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# Articles

## SOME THOUGHTS ON REGULATION OF TENDER OFFERS

MARC I. STEINBERG\*

The proliferation of hostile bids for corporate control has resulted in the emergence of defensive and offensive maneuvers limited only by the ingenuity of counsel and investment bankers. The terms for some of these maneuvers, including "golden parachutes," "shark repellent" provisions, "lock-ups," "poison pills," "scorched earth" tactics, "white-knights," and the recently coined "Pac-Man" defense,<sup>1</sup> suggest that there is something fundamentally wrong with the process. In short, tender offers are not a game in which corporate managements are entitled to play roulette with shareholder equity, employee security, and community welfare. Unfortunately, managements on both sides of these so-called "battles" for corporate control more than occasionally neglect these important responsibilities. Target managements all too often have blindly fended off offers at substantial premiums while irretrievably wasting corporate assets and depriving shareholders of an opportunity to tender their stock.<sup>2</sup> Some offeror managements also have delin-

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1. Definitions of these maneuvers are provided in Goldberg, *Regulation of Hostile Tender Offers: A Dissenting View and Recommended Reforms*, 43 Md. L. Rev. 225, 237 app. (1984). For a discussion of various defensive maneuvers and their application, see M. STEINBERG, SECURITIES REGULATION: LIABILITIES AND REMEDIES § 11.08 (1984); Block & Miller, *The Responsibilities of Corporate Directors in Takeover Contests*, 11 SEC. REG. L.J. 44, 52-66 (1983). See also Friedenberg, *Jaws III: The Impropriety of Shark-Repellent Amendments as a Takeover Defense*, 7 DEL. J. CORP. L. 32 (1982); Gilson, *The Case Against Shark Repellent Amendments: Structural Limitations on the Enabling Concept*, 34 STAN. L. REV. 775 (1982); Riger, *On Golden Parachutes—RipCORDS or Ripoffs?* Some Comments on Special Termination Agreements, 3 PAGE L. REV. 15 (1982).

2. See, e.g., *Panter v. Marshall Field & Co.*, 486 F. Supp. 1168 (N.D. Ill. 1980), *aff'd*, 646 F.2d 271 (7th Cir.), *cert. denied*, 454 U.S. 1092 (1981). There, prior to the time that Carter Hawley's tender offer proposal for Marshall Field stock was made at \$42.00 per share, Marshall Field stock was selling in the market at approximately \$22.00 per share. Marshall Field's management successfully fended off the proposal by, inter alia, engaging in a number of dubious "defensive" acquisitions and filing an antitrust suit against Carter Hawley. After Carter Hawley withdrew the offer prior to it becoming effective, the price of Marshall Field stock declined to \$19.76 per share. R. JENNINGS & H. MARSH, SECURITIES REGULATION 676

quently utilized questionable practices to make tender offers amounting to several million dollars, sometimes after employees have made significant salary and benefit concessions.<sup>3</sup>

The recurrence of this kind of irresponsible behavior, and Justice Goldberg's provocative comments on particular abuses associated with hostile tender offers,<sup>4</sup> prompt me to offer a few of my own thoughts on the subject. These thoughts are loosely grouped under four headings: application of the business judgment rule to target companies' management; application of existing federal law to target management; abuses that ought to be the subject of additional federal legislation; and a tentative proposal for vesting primary jurisdiction over pending tender offers in the Securities and Exchange Commission (SEC).<sup>5</sup>

#### APPLICATION OF THE BUSINESS JUDGMENT RULE TO TARGET MANAGEMENT

In general, the courts have not adequately redressed the misconduct of target managements in connection with hostile tender offers. Target managements have been protected by, inter alia, the mantle of the business judgment rule, under which corporate fiduciaries responsible for taking defensive actions have been shielded from liability for the ensuing consequences.<sup>6</sup> The courts have failed to recognize that, partic-

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(5th ed. 1982). The Seventh Circuit on appeal, over a vigorous dissent, affirmed the district court's grant of the defendants' motion for a directed verdict. Approximately one year later, Marshall Field was taken over in a friendly transaction by Batus, Inc. at a price of \$30.00 per share. See *Marshall Field & Co. v. Icahn*, 537 F. Supp. 413 (S.D.N.Y. 1982).

