CORPORATIONS—MERGERS—"LOCK-UP" ENJOINED UNDER SECTION 14(e) OF SECURITIES EXCHANGE ACT—*Mobil Corp. v. Marathon Oil Co.*, 669 F.2d 366 (6th Cir. 1981).

The well publicized struggle by Mobil Corporation to acquire Marathon Oil Company focused public attention on a corporate merger device that has become popular in recent years. That device is the "lock-up," a term used to describe an agreement which attempts to guarantee a merger between two corporations by making it unattractive for a third company to defeat the merger through competitive bidding for the target company.[1] Originally, a lock-up referred to the purchase by the acquiring company of a large block of shares from a major shareholder of the target company prior to the making of a tender offer.[2] Lately, however, target companies have developed variations of the lock-up through its use in arranging "white knight" takeovers and negotiated mergers.[3]

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[1] Nathan, *Lock-Ups and Leg-Ups: The Search for Security in the Acquisition Market Place*, in CORPORATE LAW AND PRACTICE COURSE HANDBOOK SERIES 16, 15, 21 (1981) (No. 373); Kramer, *The Formulated Lock-Up: New Technique Emerges in Takeover Arena*, Nat'l. L.J., Aug. 3, 1981, at 19, col. 3 (special section).

[2] Nathan, *supra* note 1, at 21; Kramer, *supra* note 1, at 19, col. 3. A tender offer is an offer made by a would-be acquiror directly to the target company's shareholders to purchase their shares, thereby gaining control of the company. *See generally* Merrifield, *Cash Tender Offers and Registered Exchange Offers, Techniques of Mergers and Acquisitions*, in CORPORATE LAW AND PRACTICE COURSE HANDBOOK SERIES 213 (1974) (No. 152).

[3] Nathan, *supra* note 1, at 59-60, 75-87. A white knight is a third company with whom the target company arranges a "friendly" merger in order to foil the attempted takeover. It is a common defensive technique in a tender offer situation. Comment, *Antitakeover Maneuvers: Developments in Defense Tactics and Target Actions for Injunctive Relief*, 35 Sw. L.J. 617, 629 (1981). A lock-up seeks to ensure the white knight's success, thus preventing the undesirable tender offer. Negotiated mergers involve a business decision between two companies to merge. A lock-up in this situation seeks to ensure completion of that agreement by preventing a subsequent takeover by a third company.

One variation of the lock-up is illustrated by the agreement between Buffalo Forge Company and Ogden Corporation. In that agreement, Buffalo Forge sought to defeat Ampco-Pittsburg Corporation's attempted takeover by granting its white knight, Ogden, an option to purchase a block of Buffalo Forge treasury shares. *Ogden's Novel Bid for Buffalo Forge*, Bus. Wk., March 2, 1981, at 29. The use of treasury shares acts as a deterrent by increasing the total number of outstanding shares, thereby increasing the number of shares the original tender offeror would need to purchase in order to acquire a controlling interest. The use of treasury shares enables a company's board of directors to offer stock while avoiding federal laws that require shareholder approval prior to disposal. *Id.* at 30. Ampco-Pittsburg ultimately succeeded in acquiring Buffalo Forge by raising its offer. *An Expensive Victory for Ampco-Pittsburg*, *id.*, March 23, 1981, at 45.

Another variation is the negotiated acquisition agreement involving options to purchase newly issued shares of common stock. This variation is exemplified by the arrangements between Reliance Universal Inc. and Tyler Corp., as well as Kearny-National Inc. and Wabash Inc. Kramer, *supra* note 1, at 21, col. 2-3.

The growth in the popularity of the lock-up technique is largely due to the increased cost of engaging in a bidding war and of defending against undesirable takeovers.[4] Companies are unwilling to act as white knights or to negotiate for a merger with a target, or potential target of another company without reasonable assurances of success.[5] A lock-up actively encourages mergers by providing such assurances. The use of a lock-up also may result in higher per share prices to the benefit of the acquired company's shareholders. Although it can be argued that its use results in lower prices by eliminating competition,[6] including a lock-up in a tender offer or merger arrangement is often the only way of obtaining a competitive bid.[7]

The lock-up which was the subject of the decision in *Mobil Corp. v. Marathon Oil Co.*,[8] involved an attempt to defeat the takeover of Marathon Oil Company (Marathon) by Mobil Corporation (Mobil) through the grant of options to U.S. Steel Corporation (U.S. Steel) for the purchase of unissued common stock and Marathon's primary asset.[9] Mobil's attempt to prevent Marathon's use of purchase options in the agreement with its white knight resulted in the first major court decision concerning the use of the lock-up.

On October 30, 1982, Mobil Corporation, the second largest petroleum company in the United States,[10] made a tender offer to the shareholders of Marathon Oil Company[11] which is ranked seventeenth in the same industry.[12] Mobil sought to purchase forty million

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The lock-up offered by Pullman Inc. to Wheelabrator-Frye Inc. as an incentive to bid against McDermott Inc. consisted of options to purchase both common stock and Pullman's engineering and construction business. Nathan, *supra* note 1, at 75-76.

In addition, a lock-up can take the form of an agreement by the target company to pay the legal expenses of the desired acquiror or a promise by the target to the desired acquiror not to solicit competing bids. Blustein & Rotbart, *Court Rulings on U.S. Steel and Mobil May Change Merger Game, Slow Oil Takeovers*, Wall St. J., Jan. 7, 1982, at 23, col. 6; *see* Nathan, *supra* note 1, at 80-87. Whatever the form, however, the ultimate goal of the lock-up is to insure the success of the desired merger.

