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PANTER v. MARSHALL FIELD & COMPANY: A TENDER OFFER FIELD'S COULD REFUSE

In recent decisions involving corporate takeovers, the courts have displayed much restraint in reviewing the actions of corporate directors in their actions to resist the takeovers.¹ The majority of the cases have involved a company fighting for the control of a target company.² The directors of a target company have used various defensive measures to maintain their independence.³ While these tactics have been successful in eliminating the takeover, they have also led to litigation. When called upon to justify their actions, the directors have relied upon the business judgment rule, a judicial doctrine that presumes the good faith of the directors and shields their activities from judicial scrutiny.⁴ Since the courts have generally held in favor of the directors, the directors have enjoyed freedom in exercising their control to eliminate all attempted takeovers whether or not the best interests of the shareholders were fairly served.⁵

A recent example of the application of the business judgment rule to takeover contests occurred in the United States Court of Appeals for

1. See generally Arshnt, *The Business Judgment Rule Revisited*, 8 HOFSTRA L. REV. 93 (1979) [hereinafter cited as Arshnt].

2. See, e.g., *Wellman v. Dickinson*, 475 F. Supp. 783 (S.D.N.Y. 1979). The fight for control may arise in two forms: a tender offer or a takeover bid. The tender offer generally refers to a situation where an individual investor is seeking to gain control of a corporation by offering to purchase a controlling percentage of its shares. A takeover bid refers to a situation in which a shareholder of a corporation wishes to wrest control of the corporation away from the present directors. For purposes of this comment, there will be no practical distinction made between a tender offer and a takeover bid since in both situations, the corporate directors are faced with a threat to their control of the corporation. See Note, *Tender Offer Decisions: Effect of the Business Judgment Rule*, 45 ALB. L. REV. 1122 (1981) [hereinafter cited as *Tender Offer Decisions*].

3. See, e.g., *Johnson v. Trueblood*, 629 F.2d 287 (3d Cir. 1980), cert. denied, 450 U.S. 999 (1981) (controlling shareholders/directors refused loan by and stock sale to minority shareholders to prevent control from moving to the minority shareholders). See also Cohn, *Tender Offers and the Sale of Control: An Analogue to Determine the Validity of Target Management Defensive Measures*, 66 IOWA L. REV. 475 (1981) [hereinafter cited as Cohn].

4. See, e.g., *Johnson v. Trueblood*, 629 F.2d 287 (3d Cir. 1980), cert. denied, 450 U.S. 999 (1981) (Business judgment rule applied to majority shareholders/directors' refusal to sell stock to minority shareholders who sought control of the corporation). Directors of corporations discharge their fiduciary duties when in good faith they exercise business judgment in making decisions regarding their corporation. When they act in good faith, they enjoy a presumption of sound business judgment, reposed in them if any rational business purpose can be attributed to their decisions. See *Tender Offer Decisions*, supra note 2, at 1125.

5. See, e.g., *Treadway Cos. v. Care Corp.*, 638 F.2d 357 (2d Cir. 1980) (Director of New Jersey corporation did not breach any duties owed to the corporation or its shareholders by counseling a Delaware corporation against making a tender offer for shares and then selling his shares to the Delaware Corporation at a premium).

the Seventh Circuit case, *Panter v. Marshall Field & Company*.⁶ The board of directors of Field's engaged in several transactions that prevented a takeover by Carter Hawley Hale,⁷ a California-based national retail chain. Subsequently, several Field's shareholders sued the corporation and its directors for breach of fiduciary duty. They sought to recover damages for their inability to tender Field's stock to Carter and to benefit from the substantial rise in market price that had occurred as a result of the proposed Carter tender offer. The district court⁸ directed a verdict for the defendant directors at the close of the shareholders' presentation of their evidence and on appeal the Seventh Circuit affirmed. The Seventh Circuit held that the Field's directors acted within the business judgment rule and, therefore, their actions were presumed fair.⁹ According to the court, the shareholders did not present sufficient evidence to shift the burden of proof to the directors.¹⁰

This case comment will discuss the historical background of the business judgment rule as well as the Seventh Circuit's interpretation of this rule as espoused in *Panter v. Marshall Field & Company*.¹¹ The court's application of the rule to the actions of the Field's directors will also be evaluated to determine whether the business judgment rule ought to have shielded their defensive tactics from judicial scrutiny. The analysis will focus on whether the Seventh Circuit should have affirmed the district court's directed verdict for the directors or whether there was sufficient evidence for the jury to decide the question of the director's breach of fiduciary duty. This article will also discuss whether the business judgment rule should apply at all in the corporate takeover setting or whether, in view of another recent case,¹² a different standard should apply.

BACKGROUND OF THE BUSINESS JUDGMENT RULE

The business judgment rule is a judicially-created doctrine whereby, in certain circumstances, a corporate transaction will not be enjoined and the directors who authorized the transaction will not be

6. 646 F.2d 271 (7th Cir.), *cert. denied*, 102 S. Ct. 658 (1981). Marshall Field & Company will hereinafter be referred to as "Field's."

7. Carter Hawley Hale will hereinafter be referred to as "Carter".

8. *Panter v. Marshall Field & Co.*, 486 F. Supp. 1168 (N.D. Ill. 1980), *aff'd*, 646 F.2d 271 (7th Cir.), *cert. denied*, 102 S. Ct. 658 (1981).

9. 646 F.2d at 299.

10. *Id.*

11. 646 F.2d 271 (7th Cir. 1981).

12. *Crane Co. v. Harsco Corp.*, 511 F. Supp. 294 (D.C. Del. 1981). See text accompanying notes 173-78 *infra*.

held personally liable for damages resulting from any harm.¹³ The business judgment rule requires that directors authorize only the transactions that they in good faith believe are in the best interest of the corporation.¹⁴ The rule does not apply in situations where the transaction involves any self-dealing,¹⁵ personal interest,¹⁶ or where the directors fail to exercise due care in ascertaining the relevant facts prior to authorizing the transaction.¹⁷ Thus, the business judgment rule protects directors from liability for good faith mistakes when they exercise their best business judgment in executing their corporate duties.¹⁸

Historically, the business judgment rule developed from the judicial concern that people would refuse to serve as directors if the law held them to a higher standard of responsibility for the consequences of their decisions.¹⁹ The early cases recognized that people acting as directors should be held to a standard of reason, intellect, and knowledge that is possessed by people of ordinary knowledge.²⁰ The rule was also designed to give directors discretion in making decisions involving corporate policy without the fear of unreasonable judicial interference.²¹ The belief is that the directors, rather than the courts, are more adept in making business decisions that maximize the shareholders' welfare.²² The rule was also designed to aid in judicial economy by keeping the courts from becoming deeply involved in complex corporate decision-making.²³

13. Arsh, *supra* note 1, at 111-12.

14. *Id.*

15. See *Sinclair Oil Corp. v. Levien*, 280 A.2d 717 (Del. 1971) (Business judgment rule should not be applied where parent corporation received benefit to the exclusion and detriment of subsidiary). Self-dealing, in this context, means any attempt by a director or controlling stockholder to appropriate corporate assets that are not in proportion to what the other shareholders will receive. See Arsh, *supra* note 1, at 116.

16. See *Petty v. Penntech Papers, Inc.*, 347 A.2d 140 (Del. Ch. 1975) (Business judgment rule was not applied where directors selectively redeemed stock of preferred shareholders in order to maintain control).

17. See *Thomas v. Kempner*, 398 A.2d 320 (Del. Ch. 1979) (Business judgment rule was not applied where directors sold land for less than adequate price in spite of a higher offer). See text accompanying notes 46-48 *infra*.

18. *Tender Offer Decisions*, *supra* note 2, at 1125. A directors' basic duty is to act with due care for the benefit of the corporation and its shareholders. *Id.*

19. See *Percy v. Millaudon*, 8 Mart (n.s.) 68 (La. 1829), wherein the court stated, "The contrary doctrine seems to us to suppose the possession, and require the exercise of perfect wisdom in fallible human beings. No man would undertake to render service to another on such severe conditions." *Id.* at 78. See also Arsh, *supra* note 1, at 97.