3. Prior to U.S. Steel's 1981 offer for Marathon Oil Co., for example, employees of the former company had agreed to significant concessions. *United Steel Workers v. United Steel Corp.*, 492 F. Supp. 1, 8 (N.D. Ohio 1980). See generally Millspaugh, *Plant Closings and the Prospects for a Judicial Response*, 8 J. CORP. L. 483, 491-92 (1983). Cf. Hymowitz & O'Boyle, *Two Steel Mills Gird for Result of Merger Bid*, Wall St. J., Feb. 22, 1984, at 35, col. 3 (A worker at one of U.S. Steel's plants remarked that "[w]e gave [U.S. Steel] concessions and finally got back to work. I thought the bad times were finally over. But now with this [proposed] merger [between U.S. Steel and National Steel Corp.], I don't know if I have a job or not."). The Wall Street Journal article also noted that some of U.S. Steel's employees are bitter about what they view as the company's inadequate investment in modernizing its plant.

4. Goldberg, *supra* note 1, at 225-26.

5. The purpose of this Article is not to present a comprehensive analysis of the many issues raised by federal regulation of tender offers. The work is offered instead as a reflection upon selected problems associated with tender offers, with suggestions for remedial action. It is hoped that its contents will stimulate further discussion of the problems noted, and that the ideas set forth will prove to be among the elements of an effective overall solution to inequities in the tender offer process.

6. See, e.g., *Panter v. Marshall Field & Co.*, 646 F.2d 271 (7th Cir.) (applying Delaware law), *cert. denied*, 454 U.S. 1092 (1981); *Treadway Cos. v. Care Corp.*, 638 F.2d 357 (2d Cir. 1980) (applying New Jersey law); *Crouse-Hinds Co. v. InterNorth, Inc.*, 634 F.2d 690 (2d Cir. 1980) (applying New York law); *Berman v. Gerber Products Co.*, 454 F. Supp. 1310 (W.D.

ularly when such actions deprive shareholders of the right to tender their stock, the basic premise underlying the business judgment rule is not valid in this context and application of the rule therefore is inappropriate.<sup>7</sup>

The business judgment rule provides that corporate officers and directors will be shielded from judicial inquiry into the propriety of their decisions and from liability for harm to the corporation resulting from their decisions, so long as (1) the decisions were within management's authority to make, and (2) such corporate fiduciaries have "[a] informed [themselves] and made reasonable inquiry with respect to the business judgment[s]; [b] acted in good faith and without a disabling conflict of interest; and [c] had a rational basis for the business judgment[s]." As the Supreme Court of Delaware recently pointed out,<sup>9</sup> the doctrine is an acknowledgment of the managerial prerogatives of corporate directors under state law. "It is a [rebuttable] presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company."<sup>10</sup> That presumption is inappropriate, however, with respect to decisions made by target managements that preclude shareholders from tendering their stock in response to a hostile tender offer.<sup>11</sup>

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Mich. 1978) (applying Michigan law). See generally M. STEINBERG, CORPORATE INTERNAL AFFAIRS—A CORPORATE AND SECURITIES LAW PERSPECTIVE 225-39 (1983).

7. With the benefit of the business judgment rule and restrictive federal court decisions construing the Williams Act, target managements usually are able to successfully fend off hostile bidders. See Austin, *Tender Offer Movement Off in 1982*, Nat'l. L.J., Jan. 16, 1984, at 15, col. 1, ("In 1982, only 21.9 percent of the contested tender offers were completely successful. On the other hand, 53.1 percent of all the contested offers were completely unsuccessful.")