[4] Blustein, *More Companies Use "The Lock-up" to Ward Off Unfriendly Takeovers*, Wall St. J., Jan. 28, 1981, at 31, col. 4. The cost of defensive techniques is augmented by the fact that they are generally unsuccessful. In approximately one such situation out of five does a target company successfully defend against an unwanted takeover. *See infra* note 74 and accompanying text.

[5] Blustein, *supra* note 4 at 31, col. 4.

[6] See *infra* text accompanying notes 63-64.

[7] Nathan, *supra* note 1, at 72.

[8] 669 F.2d 366 (6th Cir. 1981).

[9] *Id.* at 367.

[10] Marathon Oil Co. v. Mobil Corp., 669 F.2d 378, 380 (6th Cir. 1981). "Mobil has sales of $63.7 billion and net income of $3.27 billion." *Id.*

[11] 669 F.2d at 367.

[12] Paul & Nag, *Mobil Offer Fails to Lure Enough Marathon Shares*, Wall St. J., Nov. 24, 1981, at 56, col. 1. Marathon has sales of $8 billion and net income of $379 million. Marathon Oil Co. v. Mobil Corp., 669 F.2d 378, 380 (6th Cir. 1981).

shares of Marathon's outstanding common stock for eighty-five dollars per share giving Mobil ownership of sixty-seven percent of Marathon's total outstanding common stock.[13] Upon receiving a minimum of thirty million shares, fifty-one percent of the total outstanding, Mobil planned to effect a merger by exchanging thirty year debentures valued at eighty-five dollars for each of the remaining Marathon shares.[14]

In meeting to discuss Mobil's tender offer, the Marathon directors determined that the bid was undesirable largely because they believed it to be underpriced and because of Mobil's apparent intention to increase its resources by selling Marathon upon acquisition, retaining only Marathon's interest in a West Texas Oilfield.[15] Attempting to block Mobil's bid, Marathon sought to enjoin Mobil's purchase of shares tendered by Marathon shareholders on grounds that the acquisition would violate federal antitrust laws.[16] Marathon also sought

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[13] 669 F.2d at 367.

[14] *Id.*; Wall St. J., Nov. 24, 1981, at 56, col. 1. Such a two-step process whereby an offeror merges with the target company after obtaining a large percentage of the target's outstanding shares through the tender offer is a familiar tender offer tactic. Note, *Corporate Directors' Liability for Resisting a Tender Offer: Proposed Substantive and Procedural Modifications of Existing State Fiduciary Standards*, 32 VAND. L. REV. 575, 578 n.17 (1979).

[15] Brief for Appellee at 6-8, Mobil Corp. v. Marathon Oil Co., 669 F.2d 366 (6th Cir. 1981) [hereinafter cited as Brief for Appellee]. Acquisition of Marathon would increase Mobil's domestic gas and oil reserves by 75%. Mobil's own domestic drilling has been relatively unsuccessful, forcing the company to rely on imported foreign oil subject to politically motivated price swings. N.Y. Times, Dec. 10, 1981, at A1, col. 4.

[16] Marathon Oil Co. v. Mobil Corp., 669 F.2d 378 (6th Cir. 1981). Marathon alleged violations of section 7 of the Clayton Act, which provides in part:

> No person engaged in commerce or in any activity affecting commerce shall acquire, directly or indirectly, the whole or any part of the stock or other share capital and no person subject to the jurisdiction of the Federal Trade Commission shall acquire the whole or any part of the assets of another person engaged also in commerce or in any activity affecting commerce, where in any line of commerce or in any activity affecting commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly.

15 U.S.C. § 181 (1976). Marathon's injunction was granted by Judge Manos of the District Court for the Northern District of Ohio and was upheld by the Court of Appeals for Sixth Circuit in a case decided concurrently with this Note's subject case. Marathon Oil Co. v. Mobil Corp., 669 F.2d 378, 383-84(6th Cir. 1981). It was found that a Mobil-Marathon combination would result in market shares for motor gasoline of between 17 and 50% in the Middle West and of 10% in the nation as a whole. *Id.* at 380. Such large market shares in an industry as large as the oil industry where consumer demand is relatively unaffected by price, where high capital requirements prevent new firms from freely entering the market, and where the individual companies have developed strong, interdependent relationships, are significantly likely to result in lessened competition in those markets. *Id.* at 383. Thus, the court concluded that there was a substantial likelihood that the proposed takeover would violate the Clayton Act and granted an injunction. *Id.*

This opinion provided the basis for Judge Merritt's dissent in *Mobil*. Judge Merritt decided that "Mobil's ability to raise and maintain a Williams Act challenge to the option arrangement necessarily rests on the assumption that Mobil can, in fact, make a tender offer." 669 F.2d at 378 (Merritt, J., dissenting). Because that court had just enjoined Mobil from pursuing its tender competing bids from potential white knights.[17] After examining proposals from several companies, Marathon directors accepted the one presented by U.S. Steel.[18]