20. 8 Mart (n.s.) at 77-8. (Bank director not liable for losses resulting from defalcations by bank's president and cashier).

21. Block and Prussin, *The Business Judgment Rule and Shareholder Derivative Actions: Viva Zapata*, 37 BUS. LAW., 27, 32 (1981) [hereinafter cited as Block and Prussin].

22. Easterbrook & Fischel, *Takeover Bids, Defensive Tactics, and Shareholder's Welfare*, 36 BUS. LAW 1733, 1745 (1981) [hereinafter cited as *Takeover Bids*].

23. Block and Prussin, *supra* note 21, at 33. See also *Auerbach v. Bennett*, 47 N.Y.S.2d 619,

In practice, when directors make a good faith business judgment, courts are generally reluctant to scrutinize their judgment and impose liability for errors.²⁴ The business judgment rule presumes that the directors exercised their business judgment in good faith.²⁵ Thus, the presumption operates in favor of the directors and places the initial burden of proof on the party attacking the directors' action.²⁶ For example, in *Sinclair Oil Corporation v. Levien*,²⁷ a shareholder argued that the directors' decision to pay excessively large dividends instead of using the funds to expand operations was a breach of fiduciary duty.²⁸ In applying the business judgment rule to the directors' decision, the court refused to scrutinize the directors' judgment, unless the shareholder proved that the payment of the dividend was not attributed to any reasonable business objective.²⁹ Failing to meet the burden of proof, the directors' decision was presumed to have been made in good faith and thus the court found for the director.³⁰

In order to rebut the presumption of good faith and shift the burden of proof to the directors, the plaintiff must present evidence that the directors acted beyond the scope of the business judgment rule.³¹ Generally, evidence of self-dealing, personal interest, fraud, bad faith, gross overreaching or abuse of discretion will be sufficient to rebut the presumption.³² In *Gimbel v. Signal Companies, Inc.*,³³ a shareholder sued to enjoin the sale of a Signal subsidiary to an unrelated buyer for a price that was unreasonably lower than the property's fair value.³⁴ The court applied the business judgment rule and initially presumed

630, 393 N.E.2d 994, 1000, 419 N.Y.S.2d 920, 926 (1979) ("[T]he business judgment doctrine, at least in part, is grounded in the prudent recognition that courts are ill equipped and infrequently called on to evaluate what are and must be essentially business judgments.").

24. See text accompanying note 4-5 *supra*.

25. Arsht, *supra* note 1, at 111-12.

26. See *Treadway Cos. v. Care Corp.*, 638 F.2d 357, 382 (2d Cir. 1980), *Sinclair Oil Corp. v. Levien*, 280 A.2d 717, 720 (Del. 1971).

27. 280 A.2d 717 (Del. 1971).

28. *Id.* at 720-21.

29. *Id.* at 721-22.

30. *Id.* at 722.

31. Arscht, *supra* note 1, at 130-31.

32. See, e.g., *Bennett v. Propp*, 41 Del. Ch. 14, 19, 187 A.2d 405, 409 (1962) (Burden shifts when corporate funds are used to buy out an insurgent and the directors are faced with a conflict of interest); *Petty v. Penntech Papers, Inc.*, 347 A.2d 140, 143 (Del. Ch. 1975) (Burden shifts after plaintiff shows that director approved purchase in attempt to eliminate a shareholder); *Condec Corp. v. Lunkenheimer*, 43 Del. Ch. 353, 230 A.2d 769, 776-77 (1967) (Burden shifts when primary purpose of director action is to retain control).

33. 316 A.2d 599 (Del. Ch.), *aff'd*, 316 A.2d 619 (Del. 1974).

34. *Id.* at 601.

that the directors had acted in good faith.³⁵ However, the shareholder presented evidence that the directors' decision to sell property valued at \$761 million for a price of \$480 million constituted an abuse of discretion.³⁶ The court enjoined the transaction, holding that the evidence was sufficient to shift the burden of proving a proper corporate purpose to the directors.³⁷

The Business Judgment Rule and Fiduciary Duties

Although directors may often rely on the business judgment rule as a defense for their good faith actions, the rule will not apply when directors breach their duties of due care and loyalty.³⁸ These duties are based upon the fiduciary obligations that the directors owe to the corporation and the shareholders.³⁹ The duties of due care and loyalty are the standards of care by which the directors' actions must be judged.⁴⁰ Because the business judgment rule was designed to protect the directors from liability only for good faith business decisions, the rule will not be applied to shield directors who have failed to act with due care and loyalty with respect to the corporation.⁴¹

In order to fulfill their duty of due care, the directors must have made a reasonable effort to ascertain and consider all the relevant information.⁴² The business judgment rule will only protect directors from the consequences of a decision that was made with due care; that is, a decision that was made on the basis of all relevant facts that the directors knew or in the exercise of due care should have known.⁴³

35. *Id.* at 608-09. However, the court emphasized that the "business judgment rule [does not] irrevocably shield the decisions of corporate directors from challenge. *Id.* at 609.

36. *Id.* at 615. See *Arsht, supra* note 1, at 125: "What led the court to interfere was . . . a state of facts that, if proved, would demonstrate that the value of the property being sold so far exceeded the agreed sale price that the directors' judgment constituted an abuse of discretion."

37. 316 A.2d at 618.

38. See *Arsht, supra* note 1, at 119 (The duty of due care is not to be equated with the rule itself).

39. See *Guth v. Loft Inc.*, 23 Del. Ch. 255, 270, 5 A.2d 503, 510 (1939): "Corporate officers and directors are not permitted to use their position of trust and confidence to further their private interests. While technically not trustees, they stand in a fiduciary relation to the corporation and its stockholders." See also *Arsht, supra* note 1, at 115.

40. See *Tender Offer Decisions, supra* note 2, at 1124: "As fiduciaries, directors have two paramount obligations to the corporation and its shareholders: responsibility and loyalty."

41. See *Block and Prussin, supra* note 21, at 33: "The rule does not apply where the director has in fact made no decision; for the evidence must show that affirmative acts of investigation and decision-making took place."

42. See, e.g., *Kamin v. American Express Co.*, 86 Misc. 2d 809, 813-14, 383 N.Y.S.2d 807, 811 (Sup. Ct.), *aff'd*, 54 N.Y.2d 651, 387 N.Y.S.2d 993 (1976) (Board decision upheld where finance committee minutes showed the directors considered various proposed plans).

43. See, e.g., *Thomas v. Kempner*, 398 A.2d 320, 323-24 (Del. Ch. 1979) (Director's refusal to

Thus, in *Casey v. Woodruff*,⁴⁴ a director's decision was upheld where the finance committee minutes showed that the directors had considered various proposed plans prior to making their decision.⁴⁵ However, in *Thomas v. Kempner*,⁴⁶ the court enjoined a proposed sale of corporate assets where the directors refused to consider a subsequent offer from another party that was for a significantly higher price.⁴⁷ The court held that the directors did not act with due care because they ignored the relevant facts of the competing offer.⁴⁸ Therefore, the business judgment rule did not apply to the directors' decision.

The business judgment rule will also not apply where the directors breach their duty of loyalty to the corporation.⁴⁹ The duty of loyalty requires the directors to act with an unselfish and undivided loyalty to the corporation in order to avoid any conflicts between their own interests and those of the corporation.⁵⁰ Where the interests of the directors and the corporation are in conflict, the directors often will act in furtherance of their own best interests.⁵¹ For example, in cases where the directors have had a material personal interest in the outcome of a transaction or have engaged in self-dealing, the courts have applied the test of undivided loyalty, rather than the business judgment rule.⁵² Under the test of undivided loyalty, the directors have had the initial burden of proving that the transaction served a valid business purpose and that it was entirely fair to the shareholders.⁵³ Under the business judgment rule, however, the shareholder bears the initial burden of showing that a transaction serves no valid business purpose.

An example of the application of the test of undivided loyalty ap-

consider a better offer than the one accepted deemed a failure of due care). See text accompanying notes 46-48 *infra*.