8. PRINCIPLES OF CORPORATE GOVERNANCE AND STRUCTURE: RESTATEMENT AND RECOMMENDATIONS § 4.01(d) (Tent. Draft No. 1, 1982) [hereinafter cited as ALI DRAFT RESTATEMENT]. For discussion of the ALI's draft formulation of the business judgment rule, see Steinberg, *The American Law Institute's Draft Restatement on Corporate Governance: The Business Judgment Rule, Related Principles, and Some General Observations*, 37 U. MIAMI L. REV. 295 (1984). For other formulations of the business judgment rule, see Arshat, *The Business Judgment Rule Revisited*, 8 HOFSTRA L. REV. 93, 111-12 (1979); Steinberg, *Application of the Business Judgment Rule and Related Judicial Principles—Reflections from a Corporate Accountability Perspective*, 56 NOTRE DAME LAW. 903, 904-05 (1981).

9. Aronson v. Lewis, No. 203, 1983 (Del. Mar. 1, 1984), discussed in *Delaware Court Clarifies Demand Requirement for Derivative Suits*, 16 SEC. REG. & L. REP. (BNA) No. 10, at 480 (Mar. 9, 1984).

10. Aronson v. Lewis, No. 203, 1983, slip op. at 12. The court also stated that "under the business judgment rule director liability is predicated upon concepts of gross negligence." *Id.* at 14. See generally Veasey & Manning, *Codified Standard—Safe Harbor or Uncharted Reef?*, 35 BUS. LAW. 919, 926-30 (1980) (discusses inconsistent indications in the cases as to whether the standard of care required of corporate directors under Delaware law is ordinary care or merely avoidance of gross negligence).

11. *E.g.*, M. STEINBERG, *supra* note 6, at 237-39; Easterbrook & Fischel, *Takeover Bids*,

Because target management is likely to have a disabling conflict of interest,<sup>12</sup> the business judgment rule should not be applied to defensive actions undertaken by target companies in response to or in anticipation of tender offers, particularly if such actions materially impede or preclude shareholders from tendering their shares. Directors and officers of the target corporation know that they are likely to be replaced if an offer succeeds. "Inside" directors<sup>13</sup> therefore have a personal financial interest in defeating tender offers, unless the impact of a successful offer upon them has been ameliorated by "golden parachutes"<sup>14</sup> or some other form of protection.<sup>15</sup> Even "inside" directors who have such protection

*Defensive Tactics, and Shareholders' Welfare*, 36 BUS. LAW. 1733, 1745-47 (1981). See generally Comment, *The Misapplication of the Business Judgment Rule in Contests for Corporate Control*, 76 NW. U. L. REV. 980 (1982). Cf. Lowenstein, *Pruning Deadwood in Hostile Takeovers: A Proposal for Legislation*, 83 COLUM. L. REV. 249, 313-14 (1983) (the courts' use of the business judgment rule in the context of hostile tender offers necessitates a legislative solution); Note, *Tender Offer Defensive Tactics and the Business Judgment Rule*, 58 N.Y.U. L. REV. 621 (1983) (a less deferential version of the business judgment rule ought to be applied in the tender offer context).

12. *Crane Co. v. Harsco Corp.*, 511 F. Supp. 294, 305 (D. Del. 1981). But cf. *Northwest Indus. v. B.F. Goodrich Co.*, 301 F. Supp. 706, 712 (N.D. Ill. 1969) ("[W]henver a tender offer is extended and the management of the threatened company resists, the officers and directors may be accused of trying to preserve their jobs at the expense of the corporation. . . . Yet, management has the responsibility to oppose offers which, in its best judgment, are detrimental to the company or its stockholders.").

