim, *supra* note 300, at 28 (bidding firms earned significantly lower returns in the post-Williams Amendment era, although overall synergistic gains remained the same); Leebron, *supra* note 34, at 179, n.88 (citing, *inter alia*, Jarrell & Bradley, *The Economic Effects of Federal and State Regulations of Cash Tender Offers*, 23 J.L. & ECON. 371, 389, 395 (1980)). It thus appears to be the implicit policy of the Williams Act to promote fair offers and equal treatment for target shareholders at the possible expense of the overall level of tender offer activity.

346. Easterbrook and Fischel have argued for passivity on the part of target managers facing tender offers because defensive tactics reduce the welfare of shareholders. See Easterbrook & Fischel, *supra* note 140, at 1169; Easterbrook & Fischel, *Takeover Bids, Defensive Tactics, and Shareholders' Welfare*, 36 BUS. LAW. 1733 (1981); Easterbrook & Fischel, *Is Takeover Defense in Shareholders' Best Interest?*, Legal Times, Aug. 10, 1981, at 42, col. 1.

Professor Bebchuk has argued strongly that Easterbrook and Fischel are simply wrong in viewing shareholder coercion as a necessary prerequisite to economic efficiency. He points out that adequate levels of incentive for potential bidders to search for potential targets exist even absent coercion, and that a "socially excessive level of search" might result from government policies that deleted concern for shareholder freedom from coercion. Bebchuk, *supra* note 305, at 938-40. See also Bebchuk, *The Case for Facilitating Competing Offers: A Reply and Extension*, 35 STAN. L. REV. 23, 30-39 (1982).

tactics raise the premiums received by all target shareholders<sup>347</sup> as well as protecting minority shareholders in the second-stage. Both are legitimate concerns of corporate managers.

Of course, defensive tactics may decrease the overall level of tender offer activity,<sup>348</sup> but target management cannot be held accountable for this impact. The law imposes no duty on a target board to dismantle all defenses and hope that the first hostile offeror will offer a fair price and equal treatment for all shareholders.<sup>349</sup> A board cannot allow a corporation to be bought too cheaply on the grounds that from the standpoint of the national economy, it will "all even out in the end." Studies show that front-end loaded, two-tiered offers succeed with a lower average pre-

347. One of the most recent studies, conducted by proxy soliciting firm Georgeson & Co., found that poison pills appeared to raise premiums for target shareholders; the 27 companies with pills received final offers averaging 78.5% above the point at which their stock had traded six months before the tender offer began versus a figure of 56.7% for 21 targets without a poison pill. Lee, "Poison Pills" Benefit Shareholders by Forcing Raiders to Pay More for Targets, *Study Says*, Wall St. J., Mar. 31, 1988, at 55, col. 3. This result would seem to be consistent with the notion that poison pills deter front-end loaded, two-tiered offers, which can succeed with a lower average premium, and causes them to be replaced with any-and-all offers which typically carry a larger premium.

Of course, there is evidence that a price is paid for this higher premium in the form of less overall takeover activity which may manifest itself in a lower market price for a potential target corporation's shares. This result would be consistent with the policy choice underlying the Williams Act. However, the evidence is mixed. See Securities and Exchange Commission, Office of Chief Economist, A Study of the Economics of Poison Pills, [1985-1986 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,971 (Mar. 5, 1986) (according to a study of two-day, net-of-market stock returns conducted by the office of Chief Economist, United States Securities and Exchange Commission, adoption of poison pills appears to decrease market price of adopting companies' stock; Jarrell, Brickley & Netter, *supra* note 345, at 60, 64 (inconclusive evidence does not show that fair price amendments do not harm target's stock value, but evidence shows poison pills do); Malatesta & Walkling, *Poison Pill Securities: Stockholder Wealth, Profitability, and Ownership Structure*, 20 J. FIN. ECON. 347, 374 (1988) (poison pills reduce stockholder wealth by a statistically significant amount); Ryngaert, *The Effect of Poison Pill Securities on Shareholder Wealth*, 20 J. FIN. ECON. 377, 411 (1988) (on average, poison pills have had only a modest effect on firm valuation); *Lab Reports on Poison Pills*, MERGERS & ACQUISITIONS, Sept.-Oct. 1986, at 7, 7 (over longer term, price recovers and poison pills have insubstantial effect); Heard & Pound, *Shark Repellents May Fail to Benefit Shareholders*, Legal Times, Mar. 25, 1985, at 12, col. 1 (discussing conflicting studies, two finding small negative effect of shark repellents, one finding positive effect, and one finding no effect on market price of adopting companies).

348. This conclusion is not clear. The recent wave of adoptions of fair price amendments and poison pills has coincided with a continuing high level of tender offer activity. See *supra* note 1.