44. 49 N.Y.S.2d 625 (Sup. Ct. 1944).

45. *Id.* at 643-45.

46. 398 A.2d 320 (Del. Ch. 1979).

47. *Id.*

48. *Id.* See also *Gimbel v. Signal Cos., Inc.*, 316 A.2d 599 (Del. Ch. 1974), *aff'd*, 316 A.2d 619 (Del. 1974) (Directors did not act with due care in failing to make a reasonable investigation into the value of its subsidiary in charging a grossly inadequate sale price).

49. See generally *Singer v. Magnavox Co.*, 380 A.2d 969 (Del. 1977) (Business judgment rule not applied where directors breached their duty of loyalty to minority shareholders in buying out their stock at an unfair price).

50. *Guth v. Loft Inc.*, 23 Del. Ch. 255, 5 A.2d 503 (1939). See also *Bennett v. Propp*, 41 Del. Ch. 14, 20, 187 A.2d 405, 409 (1962) (Directors confronted with conflict of interest where they purchased shares with corporate funds to remove a perceived threat to corporate policy).

51. See *id.* See also *Tender Offer Decisions*, *supra* note 2, at 1123 (When directors are faced with a conflict of interest, they often will consider their own interests as opposed to the fiduciary responsibilities which they owe to the corporation and its shareholders).

52. See, e.g., *Singer v. Magnavox Co.*, 380 A.2d 969 (Del. 1977).

53. *Tender Offer Decisions*, *supra* note 2, at 1128.

peared in the case of *Singer v. Magnavox Company*.⁵⁴ The directors and majority shareholders approved a merger with another company which required the minority shareholders to sell their shares at a specified price.⁵⁵ The court held that the sole purpose of the merger was to eliminate or freeze-out the minority shareholders.⁵⁶ The merger was invalidated because the directors and majority shareholders were unable to prove that the merger served a proper corporate purpose.⁵⁷ Therefore, the court held that the directors and majority shareholders had breached their duty of loyalty to the minority shareholders and the corporation.⁵⁸

Although the test of undivided loyalty has generally been restricted to cases involving freeze-out mergers,⁵⁹ the courts have applied a similar test, the primary purpose test, when evaluating the directors' actions involving the use of corporate funds in fighting a takeover. Under the primary purpose test, the directors have been required to prove that they acted primarily to benefit the corporation, rather than to retain control.⁶⁰ In *Bennett v. Propp*,⁶¹ the court applied the primary purpose test to determine whether the directors breached their duty of loyalty to the corporation. The directors authorized the chairman's purchase of the corporation's own stock to prevent a takeover. The directors were confronted with a conflict of interest between the chairman's desire to purchase the stock and their duty of loyalty to the corporation.⁶² The court held that, in this situation, the directors had the burden of proving that their authorization of the chairman's stock purchase was made for the primary purpose of benefiting the corporation.⁶³

The primary purpose test was also applied in *Condec Corporation v. Lunkenheimer Company*,⁶⁴ where Lunkenheimer issued shares to its own subsidiary company to prevent a takeover by Condec Corporation,

54. 380 A.2d 969 (Del. 1977).

55. *Id.* at 972. The transaction was referred to in the case as "freezing out minority shareholders on a cash-out basis." *Id.* at 979.

56. *Id.* at 980.

57. *Id.*

58. *Id.*

59. See *Tender Offer Decisions*, *supra* note 2, at 1129: "The courts have framed this very strict standard because freezeout mergers create an especially great risk of self-dealing by the corporate directors and the majority shareholders."

60. See *Bennett v. Propp*, 41 Del. Ch. 14, 187 A.2d 405 (1962); *Tender Offer Decisions*, *supra* note 2, at 1129.

61. *Bennett v. Propp*, 41 Del. Ch. 14, 187 A.2d 405 (1962).

62. *Id.*

63. *Id.*

64. 43 Del. Ch. 353, 230 A.2d 769 (1967).

a minority shareholder of Lunkenheimer. The court held that the directors approved the transaction for the primary purpose of preventing control of the company from passing to the minority shareholders.⁶⁵ Although the court cancelled the transaction,⁶⁶ the court did not discuss whether the directors had the burden of proving that their decision was made primarily to benefit the corporation. The court based its decision solely on evidence that showed the lack of a proper corporate purpose resulting from the issuance of stock.⁶⁷

In *Cheff v. Mathes*,⁶⁸ the directors purchased company stock to prevent a takeover by a minority shareholder. The directors believed that if the minority shareholder gained control he would either liquidate the company or materially alter the corporate policies.⁶⁹ The court applied the primary purpose test⁷⁰ and placed the burden of proving a proper corporate purpose on the directors.⁷¹ The minority shareholder argued that the transaction was entered into for control purposes. However, the court upheld the transaction on the basis of the directors' proof that they acted to prevent the corporation from being harmed.⁷²

The Business Judgment Rule and the Hostile Tender Offer

Although the primary purpose test has been applied in some cases involving takeovers,⁷³ courts have generally applied the business judgment rule in reviewing challenges to the directors' actions.⁷⁴ Thus, under the business judgment rule, the shareholders in a takeover case have been required to prove that the directors acted with bad faith, fraud or self-interest in fighting the takeover in order to shift the bur-

65. *Id.* at 360, 230 A.2d at 777. The transaction "was not connected with a stock option plan or other proper corporate purpose, and . . . was obviously designed for the primary purpose of reducing Condec's stock holdings in Lunkenheimer below a majority." *Id.*

66. *Id.*

67. The judge stated that the transaction was clearly unwarranted and so entered an order cancelling the issuance of the stock. *Id.*

68. 41 Del. Ch. 494, 199 A.2d 548 (1964).

69. *Id.* at 506-07, 199 A.2d at 555-56.

70. *Id.*

71. The court stated that "the question then presented is whether or not defendants satisfied the burden of proof of showing reasonable grounds to believe a danger to corporate policy and effectiveness existed by the presence of the Maremount stock ownership." *Id.*

72. *Id.* at 508, 199 A.2d at 556.

73. *See, e.g.*, *Condec Corp. v. Lunkenheimer Co.*, 43 Del. Ch. 353, 230 A.2d 769 (1967); *Cheff v. Mathes*, 41 Del. Ch. 494, 199 A.2d 548 (1964); *Bennett v. Propp*, 41 Del. Ch. 14, 187 A.2d 405 (1962).

74. *See, e.g.*, *Panter v. Marshall Field & Co.*, 646 F.2d 271 (7th Cir.), *cert. denied*, 102 S. Ct. 658 (1981); *Treadway Cos. v. Care Corp.*, 638 F.2d 357 (2d Cir. 1980); *Crouse-Hinds Co. v. InterNorth, Inc.*, 634 F.2d 690 (2d Cir. 1980); *Johnson v. Trueblood*, 629 F.2d 287 (3d Cir. 1980), *cert. denied*, 450 U.S. 999 (1981).

den of proving a proper corporate purpose to the directors.⁷⁵ For example, in *Northwest Industries, Inc. v. B.F. Goodrich Company*,⁷⁶ the United States District Court for the Northern District of Illinois applied the business judgment rule in an action for a preliminary injunction against the directors of a company. The plaintiff shareholders sought to enjoin the directors' decision to issue stock to a third party in order to defeat a takeover bid by a minority shareholder. Shortly after *Northwest Industries*, a minority shareholder of B.F. Goodrich, announced its intention to make a tender offer for the shares of B.F. Goodrich, the directors of B.F. Goodrich approved an agreement with Gulf Oil Corporation to exchange the stock of the two companies. The agreement would have blocked *Northwest Industries'* attempted takeover of B.F. Goodrich.⁷⁷ In the suit against B.F. Goodrich, the *Northwest Industries* shareholders claimed that the stock was improperly issued at an inflated price in order to insure that Gulf Oil would accept the exchange agreement. However, the court held that the business judgment rule applied to the directors' determination of the price at which to sell their stock.⁷⁸ The court presumed that the transaction was fair and denied the motion for the preliminary injunction based on *Northwest Industries'* failure to present sufficient evidence of fraud to shift the burden of proof to the directors.⁷⁹

In a number of cases where the directors have defeated the takeover bid, the shareholders have claimed that the directors acted out of a desire to preserve their positions in the company.⁸⁰ The shareholders have argued that the directors feared that once the company was taken over, they would lose their jobs.⁸¹ Thus a conflict arises between the

75. See notes 13-18 *supra* and accompanying text.

76. 301 F. Supp. 706 (N.D. Ill. 1969).