13. "Inside" directors include those who also hold positions as officers of the corporation, or who are otherwise employed by the company, for example, as in-house corporate counsel. "Inside" directors also include those directors who may be said to have a pecuniary interest in the corporation's affairs greater than that arising from ownership of a less-than-controlling block of the corporation's shares. See *Cheff v. Mathes*, 199 A.2d 548, 554-55 (Del. 1964) (burden of proof as to whether a stock repurchase was in the corporate interest was not as great for directors who were merely "substantial shareholders" as for those who were the Chief Executive Officer and corporate counsel, since the former did not have "a personal pecuniary interest in the decisions made by the board of directors . . .").

14. The use of "golden parachutes" has generated extensive criticism. These executive compensation agreements, which generally provide generous severance remuneration for key officers or directors upon a change in corporate control, have been attacked as constituting a waste of corporate assets, as unconscionable self-dealing and hence a breach of the duty of loyalty, and as an unwarranted anti-takeover device. See, e.g., *Goldberg, supra* note 1, at 230-31; *Riger, supra* note 1, at 25-39. On the other hand, proponents assert that such compensation agreements may benefit shareholders by enabling the corporation to retain high quality management and more securely aligning management's interests with those of the shareholders when a hostile bid is made. E.g., ADVISORY COMMITTEE ON TENDER OFFERS, U.S. SEC. REPORT OF RECOMMENDATIONS 39 (1983) [hereinafter cited as ADVISORY COMMITTEE REPORT]. Professors Easterbrook and Jarrell assert: "Perhaps such [golden parachute] guarantees are 'unseemly,' but they grease the skids of offers by decreasing the role managerial self-protection plays in defending." *Id.* at 103 (separate statement of Easterbrook & Jarrell). See generally Note, *Golden Parachutes: Executive Employment Contracts*, 40 WASH. & LEE L. REV. 1117 (1983).

15. Some have taken the position that defeat by target management of a tender offer virtually is never in the best long-term interests of shareholders as a whole. See Easterbrook &

and "outside" directors who may not be deemed financially interested nonetheless may be "interested" in maintaining their

positions of power, prestige and prominence. . . . They are "interested" in defending against outside attack the management which they have, in fact, installed or maintained in power . . . . And they are "interested" in maintaining the public reputation of their own leadership and stewardship against the claims of "raiders" who say that they can do better.<sup>16</sup>

In addition, the element of structural bias is ever present.<sup>17</sup> Incumbent management's control of the proxy machinery and general informational processes,<sup>18</sup> combined with its control of the methods for selecting outside directors,<sup>19</sup> frequently result in undue directorial loyalty to management rather than the exercise of independent judgment.<sup>20</sup>

Fischel, *The Proper Role of a Target's Management in Responding to a Tender Offer*, 94 HARV. L. REV. 1161, 1174-75 (1981).

16. *Panther v. Marshall Field & Co.*, 646 F.2d 271, 300-01 (7th Cir.) (Cudahy, J., concurring in part and dissenting in part), *cert. denied*, 454 U.S. 1092 (1981).

17. "Structural bias" may be defined as "inherent prejudice . . . resulting from the composition and character of the board of directors [and management]." Note, *The Business Judgment Rule in Derivative Suits Against Directors*, 65 CORNELL L. REV. 600, 601 n.14 (1980) [hereinafter cited as Note, *Derivative Suits*]. For further discussion of the concept of structural bias, see *id.* at 619-26. *Cf.* *Clark v. Lomas & Nettleton Fin. Corp.*, 625 F.2d 49, 53-54 (5th Cir. 1980), *cert. denied*, 450 U.S. 1029 (1981) (recognizing the possibility of structural bias, the court held that, due to conflicts of interest, the board was incompetent to compromise the plaintiff shareholders' derivative claims); *Miller v. Register and Tribune Syndicate*, 336 N.W.2d 709, 716-18 (Iowa 1983) (recognizing structural bias problem in refusing to dismiss derivative suit against corporate fiduciaries where members comprising the special litigation committee were appointed to the committee by defendant fiduciaries).