349. Prentice, *supra* note 2, at 350 (Courts cannot ask target board "to ignore the immediate benefit accruing to the target company's particular shareholders on the ground that in the long run target management action might prove detrimental to the amorphous 'whole' of the shareholders in the country.").

mium (55.1%) than "any-and-all" offers (63.4%).<sup>350</sup> This disparity might become much greater if defensive tactics were outlawed. It is consistent with traditions of corporate law that target management be authorized to fight to obtain the highest premium possible for its shareholders.

Federal regulation of poison pills and fair price amendments would intrude into "an area that has to date been the province of state corporation law."<sup>351</sup> The proper approach is a careful, case-by-case examination of the impact that defensive tactics have on the welfare of target shareholders, which is the approach taken in *Norlin*, *Unocal*, and *Revlon*.<sup>352</sup> Federal regulation would be inconsistent with the Williams Act and would create the problems discussed by the Supreme Court in *CTS*.<sup>353</sup>

Should Congress expressly preempt state tender offer legislation? Congress has not been inclined to do so thus far.<sup>354</sup> By regulating tender offers, states enact rules which are designed to raise premiums for the shareholders of corporations within their jurisdictions.<sup>355</sup> Members of the Chicago School and many others believe that a certain level of "value" is created by most takeovers.<sup>356</sup> The states arguably have a legitimate interest in capturing as much of that value for the shareholders of their corporations as possible.<sup>357</sup>

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350. SEC Request, *supra* note 316, at 1123.

351. Concept Release on Takeovers and Contests for Corporate Control: Advance Notice of Possible Commission Actions, Exchange Act Release No. 23,486, [1986-1987 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,018, at 88,206 (July 31, 1986).

352. See *supra* notes 142-65 and accompanying text.

353. One of the consistent themes of the *CTS* opinion was the well-established hegemony of the states over regulation of internal corporate affairs. *CTS v. Dynamics Corp. of America*, 107 S. Ct. 1637, 1650 (1987) (Our "beneficial free market system depends at its core upon the fact that a corporation—except in the rarest situations—is organized under, and governed by the law of a single jurisdiction, traditionally the corporate law of the State of its incorporation.").

354. In virtually every securities law that it has ever passed, including the 1934 Act, Congress included savings clauses expressly reserving a state role in securities regulation. See, e.g., 15 U.S.C. §§ 77r, 78bb(a) (1986). See also, Warren, *Reflections on Dual Regulation of Securities: A Case Against Preemption*, 25 B.C.L. Rev. 495, 515 (1984).

355. There is evidence that both the Williams Act and corporate shark repellents have raised premiums for target shareholders, so there is reason to believe that state takeover regulations might have the same effect.

356. See *supra* notes 326-27 and accompanying text.

357. In support of a state's right to regulate tender offers in the same fashion that it regulates mergers, Professor Leebron has noted that both mergers and tender offers create some value and redistribute some value. Leebron, *supra* note 34, at 156. If one accepts the argument of those who support free-wheeling tender offers that stock prices are indicative of efficiency, then one learns that the average gain in mergers is about 20% for target

The impact of regulation *may* be to slow down the overall rate of takeover activity,<sup>358</sup> but Congress has viewed this as a price worth paying, and the Supreme Court has agreed in *CTS*.<sup>359</sup> Those who criticize regulation have not been able to conclusively prove that tender offers are invariably good for the economy. Previously, I have indicated that the economic argument, although very strong, has not been uncontrovertably established.<sup>360</sup> How-

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shareholders and nothing for the bidder. The average return in tender offers is 30% for the target's shareholders and 4% for the bidder. Since the target is usually much smaller than the bidder, these tender offer figures indicate that the bidder may be receiving up to 50% of the combinative gain. It is reasonable to assume that acquirers will use the tender offer where the potential for gain is greater and the merger where the potential for gain is less. It seems legitimate for the states to attempt to regulate the process in order to capture more of the combinative gain for the shareholders of corporations formed under their laws.

Similarly, if the front-end loaded, two-tiered offer allows hostile bidders to acquire firms by paying a smaller premium than in other types of bids, it is legitimate for states to attempt to regulate the process so that a larger portion of the gain from the combination goes to target shareholders.

As with the adoption of shark repellents and poison pills, there is an ongoing and inconclusive debate on the effects that a state's adoption of an antitakeover law has on the market price of corporations formed under its laws. One study found that Ohio's adoption of such a statute adversely affected the market prices of Ohio corporations. OFFICE OF THE CHIEF ECONOMIST, SEC, SHAREHOLDER WEALTH EFFECTS OF OHIO LEGISLATION AFFECTING TAKEOVERS 17 (1987). On the other hand, another study found that by simply extending the length of the period of study by one day, all adverse effects disappeared. Wallman & Ranard, *State Takeover Laws Work Well*, Legal Times, Sept. 21, 1987, at 22, col. 1. Moreover, an empirical study of a New Jersey takeover law found that companies subject to it "out performed the market during most of the period studied." 19 SEC. REG. & L. REP. (BNA) 1411 (Sept. 18, 1987).