U.S. Steel offered to pay Marathon shareholders "$125 a share for 30 million shares."[19] If that purchase succeeded, Marathon would then merge with a U.S. Steel subsidiary by exchanging $100 of 12.5% twelve year U.S. Steel notes for each of the remaining Marathon shares.[20] At the insistence of U.S. Steel, the offer and subsequent merger were made conditional upon Marathon's granting U.S. Steel two options.[21] The first was an option to purchase up to ten million unissued common shares in Marathon's treasury at $90 a share.[22] The second was an option to purchase Marathon's forty-eight percent interest in the Yates Oilfield for $2.8 billion should Mobil or another company succeed in acquiring Marathon.[23]

Realizing that the U.S. Steel offer and agreement would serve both to defeat the original offer as well as to make a second offer impractical, Mobil filed for injunctive relief in the United States District Court for the Southern District of Ohio.[24] Mobil alleged that the granting of the two options constituted a manipulative device

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offer to Marathon's shareholders, the issues in its suit against Marathon were moot. *Id.* The majority, however, believed that the possibility still existed that Mobil could prevail in subsequent litigation concerning the antitrust issue and, therefore, considered Mobil's request for an injunction against Marathon. *Id.* at 373.

[17] 669 F.2d at 367.

[18] *Id.* Marathon received oral offers from Gulf Oil Corporation and Allied Corporation. Allied was willing to pay $120 per share for all of Marathon's outstanding common stock. As part of the transaction, Allied requested an option to purchase the Yates Oilfield for $3 billion. Marathon rejected the proposal because of Allied's requirement that Marathon finance the tender offer by purchasing oil property owned by Allied for $3 billion. Brief for Appellant at 6, Mobil Corp. v. Marathon Oil Co., 669 F.2d 366 (6th Cir. 1981) [hereinafter cited as Brief for Appellant].

Gulf offered to pay between $130 and $140 per share for 50% of Marathon's shares if Marathon agreed to grant it an option to purchase a large block of unissued common stock and an option to purchase Marathon's interest in the Yates Oilfield. Gulf also agreed to withdraw its offer in the event that Marathon succeeded in its antitrust suit against Mobil, provided it would then be permitted to purchase 10% of Marathon's interest in the Yates Oilfield for $280 million. Gulf's offer was still tentative at the time of U.S. Steel's firm offer. Brief for Appellee, *supra* note 15, at 10.

[19] 669 F.2d at 367.

[20] *Id.*; Chavez, *Big Steel's Moves to Diversify*, N.Y. Times, Nov. 20, 1981, at D4, col. 1. With interest rates at the time at roughly 15%, the then current value of the U.S. Steel notes was $86. The overall value of the U.S. Steel offer, therefore, was $105 per share. *Id.*

[21] 669 F.2d at 367.

[22] *Id.*

[23] *Id.* The West Texas Oilfield is considered to be Marathon's principal asset. For a discussion of the field's production potential and approximate value, see Mobil Corp. v. Marathon Oil Co., No. 81-1402, slip op. at 27-28 (S.D. Ohio Dec. 7), *rev'd*, 669 F.2d 366 (6th Cir. 1981).

[24] Mobil Corp. v. Marathon Oil Co., No. 81-1402 (S.D. Ohio Dec. 7), *rev'd*, 669 F.2d 366 (6th Cir. 1981).

violative of section 14(e) of the Williams Act[25] in that it attempted to "lock-up" the Marathon-U.S. Steel agreement through the prevention of competitive bidding for Marathon shares.[26] Mobil further alleged that Marathon's directors failed to meet the disclosure requirements of section 14(e).[27] Finally, Mobil attacked the agreement under Ohio state law claiming a breach of fiduciary duty on the part of Marathon's directors, a lack of proper corporate purpose, and failure to obtain shareholder approval for a sale of all or substantially all corporate assets.[28]

Judge Joseph Kinneary granted Mobil an order temporarily restraining Marathon and U.S. Steel from pursuing the latter's tender offer and from exercising the options pending consideration of Mobil's claim.[29] The following day Mobil made a new tender offer for the purchase of thirty million Marathon shares at $126 per share. This offer was conditioned upon the court's invalidation of the purchase options, although Mobil reserved the right to waive this condition.[30]

In determining the propriety of granting Mobil's request for a preliminary injunction, Judge Kinneary considered the four factors set forth by the Court of Appeals for the Sixth Circuit in *Mason County Medical Association v. Knebel*.[31] The four factors analyzed were: (1) the showing of a substantial likelihood of success by the plaintiff on the merits; (2) a showing by the plaintiff of irreparable injury in the absence of an injunction; (3) a determination that substantial

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[25] 15 U.S.C. § 78n(e) (1976). The Williams Act was passed in 1968 as an amendment to the Securities Exchange Act of 1934. Its sole concern is tender offers which were previously "outside the scope of federal securities laws." Note, *Cash Tender Offers: Judicial Interpretation of Section 14(e)*, 23 CLEV. ST. L. REV. 262, 262 (1974). Section 14(e) is the antifraud provision of the Act and provides:

> It shall be unlawful for any person to make any untrue statement of a material fact or omit to state any material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading, or to engage in any fraudulent, deceptive, or manipulative acts or practices, in connection with any tender offer or request or invitation for tenders, or any solicitation of security holders in opposition to or in favor of any such offer, request or invitation. The [Securities Exchange] Commission shall, for the purposes of this subsection, by rules and regulations define, and prescribe means reasonably designed to prevent, such acts and practices as are fraudulent, deceptive, or manipulative.