77. *Id.* at 708.

78. *Id.* at 712. In addition to applying the business judgment rule, the court also relied on New York Business Corporation Law § 504(a), N.Y. BUS. CORP. § 504(a) (McKinney), which states: In the absence of fraud in the transaction, the judgment of the board or shareholders, as the case may be, as to the value of the consideration received for shares shall be conclusive.

79. Specifically, *Northwest* had not presented any evidence that *Goodrich's* stock transaction was fraudulent. 301 F. Supp. at 712.

80. See, e.g., *Northwest Ind. Inc. v. B.F. Goodrich Co.*, 301 F. Supp. 706 (N.D. Ill. 1969). See also *Johnson v. Trueblood*, 629 F.2d 287 (3d Cir. 1980) (Shareholders claimed that directors' refusal to sell shares to minority shareholders was for the purpose of maintaining control of corporate policy).

81. See *Panter v. Marshall Field & Co.*, 646 F.2d 271 (7th Cir.), cert. denied 102 S. Ct. 658 (1981) wherein Judge Cudahy, in dissent, explained that "[h]ostile tender offers unavoidably create a conflict of interest Nearly all directors and managers are interested in maintaining their compensation and perquisites [A] hostile tender offer unavoidably involves forces tending to shape decisions that are not necessarily for the benefit of all shareholders." *Id.* at 300, n.1 (quoting Gelfond and Sebastian, *Reevaluating the Duties of Target Management in the Hostile Tender Offer*, 60 B.U.L. REV. 403, 435-37 (1980)) [hereinafter cited as Gelfond and Sebastian].

corporation's interest in allowing the takeover and the directors' interest in opposing the takeover in order to remain in office.⁸² When presented with such a conflict of interest, the directors may reject every takeover attempt even though the shareholders' best interests might not be furthered by the rejection.⁸³ Because the business judgment rule does not ordinarily apply when a conflict of interest exists between the directors and the corporation,⁸⁴ the business judgment rule similarly should not apply in the takeover setting where the potential for a conflict of interests is extremely high.⁸⁵

The cases, however, have not so held.⁸⁶ Where the directors have been accused of acting to maintain their control, the courts have held the business judgment rule to be the applicable test. Thus, in order for the shareholders to shift the burden of proof to the directors, the courts have held that the shareholders had the burden of proving that the directors acted for the sole or primary purpose of retaining their positions in the company.⁸⁷ In many cases, however, the shareholders have been unable to present evidence of a sole or primary purpose to maintain control.⁸⁸ Therefore, the cases have generally resulted in victory for the directors.⁸⁹

82. See *Bennett v. Propp*, 41 Del. Ch. 14, 187 A.2d 405, 409 (1962) wherein the court stated: "We must bear in mind the inherent danger in the purchase of shares . . . when a threat to control is involved. The directors are of necessity confronted with a conflict of interest, and an objective decision is difficult." *Id.*

83. See *Tender Offer Decisions*, *supra* note 2, at 1123: "Their [directors] own interest dictate that takeovers be rejected, which may conflict with the interests of the shareholders which lie primarily in the financial return on their investment."

84. See generally *Singer v. Magnavox Co.*, 380 A.2d 969 (Del. 1977).

85. Gelfond and Sebastian, *supra* note 76, at 437 contended that "[A] business judgment approach in hostile tender offer cases is inappropriate." This statement has been the subject of much dissent among commentators. See *Takeover Bids*, *supra* note 22, at 1745 wherein Professors Easterbrook and Fischel stated: "This presumption in favor of management's decision-making has never been applied, however, in situations where managers have acute conflicts of interest For this reason alone, the business judgment rule should not apply to the decision to resist a tender offer." *But see Lipton, Takeover Bids in the Target's Boardroom: An Update After One Year*, 36 BUS. LAW. 1017 (1981) [hereinafter cited as Lipton] wherein the author stated: "[T]he business judgment rule applies to the consideration by the board of directors of a target of an unsolicited takeover bid." *Id.* at 1017.

86. See *Panter v. Marshall Field & Co.*, 646 F.2d 271 (7th Cir.), *cert. denied*, 102 S. Ct. 658 (1981); *Treadway Co. v. Care Corp.*, 638 F.2d 357 (2d Cir. 1980); *Crouse-Hinds Co. v. InterNorth, Inc.*, 634 F.2d 690 (2d Cir. 1980); *Johnson v. Trueblood*, 629 F.2d 287 (3d Cir. 1980), *cert. denied*, 450 U.S. 999 (1981).

87. See *Cheff v. Mathes*, 41 Del. Ch. 494, 504, 199 A.2d 548, 554 (1964) (In applying the primary purpose test to actions taken by directors in resisting a takeover attempt, directors were required to show that they acted primarily to benefit the corporation rather than to retain control. *See also Tender Offer Decisions*, *supra* note 2, at 1129.

88. See, e.g., *Treadway Cos. v. Care Corp.*, 638 F.2d 357 (2d Cir. 1980) (Proof that directors issued stock to secure a merger partner that defeated a takeover was insufficient to show that the primary purpose was to retain control).

89. See cases cited in note 86, *supra*.

In *Johnson v. Trueblood*,⁹⁰ for example, the United States Court of Appeals for the Third Circuit upheld a verdict in favor of the directors who allegedly acted to retain control of the corporation.⁹¹ Minority shareholders of a financially troubled corporation offered to aid the corporation through the purchase of additional corporate stock and the issuance of loans to the corporation. However, the transactions also would have caused the minority shareholders to gain control of the corporation.⁹² The directors refused their offers and instead, approved transactions that were less advantageous to the corporation. Although the shareholders argued that the desire to maintain control was a purpose of the challenged action, the Third Circuit held that the shareholders had to prove that it was the primary purpose of the directors' actions.⁹³ Since the shareholders were unable to present sufficient proof to shift the burden of proof to the directors, the court found for the directors. Even though a motive to retain control was present, and a conflict of interest existed, the business judgment rule was held to be applicable to the directors' actions.⁹⁴

Similarly, in *Treadway Cos. v. Care Corp.*,⁹⁵ the business judgment rule was applied to a takeover fight between two companies. In opposing a threatened takeover of Treadway by Care, Treadway merged with Fair Lanes, through the issuance of stock. The Second Circuit held that the business judgment rule applied to both the directors' decision to fight the takeover and the choice of the defensive measure, including the stock transaction.⁹⁶ As the directors were presumed to have acted fairly in opposing the takeover, the shareholders had the burden of proving bad faith, self-interest, or some other improper purpose.⁹⁷ Failing to meet the burden of proof, the shareholders were denied relief.⁹⁸

90. 629 F.2d 287 (3d Cir. 1980), *cert. denied*, 450 U.S. 999 (1981).

91. 629 F.2d at 295.

92. *Id.* at 289.

93. *Id.* at 293.

94. The court explained that by the very nature of corporate life a director has a certain amount of self-interest in everything he does. *Id.* at 294. "The business judgment rule seeks to alleviate this problem by validating certain situations that otherwise would involve a conflict of interest for the ordinary fiduciary." *Id.*

95. 638 F.2d 357 (2d Cir. 1980).

96. *Id.* at 381. The court stated: "Once they [directors] determined that a Care takeover would be detrimental to Treadway, it was similarly reasonable that the directors should move to oppose it." *Id.*

97. *Id.* at 382.

98. *Id.* at 384. The case is an excellent example of how two courts applied the primary purpose test and the business judgment rule to the same facts with opposite results. In *Treadway*, the district court held that the primary purpose test was the appropriate standard to determine whether the directors acted to maintain control. The court held for the shareholders. 490 F. Supp.