Another study claimed that passage of the Indiana anti-takeover law approved in *CTS* cost shareholders of publicly traded Indiana corporations some \$2.65 billion, \$1.7 billion of that loss falling on shareholders of Amoco Corporation. Woodward, *How Much Indiana's Anti-Takeover Law Cost Shareholders*, Wall St. J., May 5, 1988, at 32, col. 3. The study was based on one-day abnormal returns on various dates when separate legislative and judicial actions took place. However, these findings have also been criticized by Amoco's chief economist, who notes that they are completely inconsistent with the efficient market hypothesis—arbitrageurs know that bills might be passed long before they are actually signed and thus incorporate that likelihood into their assessment of the stock's value. To select single events, therefore, is arbitrary and misleading. Furthermore, the loss to Amoco shareholders is easily explained by reference to other events occurring in the oil industry. See Quirin, *Indiana's Anti-Takeover Law*, Wall St. J., May 24, 1988, at 39, col. 1.

358. Jarrell & Bradley indicate that traditional antitakeover laws have had little effect on tender offer activity. See Jarrell & Bradley, *supra* note 245, at 401-02 ("To describe the state tender offer laws as 'antitakeover' statutes is not accurate by our evidence, although the laws do marginally reduce the number of cash offers.").

359. *CTS v. Dynamics Corp. of America*, 107 S. Ct., 1637, 1652 (1987)("[E]ven if the [Indiana] Act should decrease the number of successful tender offers for Indiana corporations, this would not offend the Commerce Clause.").

360. Prentice, *supra* note 197, at 42-49. See also Scherer, *Corporate Takeovers: The Efficiency Arguments*, 2 J. ECON. PERSP. 69, 80 (1987)("Evidence on 1960s and early



ever, I am less troubled by its force now that tender offers once again are made primarily for business reasons rather than for speculative purposes.<sup>361</sup>

Front-end loaded, two-tiered tender offers need not be outlawed. The tactic's super potency has already been neutralized. Under the present version of the Williams Act, such offers are clearly legal. It would be difficult to outlaw them, and at the same time permit other partial offers. Partial offers have a long history, and the SEC's Advisory Committee on Tender Offers has recognized them as useful and necessary.<sup>362</sup>

The most sensible alteration to current law would be to adopt the British system which allows shareholders to tender their shares if they are afraid they must do so in order to protect their position, but simultaneously allows shareholders to vote against the tender offer if they truly oppose it.<sup>363</sup> This change would counteract the coercive effects of all tender offers, not only front-end loaded, two-tiered bids.

Although explicit front-end loaded, two-tiered tender offers have nearly disappeared as offensive takeover weapons, the tactic remains worth studying. It is often used defensively, and occasionally it is still used offensively as demonstrated by the battle over

1970s tender offer takeovers reveals no significant long-term improvements in operating profitability following takeover. Recent takeovers have probably accelerated needed divisional restructuring and led to lower-cost financial structures, but not without risks to the microeconomy. Whether such takeovers and the more pervasive threat that they will occur have wide-ranging behavioral consequences remains unknown . . ."). Carney has argued that certain types of two-tier offers may lead to inefficient results. See Carney, *Fundamental Corporate Changes, Minority Shareholders, and Business Purposes*, 1980 AM. B. FOUND. RES. J. 69, 109-18.

361. Burrough, *Companies Take Over the Takeover Game from Flashy Raiders*, Wall St. J., Jan. 25, 1988, at 1, col. 6; Wayne, *Takeovers Revert to the Old Mode*, N.Y. Times, Jan. 4, 1988, at D1, col. 3.

362. ADVISORY COMM., *supra* note 119, at 24-25.

[T]here are many valuable roles for partial offers and partial ownership, including: (1) allowing companies to invest in one or more industries with more limited financial exposure than if ownership were 100%; (2) facilitating technology exchange relationships; (3) permitting change of control and reducing management entrenchment in large companies; (4) facilitating private direct investment, such as venture capital; (5) acknowledging the common practice of suppliers of foreign capital in the United States; and (6) allowing acquirors to get to know a potential acquiree over time with a view to moving to 100% ownership.

*Id.*

363. COUNCIL FOR THE SECURITIES INDUSTRY, *THE CITY CODE ON TAKE-OVER AND MERGERS*, Rule 27 (5th rev. ed. 1981). This approach has been favored by various American commentators. See Bebchuk, *supra* note 305, at 931-32; Strauch, *supra* note 268, at 80.

Federated Department Stores.<sup>364</sup> Furthermore, takeover expert Martin Lipton has suggested that the post-Black Monday demise of junk bonds may revive the use of this tactic.<sup>365</sup>

In conclusion, the coercive and unfair elements inherent in the offensive use of front-ended loaded, two-tiered tender offers have probably justified an official response, although the response is somewhat out of proportion to the provocation.

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364. See *supra* notes 287-99 and accompanying text.

365. Lipton, *supra* note 38, at 19-20.