15 U.S.C. § 78n(e) (1976).

[26] Mobil Corp. v. Marathon Oil Co., No. 18-1402, slip op. at 2 (S.D. Ohio Dec. 7), *rev'd*, 669 F.2d 366 (6th Cir. 1981).

[27] *Id.* at 3.

[28] *Id.* at 3-4. Mobil's claim at failure to obtain shareholder approval is based on its belief that the Yates Oilfield, for which Marathon granted U.S. Steel a purchase option, constitutes substantially all of Marathon's assets. *Id.* at 3.

[29] *Id.* at 31.

[30] *Id.*

[31] 563 F.2d 256, 261 (6th Cir. 1977).

harm would not result to others should an injunction issue; and (4) a determination that a furthering of the public interest would result from the issuance of a preliminary injunction.[32] Judge Kinneary found potential irreparable injury to Mobil due to the likelihood that Mobil would lose the Yates Oilfield even if it succeeded in acquiring Marathon.[33] Similarly, if the preliminary injunction were denied and Mobil later prevailed on its claims, the formulation of an adequate remedy would be improbable in the face of a successful Marathon-U.S. Steel merger.[34] Marathon shareholders would also be harmed in that if the non-disclosure allegations proved true, they would have tendered shares without complete information.[35] In addition, the district court found no indication that the injunction would result in substantial harm to others. On the contrary, an injunction would serve the public interest by enforcing compliance with legislation designed to protect investors.[36]

Nevertheless, the court denied Mobil's application for an injunction because of the company's failure to demonstrate probable success on the merits of its claim.[37] Judge Kinneary found no violation of section 14(e)'s disclosure requirements[38] and no convincing evidence that the use of the lock-up would constitute a manipulative act was put forth.[39] The latter conclusion was based on the determination that Mobil's allegations constituted a claim of breach of fiduciary duty which, pursuant to *Santa Fe Industries, Inc. v. Green*,[40] would not be actionable under the federal securities statute.[41] Additionally, because Marathon's directors had carefully examined all possible offers and had openly communicated the undesirability of the Mobil offer to its shareholders, the district court also found that the Mara-

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[32] *Id.*

[33] Mobil Corp. v. Marathon Oil Co., No. 81-1402, slip op. at 32-33 (S.D. Ohio Dec. 7), *rev'd*, 669 F.2d 366 (6th Cir. 1981).

[34] *Id.* at 33.

[35] *Id.*

[36] *Id.* at 34.

[37] *Id.* at 48.

[38] *Id.* at 39-46.

[39] *Id.* at 46-47.

[40] 430 U.S. 462 (1977).

[41] *Id.* In *Santa Fe*, a minority stockholder seeking to set aside a merger between Santa Fe Industries and a subsidiary brought an action alleging violations of section 10(b) of the Securities Exchange Act, 15 U.S.C. § 78j(b) (1976). 430 U.S. at 467. See *infra* note 60 for the text of the statute. Specifically, Green charged that the corporation's stock had been deliberately underappraised in an attempt to force minority shareholders to sell their stock at an inadequate price. *Id.* The Supreme Court interpreted section 10(b) as applying to conduct that was manipulative and deceptive but found that the Santa Fe merger was neither. *Id.* at 473-74. Therefore, the action could not be brought under section 10(b). The Court decided that the allegation was one of breach of fiduciary duty which is actionable only under state law. *Id.* at 478-80.

thon directors acted in good faith and were not in violation of state standards applicable to a breach of fiduciary duty.[42]

Reversing the decision of the district court, the Court of Appeals for the Sixth Circuit found that Mobil had demonstrated a substantial likelihood of succeeding on the merits of its claim of manipulation under section 14(e), thus meeting the first *Knebel* factor for injunctive relief.[43]

Because Mobil alleged violations of section 14(e) of the Williams Act,[44] the court of appeals found it necessary to first determine whether Mobil, as a tender offeror, had standing to bring a private cause of action for injunctive relief under the statute.[45] Although the Supreme Court in *Piper v. Chris Craft, Inc.*,[46] held that a defeated tender offeror could not bring an action for damages against the target company and the successful tender offeror, it left open the question of whether standing would exist in a suit for injunctive relief.[47]

Following *Piper*, the court of appeals determined that the four factor analysis set forth by the Supreme Court in *Cort v. Ash*[48] was relevant to the determination of whether a private cause of action

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[42] Mobil Corp. v. Marathon Oil Co., No. 18-1402, slip op. at 53-57 (S.D. Ohio Dec. 7), 669 F.2d 366 (6th Cir. 1981). The court also decided that the sale of the Yates Oilfield did not constitute substantially all of Marathon's assets, *id.* at 52, and that Marathon's directors had the power to authorize the lock-up. *Id.* at 53.

[43] 669 F.2d at 375.

[44] See *supra* note 25 and accompanying text.

[45] 669 F.2d at 370. The court rejected Mobil's contention that it had brought this action as a Marathon shareholder by virtue of prior stock purchases, since, as a tender offeror, Mobil did not have the ordinary shareholder interest in raising the value of Marathon's shares. As a tender offeror, Mobil's interest was in keeping the value low, thus making its acquisition of Marathon less costly. *Id.*

[46] 430 U.S. 1 (1977).