Although the business judgment rule was created to free directors from liability for good faith mistakes in business decisions, courts have expanded its scope. Today, the business judgment rule applies to directors' judgments as to whether to accept or reject a tender offer or takeover bid.⁹⁹ Although a conflict of interest potentially exists, the directors' actions in preventing a takeover are presumed fair.¹⁰⁰ Thus, the business judgment rule also serves as a procedural device for allocating the initial burden of proof to the plaintiffs.¹⁰¹ The plaintiffs must prove that the primary purpose of the directors' actions was to retain their control over the corporation.¹⁰² Otherwise, the plaintiffs will be denied relief. This view of the business judgment rule was the basis for the court's decision in *Panter v. Marshall Field & Company*.¹⁰³

PANTER V. MARSHALL FIELD & COMPANY

*Panter v. Marshall Field & Company*¹⁰⁴ involved the attempted takeover of Marshall Field & Company by Carter Hawley Hale. In October, 1977, Carter expressed an interest in merging with Field's. The Field's board met and decided to reject the merger offer. They believed that independence and internal expansion would be in the best interests of the company. They also felt that a Field's-Carter combination would constitute a violation of antitrust laws.¹⁰⁵ In early December, Field's president received a letter from Carter stating their intentions to make a tender offer.¹⁰⁶ The directors held a special meet-

668 (S.D.N.Y. 1980). However, the Second Circuit reversed and held that the business judgment rule should have been applied. The Second Circuit held for the directors. 638 F.2d 357 (2d Cir. 1980). This supports the view that courts are confused about when to apply the two tests. See *Tender Offer Decisions*, *supra* note 2, at 1130.

99. See cases cited in note 86 *supra*.

100. See text and accompanying notes 80-89 *supra*.

101. See text and accompanying notes 25-30 *supra*.

102. See text and accompanying notes 86-98 *supra*.

103. 646 F.2d 271 (7th Cir. 1981), *cert. denied*, 102 S. Ct. 658 (1981).

104. *Id.*

105. *Id.* at 279. Field's counsel had investigated the proposed combination and stated that it would be illegal under antitrust laws. This determination was based on the competition that would have existed between the Field's stores and the Carter-owned Neiman-Marcus store located in Northbrook, Illinois. It was also based on the potential competition between Field's Chicago stores and a proposed Neiman-Marcus store which would be located one block south of the Field's store. There was also concern over the competition between the book departments in Field's stores and Carter-owned Walden book stores which were also located in Chicago. *Id.* However, Carter's counsel did not believe there would be any antitrust problems with a Field's-Carter combination. *Panter v. Marshall Field & Co.*, 486 F. Supp. 1168, 1180 (N.D. Ill. 1980). Carter was even willing to sell the Neiman-Marcus store in Northbrook, Illinois, in order to eliminate the overlap in the competitive area with the Field's store. *Id.*

106. 646 F.2d at 279. The letter stating Carter's intention to make a tender offer was made in response to Field's directors' refusal to negotiate a merger between the two companies. *Id.* Prior to the letter, Field's president had received a call from Carter's president stating Carter's intention

ing and authorized the filing of an antitrust suit. The next day, the directors discussed the implications of Carter's proposal and voted unanimously to reject the proposed tender offer based on their view that it was "illegal, inadequate, and not in the best interests of Marshall Field & Company."¹⁰⁷

Prior to Carter's announcement of its intention to make a tender offer, Field's held a shareholder meeting in late January to discuss two expansion proposals. The first proposal was the opening of a store in a Houston shopping mall which was also the location of Carter's Neiman-Marcus store.¹⁰⁸ The second was the acquisition of a group of five Liberty House Stores in the Pacific Northwest.¹⁰⁹ The board approved both expansion proposals.

On February 1, 1978, Carter announced a \$42 a share tender offer.¹¹⁰ The next day, Field's directors began to execute the expansion program. Shortly after learning of Field's directors' acquisitions, Carter withdrew its proposed tender offer. Carter stated that the acquisition of Field's was no longer in their shareholders' best interest because Field's expansion program created doubt as to their earning potential.¹¹¹ After the announcement, the price of Field's stock dropped to \$19.¹¹²

The shareholders brought suit in the United States District Court for the Northern District of Illinois against the directors, claiming that the defendant directors breached their fiduciary duty.¹¹³ The share-

to make a tender offer. Field's president construed the conversation as the beginning of an unfriendly takeover attempt. *Id.* During the conversation, Carter stated that it was prepared to offer \$36.00 for each share of Field's stock. *Id.* At the time, Field's stock was trading for \$22.00. Field's stock was trading for less than \$20.00 per share in September, 1977, when Carter began making plans for an offer. The price rose to approximately \$30.00 when the letter was received. *Id.* at 279-80.

107. *Id.* at 280.

108. *Id.*

109. *Id.*

110. *Id.* Carter decided to offer \$42.00 after a Field's press release which indicated that \$36.00 was "inadequate". *Id.* The market price of Field's stock had risen to \$34.00.

111. *Id.* at 281.

112. *Id.* In subsequent months, Field's stock traded below \$15.00. *Takeover Bids, supra* note 22, at 1743 n.24.

113. *Panter v. Marshall Field & Co.*, 486 F. Supp. 1168 (N.D. Ill. 1980). In addition to alleging violations under state law, the shareholders' suit claimed violations of §§ 10b, 14d and 14e under Federal securities laws and rules and regulations of the Securities and Exchange Commission. Jurisdiction of the federal district court was invoked under 15 U.S.C. § 78aa. *Id.* at 1172. The district court dismissed the federal securities law claims because the plaintiffs did not state a cause of action under the particular statutes. In addition, the shareholders also claimed that Field's directors interfered with their prospective economic advantage. They argued that as a result of the directors' actions, Carter withdrew the proposed tender offer leaving the shareholders unable to tender their shares. The district court also dismissed this claim on the basis that the shareholders did not allege and prove that the directors acted with the purpose of injuring their

holders alleged that the breach occurred through the directors' adoption and nondisclosure of a secret policy to resist all takeovers regardless of benefit, the execution of defensive acquisitions, and the filing of an antitrust suit against Carter.¹¹⁴ The district court held that the business judgment rule was the proper standard to apply in analyzing the shareholders' claims.¹¹⁵ Under the business judgment rule, the Field's directors were presumed to have acted in good faith.¹¹⁶ Thus, the shareholders had the initial burden of proving that the directors' actions constituted fraud, bad faith, gross overreaching, or an abuse of discretion.¹¹⁷ The district court held that the Field's directors had exercised their business judgment in good faith when they decided that Carter's proposed tender offer was "illegal, inadequate, and not in the best interests" of Field's shareholders.¹¹⁸ The district court also decided that the directors' actions in filing the antitrust suit and in acquiring various properties was not a violation of any fiduciary duty.¹¹⁹ The district court directed a verdict for the directors, holding that the shareholders had not presented sufficient evidence for a jury to decide whether the directors breached any fiduciary duty.¹²⁰

On appeal to the United States Court of Appeals for the Seventh Circuit, the shareholders argued that, instead of applying the business judgment rule, the court should place the burden of proof on the directors in the takeover context "to establish the compelling business purpose of any transaction which would have the effect of consolidating or retaining the directors' control."¹²¹ The court did not agree,¹²² however, and found support in the "overwhelming weight of authority" for applying the business judgment rule to the directors' actions even when the intent to retain control was a motive. Under the business judgment rule, the majority held, the shareholders must overcome the presumption in favor of the directors by showing that personal motivations "predominated" in the directors actions.¹²³ In order to shift the burden

expectancies. The district court applied the same business judgment analysis as it did in its discussion of the breach of fiduciary duty claim. See text accompanying notes 116-20 *infra*. As this comment focuses on the business judgment rule in relation to the breach of fiduciary duty issue, the securities laws and interference with expectancy claims will not be discussed further.

114. 486 F. Supp. at 1173.

115. *Id.* at 1194.