[47] The issue of standing for both a target company and a tender offeror seeking injunctive relief under the Williams Act has been addressed by a number of courts with varying results. *See* Weeks Dredging & Contracting, Inc. v. American Dredging Co., 451 F. Supp. 464 (E.D. Pa. 1978) (granting tender offeror standing to sue for injunctive relief under Williams Act); Humana, Inc. v. American Medicorp., 445 F. Supp. 613 (S.D.N.Y. 1977) (granting tender offeror standing to sue for injunctive relief under Williams Act); *see also* Dan River, Inc. v. Unitex Ltd., 624 F.2d 1216 (4th Cir. 1980), *cert. denied*, 449 U.S. 1101 (1981) (granting target company standing to sue for injunctive relief); Kirsch Co. v. Bliss & Laughlin Indus., Inc., 495 F. Supp. 488 (W.D. Mich. 1980) (granting target company standing to sue for injunctive relief). *But see* Gateway Indus., Inc. v. Agency Rent-A-Car, Inc., 495 F. Supp. 92 (N.D. Ill. 1980) (standing denied to target company); Sta-Rite Indus., Inc. v. Nortek, Inc., 494 F. Supp. 358 (E.D. Wis. 1980) (standing denied to target company). *See generally* Note, *Preliminary Injunctive Relief and Tender Offers: An Analysis Under the Williams Act*, 49 GEO. WASH. L. REV. 563 (1981).

[48] 422 U.S. 66 (1975). In *Cort v. Ash*, the Supreme Court denied the existence of a federal private cause of action for damages against corporate directors who made political contributions in violation of 18 U.S.C. § 610 (1976), limiting the plaintiff to remedies under state law. 422 U.S. at 84-85.

existed under a particular statute.[49] These factors are: (1) whether the plaintiff is "one of the class for whose *especial* benefit the statute was enacted;" (2) whether there was "any indication of legislative intent, explicit or implicit, either to create such a remedy or to deny one;"(3) whether granting the private remedy is "consistent with the underlying purposes of the legislative scheme;" and (4) whether the cause of action in question is "one traditionally relegated to state law, in an area basically the concern of the States, so that it would be inappropriate to infer a cause of action based solely on federal law."[49] Applying the *Cort* factors, the court of appeals in *Mobil* decided that Congress intended the Williams Act to provide a tender offeror with a cause of action for injunctive relief.

Evaluating Mobil's request under the *Cort* analysis, the court noted that a defeated tender offeror did not appear to be of the class which the legislature intended to benefit by the Williams Act.[50] The legislation was enacted to protect the shareholders of the target company by ensuring that the decision to tender shares to the offeror is based upon complete freedom and information.[51] The Court of Appeals for the Sixth Circuit, however, reasoned that a tender offeror, due to the nature of a tender offer situation, is in the best position to protect the target shareholders. Because the tender offeror makes a thorough investigation of both the target company and the overall industry prior to making its offer, it is the party best able to provide the target shareholders with the necessary information in the short period of time before the acceptance or rejection of the tender offer.[52] According to the court, affording the tender offeror standing to seek injunctive relief would benefit the target company's shareholders who are the intended beneficiaries of the Williams Act.

As to the second *Cort* factor, the *Mobil* court suggested that a private action for injunctive relief was implicitly intended by the legislature because it would further the purpose of the Williams Act to afford protection to the target's shareholders without favoring one tender offeror over another.[53] This resulting protection of the target company's shareholders made the granting of injunctive relief to a

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[49] 422 U.S. at 78 (emphasis in original and citations omitted).

[50] 669 F.2d at 371. The *Piper* Court stated that the legislative history of section 14(e) of the Williams Act shows that its sole purpose was the protection of investors who are confronted with a tender offer. Tender offerors were the class to be regulated by the statute, not the intended beneficiaries of the statute. 430 U.S. at 35.

[51] 669 F.2d at 371.

[52] *Id.*

[53] *Id.* at 371-72.

tender offeror consistent with the underlying purpose of the statute. Thus, the third *Cort* factor was also satisfied.[54]

Addressing the final *Cort* factor of whether the cause of action should be relegated to state law, the court of appeals concluded that the available state remedy provided an inadequate substitute for the relief afforded by section 14(e). Rejecting the suggestion of the district court that Mobil could bring an action for breach of fiduciary duty under state law, the court noted that such a cause of action would permit violations of the federal securities laws to be justified merely upon a showing of good faith.[55] Since all the *Cort* requirements had been met, the court concluded that Mobil, as a tender offeror, had an implied cause of action for injunctive relief pursuant to section 14(e) of the Williams Act.[56]

The court of appeals next addressed the merits of Mobil's request for an injunction. Returning to the district court's analysis according to the test set forth in *Knebel*,[57] the court of appeals overturned the lower court's holding that Mobil failed to show a substantial likelihood of success on the merits.[58] The court of appeals' finding of a substantial likelihood of success was based on the decision that the Yates Oilfield option and the stock option in the Marathon-U.S. Steel agreement constituted manipulative devices prohibited by section 14(e).[59]

Noting that neither the Williams Act nor the Securities Exchange Act in general defines the term "manipulation," the court adopted the definition propounded by the Supreme Court in *Ernst & Ernst v. Hochfelder*.[60] The Supreme Court described manipulation as "inten-

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[54] *Id.* at 372.

[55] *Id.*

[56] *Id.*

[57] See *supra* text accompanying notes 31-37.

[58] 669 F.2d at 375.

[59] *Id.*

[60] 425 U.S. 185, 199 (1976). Ernst & Ernst v. Hochfelder concerned alleged manipulation in violation of section 10(b) of the Securities Exchange Act which provides:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange . . . (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the [Securities Exchange] Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

15 U.S.C. § 78j(b) (1976). Because of the similarity of purposes and prohibitions of section 10(b) and section 14(e) of the Securities Exchange Act, a ruling concerning one generally applies to the other as well. Panter v. Marshall Field & Co., 646 F.2d 271, 282 (7th Cir. 1981), *cert. denied*, 50 U.S.L.W. 3448 (U.S. Oct. 5, 1981) (No. 81-666); Altman v. Knight, 431 F. Supp. 309, 314 (S.D.N.Y. 1977).

tional or willful conduct designed to deceive or defraud investors by controlling or artificially affecting the price of securities."[61] Applying this definition to an evaluation of the potential effects of the granting of the Yates Oilfield option and the stock option, the *Mobil* court found that the options, operating both individually and jointly, were manipulative devices.[62] The court of appeals concluded that granting U.S. Steel options to purchase a large block of stock and a major asset to be exercised only in the event that a third party succeed in the acquisition of Marathon was indicative of an intent to prevent competitive bidding for Marathon shares.[63] Due to the existence of the options, the court reasoned that the unlikelihood of an offer higher than the $125 per share offered by U.S. Steel served to establish that figure as a ceiling on the valuation of Marathon shares.[64] Because the lock-up agreement with U.S. Steel represented an attempt to artificially affect the price of Marathon stock, the court concluded that the options constituted a manipulative device.[65] For this reason, the court allowed the continuation of U.S. Steel's tender offer minus "the inhibiting and unlawful impact of the two options,"[66] and extended the period of time the offer was to remain open to allow interested companies to make competing bids.[67]

Although the court disclaimed an intention to create a rule for all options which might be considered lock-ups or which might prevent competitive bidding,[68] its decision could substantially affect the use of lock-ups both in defeating an unwanted tender offer and in ensuring the completion of a negotiated merger.[69] Because the decision involved a finding of illegality, its effect on the use of lock-ups is likely to be negative. A company will be reluctant to avail itself of the technique, if only to avoid the litigation which is likely in the wake of

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[61] 425 U.S. at 199. The term "artificial" has been construed to mean "unrelated to the natural forces of supply and demand." 669 F.2d at 374.

[62] 669 F.2d at 376.

[63] *Id.* at 374.

[64] *Id.* at 375.

[65] *Id.*

[66] *Id.* at 377.

[67] *Id.*

[68] *Id.*

[69] The potential impact of the decision was recognized by Mobil. They stated:

> The issue of legality thus comes before this Court—the first Court of Appeals to consider it—as one of landmark significance, in a case followed closely by the business and financial world which is certain to have immediate and far-reaching impact upon the future form and substance of corporate mergers and acquisitions.

Brief for Appellant, *supra* note 18, at 14.

Mobil's success.[70] This probable result is unfortunate because it will deprive corporate directors of a valuable tool in defeating an undesirable tender offer.

Despite the argument by some that corporate directors should not be permitted to oppose tender offers,[71] the courts have clearly established that directors have a duty to fight an offer which, after careful consideration, they deem to be against the best interests of the corporation's shareholders.[72] This duty is not without restrictions, however, as directors are required to be fair and impartial in making decisions and to act pursuant to the general fiduciary duties imposed upon them. That is, they must be motivated by a desire to further the interests of the shareholders rather than by self-interest.[73] Corporate directors have been greatly frustrated in their efforts to fulfill this duty. In the majority of contested takeovers the bidder acquires the target despite the target management's use of various defensive techniques.[74] The lock-up is intended to increase the probability that the use of one defensive technique—the merger with a white knight—will be successful. Thus, it would aid directors in fulfilling a judicially imposed obligation. An attempt to arrange a merger with a white

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[70] One Wall Street attorney's opinion of the impact of the *Mobil* decision on the future use of the lock-up is: " 'It won't necessarily be a good idea' for a target company to enter into a lock-up agreement of any kind during a tender, 'because that will clearly lead to litigation, which could cause a significant delay.' " Blustein & Rotbart, *supra* note 3, at 23, col. 6.

[71] Easterbrook & Fischel, *The Proper Role of a Target's Management in Responding to a Tender Offer*, 94 HARV. L. REV. 1161 (1981). Professors Easterbrook and Fischel argue that management's resistance to a tender offer is detrimental to shareholder welfare. Such resistance drains corporate resources, and deprives shareholders of a premium over the market price of their shares. Even when resistance results in shareholders receiving a higher premium, as in a white knight merger, the effect is to decrease the overall number of tender offers made. This deprives all shareholders of the tender offer's effect of moving productive assets to the hands of better management (assuming that tender offerors seek companies which suffer from poor management). *Id. Contra* Lipton, *Takeover Bids in the Target's Boardroom*, 35 BUS. LAW. 101 (1979); Steinbrink, *Management's Response to the Takeover Attempt*, 28 CASE W. L. REV. 107 (1980).