116. *Id.* at 1192.

117. *Id.*

118. *Id.* at 1194-95.

119. *Id.*

120. *Id.* at 1195.

121. 646 F.2d at 293-94.

122. *Id.* at 294.

123. *Id.* at 295, citing *Johnson v. Trueblood*, 629 F.2d 287 (3d Cir. 1980), *cert. denied*, 450 U.S.

of proof to the directors, the shareholders were required to prove that the intent to retain control was a primary motive for making the decisions.¹²⁴

In arguing that the burden of proof should have shifted to the directors, the shareholders raised three issues. First, they claimed that Field's maintained a secret policy of rejecting every proposed combination whether or not it was in the shareholders' best interests. The court held that absent evidence of self-dealing, fraud, or bad faith, the directors had acted to further a rational business purpose in deciding to maintain Field's independence.¹²⁵ The court also decided that the directors had not breached any fiduciary duty in failing to reveal the policy of independence.¹²⁶

Second, the shareholders contended that the expansion program was designed to perpetuate the control of the present directors. They argued that the acquisitions were undertaken to defeat the takeover as it enabled Field's to appear less attractive as a takeover prospect. The court again relied on the business judgment rule's presumption of fairness and stated that the planned acquisitions were reasonable.¹²⁷ As to the question of control, the court stated that even if the expansion program was intended as a motive to maintain control, it was not the primary motive.¹²⁸ Thus, the Seventh Circuit held that the directors did not violate any fiduciary duty in authorizing the acquisitions.¹²⁹

Third, the shareholders argued that the filing of an antitrust suit against Carter constituted a breach of fiduciary duty. The court decided that the directors' decision to file the antitrust suit was a proper exercise of their business judgment.¹³⁰ A significant factor in the court's determination was the fact that the directors sought the advice of experienced and knowledgeable antitrust lawyers. In addition, the court did not find any evidence of bad faith or improper motive in the filing of the antitrust suit.¹³¹

Having rejected all the shareholders' arguments, the Seventh Cir-

999 (1981). In the *Johnson* case, the Third Circuit decided that the directors did not act with a primary motive to retain control in their refusal to sell stock to and accept loans from minority shareholders. 629 F.2d at 293. See text accompanying notes 90-94 *supra*.

124. 646 F.2d at 297, citing *Cheff v. Mathes*, 41 Del. Ch. 494, 199 A.2d 548 (1964) (Board's decision to purchase shares of corporation held to be primarily for a proper corporate purpose).

125. 646 F.2d at 296.

126. *Id.*

127. *Id.* at 297.

128. *Id.*

129. *Id.*

130. *Id.*

131. *Id.*

cuit affirmed the district court's ruling. The court held that the shareholders had presented insufficient evidence either to shift the burden of proof to the directors or for a reasonable jury to find that the directors had breached any fiduciary duty.¹³²

A strong dissent by Judge Cudahy followed the majority's opinion. He felt that there was sufficient evidence for the jury to decide the breach of fiduciary duty issue.¹³³ He disagreed with the majority's holding that the business judgment rule was applicable to every director's decision to resist takeover bids other than those amounting to fraud, bad faith or abuse of discretion.¹³⁴ The judge stated that in the corporate takeover setting, the directors act to maintain control. Under the business judgment rule, once the shareholder has proven that the directors had an interest in the transaction, the burden of proof should shift to the directors to prove the fairness of the transaction.¹³⁵ The judge believed that the Field's directors were faced with a conflict of interest so that their defensive tactics were motivated by their desire to maintain control. Accordingly, Judge Cudahy believed that the burden of proof should have shifted to the directors, requiring them to justify their actions.¹³⁶

ANALYSIS OF THE COURT'S OPINION

In analyzing the breach of fiduciary duty claims, the Seventh Circuit took a business judgment rule approach similar to that applied in other recent takeover cases.¹³⁷ In these cases, in order for the shareholders to sustain their burden of proof, they were required to present evidence that the directors' actions were intended for the primary purpose of retaining control.¹³⁸ In cases where the directors had authorized transactions solely to defeat the tender offer, courts have held that they acted for the primary purpose of maintaining control and therefore breached their fiduciary duty to the corporation.¹³⁹

132. *Id.* at 298.

133. *Id.* at 299. (Cudahy, J., dissenting in part and concurring in part). Judge Cudahy concurred in the court's holdings on the securities laws issues, but dissented from the court's rulings on the business judgment rule. As this comment focuses solely on the court's treatment of the business judgment rule, Judge Cudahy's opinion will be termed a dissent.

134. *Id.* at 301.

135. *Id.* at 304.

136. *Id.*

137. *See, e.g.*, *Johnson v. Trueblood*, 629 F.2d 287 (3d Cir. 1980); *Treadway Co. v. Care Corp.*, 638 F.2d 357 (2d Cir. 1980); *Crouse-Hinds Co. v. InterNorth, Inc.*, 634 F.2d 690 (2d Cir. 1980).

138. *See* cases cited in note 137 *supra*.

139. *See, e.g.*, *Bennett v. Propp*, 41 Del. Ch. 14, 187 A.2d 405 (1962) (The director's purchase

For example, in *Royal Industries, Inc. v. Monogram Industries, Inc.*,¹⁴⁰ Royal, the target company, acquired Sar Industries five days after Monogram Industries announced its intention to make a tender offer for Royal's shares. At the time of the acquisition, Sar Industries had a suit pending against Monogram Industries for antitrust violations. The acquisition of Sar would have provided Royal's management with an antitrust defense to the Monogram tender offer.¹⁴¹ The United States District Court for the Central District of California enjoined Royal's acquisition of Sar and held that the "sole, primary, controlling or compelling" purpose of the acquisition was to thwart the tender offer.¹⁴² The court also held that the directors breached their fiduciary duty to the corporation because they manipulated the corporation to further their best interests.¹⁴³

Contrary to the majority's construction of the facts, the Field's directors also authorized transactions that were intended to bolster their claim that a Carter takeover would violate antitrust laws.¹⁴⁴ Shortly after the directors rejected the proposed tender offer, they approved proposals to acquire retail operations adjacent to Carter operations. After reviewing a list of available candidates for immediate acquisition, the directors approved plans to acquire space in Houston and Dallas shopping centers where Carter's Neiman-Marcus stores were located.¹⁴⁵ They also authorized plans to develop a Field's store in Northbrook Court, located in Chicago's northern suburbs, which was also the site of a Neiman-Marcus store. In addition, the directors attempted to acquire a southwestern retailer who was in direct competition with the Neiman-Marcus division. Although the later two transactions ultimately were not consummated,¹⁴⁶ as the dissent cor-

of the corporation's stock primarily to prevent control from being transferred to outsiders was held to be a breach of fiduciary duty).

140. [1976-77 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 95,863 (C.D. Cal. 1976).

141. *Id.* at 91,138.

142. *Id.* at 91,136.

143. *Id.* at 91,137.

144. See 646 F.2d at 306-09 (Cudahy, J., dissenting). The concentration of Field's and Carter stores in Chicago allegedly would have been a combination in restraint of trade and, thus, a violation of antitrust laws. A combination in restraint of trade is an "agreement . . . between two or more persons . . . for the purpose of unduly restricting competition, monopolizing trade and commerce in a certain commodity Such combinations are prohibited by the Sherman Antitrust Act, 15 U.S.C. §§ 1-7." BLACK'S LAW DICTIONARY 241 (5th ed. 1979).

145. 646 F.2d at 308 (Cudahy, J., dissenting). Dallas is also the headquarters of Carter's Neiman-Marcus division.