[72] *See* Panter v. Marshall Field Co., 646 F.2d 271, 288 (7th Cir. 1980), *cert. denied*, 50 U.S.L.W. 3448 (U.S. Oct. 5, 1981) (No. 81-666); Treadway Cos. v. Care Corp., 638 F.2d 357, 381 (2d Cir. 1980); Heit v. Baird, 567 F.2d 1157, 1161 (1st Cir. 1977); Northwest Indus., Inc. v. B.F. Goodrich, 301 F. Supp. 706, 712-13 (N.D. Ill. 1969).

[73] Northwest Indus., Inc. v. B.F. Goodrich, 301 F. Supp. 706, 712-13 (N.D. Ill. 1969).

[74] A survey of tender offer activity during 1978 and early 1979 indicates that the tender offeror generally succeeds in obtaining its target despite the target management's use of defensive techniques. In 1978, tender offerors succeeded in 55% of contested offers. In the first six months of 1979, 60% of contested offers were completed. Austin, *Tender Offers Update: 1978-1979*, 15 MERGERS & ACQUISITIONS 13, 18-19 (Summer 1980). A survey taken a year later showed an increase in the trend. In 1980, 47 tender offers were contested but only one target's management was successful in defending against the unwanted takeover. Austin & Mandula, *Tender Offer Trend in the 1980's*, 16 MERGERS & ACQUISITIONS 46, 46 (Fall 1981).

knight using a lock-up for reasons other than the protection of the target shareholders would be actionable under state law as a breach of fiduciary duty.[75]

Although other defensive techniques are available,[76] they result in the target company remaining independent. In a white knight merger, however, the shareholders are permitted an opportunity to sell their shares at a premium over the market price.[77] This premium is, almost without exception, greater than that offered by the defeated tender offeror.[78] Consequently, by ensuring the success of the white knight merger, the lock-up acts to further the interests of the shareholders. A discussion of the value of a lock-up agreement must also consider the fact that it is a product of recent economic conditions which have increased the financial risk associated with making a competitive bid for a target company. As mentioned above,[79] it is only by the inclusion of a lock-up agreement that many firms will agree to assume the risk and act as a white knight, thereby allowing target management to defeat an unwanted takeover and providing target shareholders with the opportunity to sell their shares at a higher premium.

The potential chilling effect of the *Mobil* decision on the use of a lock-up can be avoided if courts apply a standard of interpretation for section 14(e) violations which provides for a weighing of the benefits provided by the lock-ups and management's desire to assure its shareholders of those benefits against the potential harm.[80] Courts have applied different standards in determining section 14(e) violations including the "valid business purpose" test, and the "primary purpose" test often employed in evaluating claims of breach of fiduciary

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[75] Generally, state corporate law places corporate directors in the position of a fiduciary with respect to the corporation and the corporation's shareholders and imposes a duty of "honesty, loyalty, good faith, diligence and fairness." Panter v. Marshall Field & Co., 486 F. Supp. 1168, 1192 (N.D. Ill. 1980), *aff'd*, 646 F.2d 271 (7th Cir. 1980), *cert. denied*, 50 U.S.L.W. 3448 (U.S. Oct. 5, 1981) (No. 81-666).

[76] Other defensive techniques include changing corporate by-laws to require a supermajority of shareholder votes for merger approval; issuing additional corporate shares to impair the offeror's ability to obtain a controlling interest; instituting litigation against the tender offeror; declaring dividends to increase the price of the target company's shares; and, urging target shareholders not to tender. Fischel, *Efficient Capital Market Theory, the Market for Corporate Control, and the Regulation of Cash Tender Offers*, 57 TEXAS L. REV. 1, 30-39 (1978).

[77] Fischel, *supra* note 76, at 39. White knight mergers "are unique among defensive tactics because they create an auction between the offeror and other companies interested in merging with the target to the ultimate advantage of all shareholders." *Id.*

[78] Comment, *supra* note 3, at 629.

[79] See *supra* notes 4-5 and accompanying text.

[80] See *infra* notes 89-92 and accompanying text.

duty.[81] The court of appeals in *Mobil*, however, did not use a clearly defined standard. Instead it noted that the underlying purpose of the Williams Act was to protect "the free, informed choice of shareholders" in a tender offer situation.[82] The court then assumed that such freedom of choice required that all potential tender offerors be able to compete on an equal basis for the target shares.[83] Because the lock-up favored one particular tender offeror, it precluded other potential offerors from making competing bids, thus acting to the detriment of Marathon shareholders whose choice was then limited to the U.S. Steel offer.[84] In addition, the court of appeals reasoned that the lock-up options "could be construed as expressly designed solely" for the purpose of blocking "healthy market activity."[85]

The standard used by the court of appeals in *Mobil* is inadequate for determining the validity of a lock-up, or any action allegedly violative of section 14(e), for two reasons. First, it misconstrues the fundamental purpose of the Williams Act which is:

> [T]o provide the investor, the person who is required to make a decision, an opportunity to examine and to assess the relevant facts and to reach a decision without being pressured and without being subject to unwarranted techniques which are designed to prevent that from happening.[86]

Thus, the Williams Act seeks to protect shareholder decision-making with respect to offers with which they are actually faced. Although the possibility of competitive bids is a factor to be considered in determining the attractiveness of an existing offer, a free and informed decision could be made without requiring, as the *Mobil* court did, that all possible tender offerors operate on an equal basis. The

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[81] The "valid business purpose" test requires that corporate directors have some valid business reason for their action. *See* Applied Digital Data Sys., Inc. v. Milgo Electronic Corp., 425 F. Supp. 1145, 1158 (S.D.N.Y. 1977) (applied "valid business purpose" test to alleged Williams Act violations).

The "primary purpose" test requires that the controlling purpose of a director's actions be a valid corporate purpose. Thus, it is a stricter test than the above. *See* Klaus v. Hi-Shear Corp., 528 F.2d 225, 234 (9th Cir. 1975) (upheld application of "primary purpose" test to Williams Act claim).

[82] 669 F.2d at 371.

[83] *Id.* at 376.

[84] *Id.*

[85] *Id.* at 374.

[86] *Full Disclosure of Corporate Equity Ownership and in Corporate Takeover Bids: Hearings on S.510 Before the Senate Subcomm. on Securities of the Comm. on Banking and Currency*, 90th Cong., 1st Sess. 15 (1967) (statement of Manuel F. Cohen, Chairman, Securities Exchange Commission) *cited in* Lynch & Steinberg, *The Legitimacy of Defensive Tactics in Tender Offers*, 64 CORNELL L. REV. 901, 912 (1979).

approach adopted in the Sixth Circuit also frustrates the express intent of Congress to structure the Williams Act in a way that favors neither the tender offeror nor the target's management.[87]

Second, the Court of Appeals for the Sixth Circuit inferred an intent on the part of the directors to defraud the shareholders. This inference was drawn without an examination of all the facts relevant to the Marathon director's decision to grant U.S. Steel the lock-up options. The detrimental effect of this inference becomes apparent when the result in *Mobil* is compared to the possible result of using a standard in which management's decision is more fully examined.[88]

Such a standard has been proposed. It would allow courts to weigh the target directors' actions in attempting to use a lock-up for the benefit of their shareholders while preventing the denial of the protection afforded the shareholders under section 14(e).[89] This standard involves a two-step process which begins with a determination of whether the device employed materially impeded the target shareholder's consideration of existing offers. Devices which do not hinder shareholder decision-making are not violative of section 14(e).[90] If a device is found to have such an effect, however, the presumption arises that target management intended to prevent shareholders from considering an existing offer or offers.[91] Management, however, may rebut the presumption and thereby preclude a finding of section 14(e) liability by producing evidence to show that the primary purpose was not to inhibit shareholder decision-making.[92] Thus, this standard applies the primary purpose test previously used in section 14(e) decisions but only after a violation had been found—not to determine the existence of such a violation.

It is the latter introduction of the primary purpose test which would have produced a more favorable decision with respect to the use of the lock-up device in the Marathon-U.S. Steel argument.[93] There is considerable evidence indicating that the major aim of Marathon's directors was not to impede shareholder decision-making but to enhance it. At the board meeting called the day following Mobil's

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[87] H.K. Porter Co. v. Nicholson File Co., 482 F.2d 421, 423 (1st Cir. 1973).

[88] See *infra* notes 93-98 and accompanying text.

[89] Lynch & Steinberg, *supra* note 86, at 924-28.

[90] *Id.* at 927.

[91] *Id.* at 927-28.

[92] *Id.* at 928.

[93] Although the discussion concerns application of the proposed standard to lock-ups, this standard would, as its creators suggest, be applicable to all tender offer defensive techniques as well as to all devices which are subject to scrutiny under the Williams Act. *Id.* at 912.

initial offer, the directors were reminded by counsel that their first responsibility was to Marathon's shareholders.[94] During that meeting the directors concluded, based on advice of counsel concerning possible antitrust complications and recommendations of investment advisers concerning the adequacy of the price offered, that Mobil's offer was inadequate.[95] Marathon then sought a tender offeror who would provide the shareholders with a fair price for their stock.[96] All three major white knight candidates, U.S. Steel included, insisted upon some form of lock-up as a condition to a tender offer for Marathon shares.[97] Hence, Marathon's directors were required to use a lock-up to ensure a fair price for their shareholders. The above was sufficient for the district court to find the existence of a proper corporate purpose.[98] It is likely, therefore, that it would have been sufficient to rebut a presumption that the Marathon directors' primary purpose was to impede the shareholders' decision to tender shares.

Examining a lock-up in terms of the purpose of the Williams Act and in terms of target management's purpose in utilizing the technique provides the balancing necessary for the continued use of the technique. The approach taken by the Court of Appeals for the Sixth Circuit involves a broadened interpretation of the purpose of the Act and fails to consider all factors relevant to management's intent. It resulted in a decision which invalidates the use of the lock-up in question and discourages future use of the technique. Such a result deprives management of an effective tool for implementing decisions which further the interests of the shareholders. The suggested standard, however, allows target management to advance the interests of shareholders without diluting the protection given the shareholders pursuant to the Williams Act. As such, it provides the best approach to evaluating a lock-up as well as other devices allegedly in violation of section 14(e).

Barbara A. Koza

Although this note focuses upon the actions of Marathon's directors, its propositions also apply to U.S. Steel's directors whose actions in requesting the lockup could also give rise to a section 14(e) violation.

[94] Brief for Appellee, *supra* note 15, at 6.

[95] *Id.* at 6-8.

[96] *Id.* at 7.

[97] See *supra* note 18.

[98] Mobil Corp. v. Marathon Oil Co., No. 81-1405, slip op. at 44 (S.D. Ohio Dec. 7), *rev'd*, 669 F.2d 366 (6th Cir. 1981).