146. *Id.* at 307. The directors' attempt to purchase the southwestern store was defeated when the store was purchased by Dutch interests. *Id.* The negotiations to put a Field's store in Northbrook Court fell apart because the developer did not want another major retailer in the mall. *Id.* at 308.

rectly pointed out, they were evidence of the directors' improper intention to defeat the takeover.¹⁴⁷ As was the case in *Royal Industries*, the Field's directors approved the transactions in order to create antitrust obstacles to a Carter takeover. As the defensive acquisitions would have placed Field's in an offensive litigating position in their antitrust suit, the Seventh Circuit should have held that the directors acted for the primary purpose of defeating the tender offer and maintaining their control.¹⁴⁸

In finding that the burden of proof on the question of intent to retain control remained with the shareholders, the Seventh Circuit relied on *Crouse-Hinds v. InterNorth*,¹⁴⁹ a case involving facts significantly different than those in the *Field's* case. In *Crouse-Hinds*, Crouse-Hinds, the target company, negotiated a merger agreement with the Belden Company. A short time later, InterNorth proposed a tender offer for the control of Crouse-Hinds. After Crouse-Hinds rejected the tender offer, InterNorth sued on the basis that the Crouse-Hinds/Belden merger was negotiated for the purpose of defeating the tender offer and retaining control within the Crouse-Hinds directors. The Second Circuit, however, held that the evidence presented failed to establish that the merger was intended solely to perpetuate the control of the directors in the corporation.¹⁵⁰

In the *Crouse-Hinds* case, the contested merger was negotiated prior to InterNorth's announcement of the proposed tender offer. However, in the *Field's* case, the alleged improper transactions occurred after the proposed tender offer was announced. Therefore, the Second Circuit was correct in holding that the Crouse-Hinds directors' decision to merge with Belden was not motivated by the desire to retain control.¹⁵¹ However, the holding in *Crouse-Hinds* should not have been applicable to a situation where the Field's directors' actions were initiated after the tender offer had been announced.¹⁵² Thus, the Seventh Circuit was incorrect in relying on the *Crouse-Hinds* decision in

147. *Id.* at 306. Judge Cudahy stated that the defensive acquisitions were undertaken to "create additional antitrust problems." *Id.*

148. See *Takeover Bids*, *supra* note 22, at 1748. Field's "made several defensive acquisitions that . . . aggravated a potential antitrust problem. . . ." *Id.*

149. 634 F.2d 690 (2d Cir. 1980).

150. *Id.* at 703.

151. *Id.* The court noted that InterNorth's good faith and lack of "interest" in entering into the merger agreement was unchallenged. *Id.*

152. 646 F.2d at 302 (Cudahy, J., dissenting). Within a short time after the tender offer, Field's directors approved the acquisition of five stores in the Pacific Northwest, a \$17 million commitment for a Field's store in Texas and the institution of a major antitrust action. *Id.*

holding that the directors did not act primarily to maintain control.¹⁵³

In addition, the Seventh Circuit quoted at length from *Johnson v. Trueblood*¹⁵⁴ as its' authority for allocating the burden of proof under the business judgment rule. The majority stated that, according to the *Johnson* case, the shareholders had the burden of proving that the directors' sole or primary purpose for adopting a course of action was to retain control.¹⁵⁵ The issue arose in the *Johnson* case in deciding how a jury was to be charged.¹⁵⁶ However, the majority in the *Field's* case cited the *Johnson* case to decide whether there was even sufficient evidence to present a jury question. The Seventh Circuit should not have relied on a sole or primary purpose standard when determining whether the jury should have been allowed to hear the case.¹⁵⁷ As the business judgment rule was applied in the *Johnson* case at a different point in the trial, the Seventh Circuit should not have relied on the *Johnson* court's use of the rule as support for its decision.

During the majority's discussion of whether the defensive acquisitions were made for control or antitrust considerations, the court cited *Cheff v. Mathes*¹⁵⁸ as requiring proof that such a motive was the sole or primary purpose.¹⁵⁹ In the *Cheff* case, the business judgment rule was recognized as the appropriate standard for evaluating the corporation's purchase or sale of its own stock.¹⁶⁰ When the court in *Cheff* reached the question of the burden of proving the presence or lack of good faith, the court allocated the burden to the directors to justify the transaction "as one primarily in the corporate interest"¹⁶¹ because the purchase of shares involved the use of corporate funds where control of the corporation was threatened. The court upheld the directors' actions because they were justifiably taken to prevent the corporation from being harmed by the attempted takeover of a dissident shareholder.¹⁶² Therefore, a closer reading of the *Cheff* case could have led the court in *Field's* to hold that the directors had the burden of proving that the defensive acquisitions were made primarily to benefit the corporation.

153. *Id.* Judge Cudahy stated that since the Crouse-Hinds/Belden merger was negotiated prior to the proposed tender offer, "any activity to facilitate the merger . . . could legitimately be ascribed to a valid business purpose." *Id.*

154. 629 F.2d 287 (3d Cir. 1980), *cert. denied*, 450 U.S. 999 (1981).

155. 646 F.2d at 294 (quoting *Johnson v. Trueblood*, 629 F.2d at 292-93).

156. 629 F.2d at 292.

157. *See* 646 F.2d at 304 (Cudahy, J., dissenting): "Nothing in *Trueblood* supports the view that the district court properly foreclosed jury consideration of the claims of *Field's* shareholders."

158. 41 Del. Ch. 494, 199 A.2d 548 (1964).

159. 646 F.2d at 297.

160. 41 Del. Ch. at 500, 199 A.2d at 554.

161. *Id.*, *citing* *Bennett v. Propp*, 41 Del. Ch. at 19, 187 A.2d at 409.

162. 41 Del. Ch. at 500, 199 A.2d at 554.

Because a Carter takeover of Field's did not have the same potential for harm that existed in the *Cheff* case, the majority should have more closely scrutinized the directors' actions.

The Seventh Circuit's interpretation of the business judgment rule in the *Field's* case placed an unreasonable burden of proof on the shareholders to prove their claim. First, the court presumed that the directors acted in good faith in not only rejecting the takeover but also in upholding the defensive measures that were employed.¹⁶³ Second, Field's hired antitrust lawyers and financial experts who provided the directors with the appropriate justifications for their actions in fighting the Carter takeover.¹⁶⁴ The majority stated that the employment of these people was evidence that the directors exercised proper business judgment in considering the merits of the tender offer and the defensive measures that were subsequently undertaken.¹⁶⁵ When the shareholders claimed that the directors acted for the primary purpose of maintaining control, Field's had little difficulty in attributing their business judgment to some rational purpose.¹⁶⁶ The business judgment rule was applied to allow the Field's directors virtual freedom in fighting off the Carter takeover without considering the interests of the corporation or its shareholders. This interpretation of the rule seems to be a far cry from the rule that was originally intended to keep directors from being liable for their errors in judgment. Therefore, the shareholders should not have been required to sustain the stringent burden of proof under the business judgment rule.¹⁶⁷

In applying the business judgment rule to decisions involving tender offers, the Seventh Circuit failed to recognize the limitations of the rule. The rule is not applicable where the directors breach their duty of loyalty to the shareholders.¹⁶⁸ This occurs when a conflict of interest exists between the directors and the shareholders.¹⁶⁹ In the

163. 646 F.2d at 297.

164. See *id.* at 299 (Cudahy, J., dissenting): "[T]he majority has adopted an approach which would virtually immunize a target company's board of directors against liability to shareholders, provided a sufficiently prestigious (and expensive) array of legal and financial talent were retained to furnish *post hoc* rationales for fixed and immutable policies of resistance to takeover."

165. *Id.* at 297. The court stated that the reliance on antitrust counsel was sufficient to satisfy the business judgment rule.

166. *Id.* The court was satisfied that a rational business purpose existed for the directors' decision to file the antitrust suit.

167. See Cohn, *supra* note 3, at 477-78: "The relative ease by which management may create a patina of legitimacy for defensive measures results in even further constriction of judicial relief."

168. See text accompanying notes 49-58 *supra*.

169. See text accompanying notes 80-85 *supra*. See *Takeover Bids*, *supra* note 22, at 1745: "This presumption in favor of management's decision-making has never been applied, however, in situations where managers have acute conflicts of interests."

Field's case, the shareholders were offered \$42 a share which represented almost a 100% premium.¹⁷⁰ In addition, the tender offer was made to them in their individual capacities as shareholders.¹⁷¹ In acting to defeat the takeover, the directors eliminated the shareholders' opportunity to earn a substantial profit on their investment.¹⁷² The directors also sought to remain in control of *Field's*. Thus, a conflict of interest existed between the desires of the directors and the shareholders. In causing the defeat of the Carter tender offer and the subsequent denial of financial profit to the shareholders, the *Field's* directors breached their duty of loyalty. Hence, the protection of the business judgment rule should not have been available.

The limitations of the business judgment rule in the takeover setting have been recognized in a recent case which may indicate that courts are shifting away from applying the business judgment rule. In a case decided around the time of the *Field's* decision, the United States District Court in Delaware applied a different standard than the one applied by the majority in *Field's*. In *Crane Co. v. Harsco Corp.*,¹⁷³ the Crane Company proposed a tender offer for the stock of the Harsco Corporation. As some professional traders held a large number of Harsco's stock, Harsco directors were fearful that they might tender the stock to Crane.¹⁷⁴ In order to prevent this occurrence, Harsco directors purchased a portion of the stock that was held by the professional traders. Crane sought to prevent Harsco from completing the purchase, alleging breach of fiduciary duty.¹⁷⁵

In deciding whether the directors acted improperly, the court stated that the use of corporate funds to perpetuate control was improper.¹⁷⁶ The court also stated that when the stock purchase occurs in the context of a tender offer, the directors have an inherent conflict of

170. See *id.* at 1747. *Field's* stock was trading in the lower \$20.00 range when Carter first announced its intentions to make a tender offer. *Id.* at 1743 n.24.

171. See *id.* at 1749 ("[M]anagement has no business decision to make when confronted with a tender offer.").

172. See *id.* at 1748-49. In arguing that the business judgment rule is not applicable to takeovers, Professors Easterbrook and Fischel wonder how shareholders are benefitted by a legal rule that prevents them from doubling the value of their investment. They claimed that the *Field's* directors' defensive tactics diminished the shareholders' welfare. They also argue that the directors' duty in responding to takeover bids is to remain completely passive. See also Easterbrook and Fischel, *The Proper Role of a Target's Management in Responding to a Tender Offer*, 94 HARV. L. REV. 1161 (1981).

173. 511 F. Supp. 294 (D.C. Del. 1981).

174. *Id.* at 297.

175. *Id.*

176. *Id.* at 305. See, e.g., *Singer v. Magnavox Co.*, 380 A.2d 969, 979 (Del. 1977).

interest.¹⁷⁷ The court held that the burden was on the directors to justify the purchase as one primarily in the corporate interest.¹⁷⁸

As the burden of proof was placed on the directors, they could have justified the transaction in two ways. First, the directors could have shown that the transaction was made primarily for some other reason than to retain control.¹⁷⁹ Second, the directors could have shown that although the transaction was a defensive maneuver, it was made to prevent a clear threat of harm to the business.¹⁸⁰ However, the directors failed to meet the burden of proof as there was evidence that the transaction was intended to retain control and prevent the shares from being tendered to Crane.¹⁸¹ In addition, the court found that the purchase was primarily intended as a defensive maneuver.¹⁸² The transaction was not justified since there was little evidence that Crane's takeover of Harsco would have imposed a threat to the future of Harsco. Although the court denied injunctive relief on the basis that Crane would not be irreparably harmed, the court held that Crane had established a substantial likelihood of success on the merits of the fiduciary duty claim.¹⁸³

The *Crane* case is a departure from the line of reasoning that was used to decide the *Field's* case.¹⁸⁴ As in the *Crane* case, the *Field's* directors used corporate funds to fight off the Carter takeover.¹⁸⁵ Corporate funds were expended when *Field's* acquired the five stores in the Pacific Northwest; committed \$17 million for a *Field's* store in Texas; instituted a major antitrust suit and retained expert counsel.¹⁸⁶ Because *Field's* directors used corporate funds in the context of a hostile tender offer, a context in which the interest in perpetuating control is acute, then, under the reasoning of the *Crane* case, the directors were in a

177. *Id.* See *Bennett v. Propp*, 41 Del. Ch. 14, 18, 187 A.2d 405, 409 (1962).

178. 511 F. Supp. at 305.

179. *Id.*

180. *Id.* See *Kaplan v. Goldsamt*, 380 A.2d 556, 569 (Del. Ch. 1977); *accord*, *Cheff v. Mathes*, 41 Del. Ch. 494, 506, 199 A.2d 548, 555 (1964).

181. 511 F. Supp. at 305. The court cited a statement made by Harsco's financial vice-president taken from a deposition in which he stated that the purchase was made primarily to make the shares not available to Crane. *Id.*

182. *Id.* at 305-06.

183. *Id.* at 306.

184. See *Panter v. Marshall Field & Co.*, 646 F.2d 271, 295-99 (7th Cir. 1981), *cert. denied*, 102 S. Ct. 658 (1981).

185. It has long been established that, as a general rule, use of corporate funds to perpetuate control of the corporation is improper unless the directors can justify the purchase as one primarily in the corporate interest. See, e.g., *Singer v. Magnavox Co.*, 380 A.2d 969, 979 (Del. 1977) (Corporate funds used for sole purpose of freezing out minority shareholder is a breach of directors' fiduciary duty).

186. 646 F.2d at 308 (Cudahy, J., dissenting).

conflict-of-interest situation.¹⁸⁷ Therefore, the Field's directors should have had the burden of justifying the transaction. Whether the Field's directors would have met this burden should have been a proper question for the jury. Thus, according to the reasoning in *Crane*, the Field's shareholders should not have had the burden of proving that the directors acted improperly.¹⁸⁸ The *Crane* decision raises significant doubt whether the business judgment rule's presumption that flows to the directors should be applied in the tender offer context. As the *Crane* case is the better reasoned decision, subsequent courts should rely upon it, rather than upon the *Field's* decision.

CONCLUSION

In *Panter v. Marshall Field & Company*,¹⁸⁹ the Seventh Circuit held that the business judgment rule was properly applied in presuming the good faith of directors who fight the takeover of their company.¹⁹⁰ Under the business judgment rule, the shareholders had the initial burden of proving that the directors' actions involved fraud, bad faith, gross overreaching or abuse of discretion.¹⁹¹ However, the court failed to recognize the conflict that existed between the shareholders' interests in reaping the benefits of a Carter takeover and the directors' interests in preserving their control of Marshall Field & Company. Despite a conflict of interest, the court held that the burden of proving a proper corporate purpose did not shift to the Field's directors since the shareholders were unable to prove that the directors acted for the sole or primary purpose of maintaining control.¹⁹² As the shareholders failed to sustain their burden of proof, the district court's grant of a directed verdict was affirmed.

However, in discussing the business judgment rule, the court incorrectly relied on cases that had applied the rule to significantly different fact situations than that present in the *Field's* case. In addition, the requirement of a proof of primary purpose to control placed an unreasonable burden of proof on the shareholders. Thus, the court found that the directors' decisions to expand Field's operations and to file an antitrust suit were not made solely or primarily for control purposes

187. See 511 F. Supp. at 306.

188. See *Id.*

189. 646 F.2d 271 (7th Cir. 1981), cert. denied, 102 S. Ct. 658 (1981).

190. *Id.* at 299.

191. See *id.*

192. *Id.* at 297.

even through the acquisitions aggravated any antitrust problems associated with a Carter takeover.

The Seventh Circuit also failed to recognize that the directors breached their duty of loyalty to the shareholders in causing the defeat of the Carter takeover. In denying the shareholders the opportunity to earn a substantial profit from the \$42 tender offer that Carter was offering, the directors did not act in furtherance of the shareholders' best interests. Therefore, the business judgment rule should not have been applied. Instead, the directors should have had the burden of proving that they acted for proper business purposes.

Finally, the *Field's* case should be viewed in light of a recent Delaware case where, under similar facts, the burden of proof was placed on the directors to prove that their transaction was made in the corporate interest. Under the *Crane* test, the *Field's* directors' decisions would not have been shielded from the presumption of fairness under the business judgment rule and the shareholders' suit would not have been decided for *Field's* directors.

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