The inherent problem of structural bias is discussed at length in Note, *The Propriety of Judicial Deference to Corporate Boards of Directors*, 96 HARV. L. REV. 1894 (1983) [hereinafter cited as Note, *Judicial Deference*]. Drawing upon studies of group dynamics, the author of the Note concluded: "Given cohesiveness and informational dependence in the boardroom, directors are likely to conform to the expectations both of management and of their fellow board members." *Id.* at 1901.

18. See, e.g., Mace, *Directors: Myth and Reality—Ten Years Later*, 32 RUTGERS L. REV. 293, 297-303 (1979) ("C.E.O.'s continue to control board functions through the proxy process."); Note, *Judicial Deference*, *supra* note 17, at 1898 ("Confronted by difficult issues of business policy and largely dependent upon management for information about these issues, directors are likely to believe that management's views and judgments are worth adopting.") (footnote omitted).

19. See Comment, *supra* note 11, at 1002 n.106 (outside directors are selected by C.E.O.'s partially on the basis of whether they can be expected "not to rock the boat"; the problems arising from management's control over directors may be mitigated, but not entirely eliminated, by utilizing nominating committees of disinterested directors to control the corporate proxy machinery).

20. See Note, *Derivative Suits*, *supra* note 17, at 619-22. *Cf.* Note, *Judicial Deference*, *supra* note 17, at 1896-1902 (discussing the pressures on directors to conform their judgments to those of management).

Target management therefore has an inherent conflict of interest when faced with a hostile tender offer.<sup>21</sup> Drawing on traditional common law standards<sup>22</sup> as well as the more recent "interested director" statutes,<sup>23</sup> it may be argued that the burden should be placed on target management to show the substantive and procedural propriety of its conduct. Hence, to pass muster under state law, target management should be required to prove that its actions were taken for the corporation's best interest and were intrinsically fair to the corporation and other affected parties.<sup>24</sup>

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21. *See, e.g.*, *Crane Co. v. Harsco Corp.*, 511 F. Supp. 294, 305 (D. Del. 1981) ("in the context of a tender offer, the directors have an inherent conflict of interest") (citation omitted).

The Supreme Court of Delaware has recognized that a similar conflict of interest may arise when, on the recommendation of a special litigation committee comprised of nondefendant directors, a corporation seeks dismissal of a shareholder derivative suit. In *Zapata Corp. v. Maldonado*, 430 A.2d 779 (Del. 1981), that court held that if demand on the board is excused, a two-step test should be applied in determining whether to grant the corporation's motion to dismiss: first, the court should inquire into the special litigation committee's independence and good faith and the bases supporting its conclusions, with the burden of proof on the corporation; second, providing that the first step is satisfied, the court should apply "its own independent business judgment" and "should, when appropriate, give special consideration to matters of law and public policy in addition to the corporation's best interests." *Id.* at 788-89. *See* *Aronson v. Lewis*, No. 203, 1983 slip op. at 16 (Del. Mar. 1, 1984) (the chancery court "must" apply both steps).

22. *See, e.g.*, *Geddes v. Anaconda Copper Mining Co.*, 254 U.S. 590, 599 (1921); *Pappas v. Moss*, 393 F.2d 865, 867 (3d Cir. 1968); *Petty v. Penntech Papers, Inc.*, 347 A.2d 140, 143 (Del. 1975); *Guth v. Loft Inc.*, 5 A.2d 503, 510-12 (Del. 1939). As the Supreme Court of Delaware stated in *Guth*: "The occasions for the determination of honesty, good faith and loyal conduct are many and varied, and no hard and fast rule can be formulated. The standard of loyalty is measured by no fixed scale." *Id.* at 510.

23. *See, e.g.*, CAL. CORP. CODE § 310 (West 1977); DEL. CODE ANN. tit. 8, § 144 (1983); MD. CORPS. & ASS'NS CODE ANN. § 2-419 (1975 & Supp. 1983); MODEL BUSINESS CORP. ACT § 41 (1982); N.Y. BUS. CORP. LAW § 713 (McKinney 1963). For judicial decisions construing these interested director statutes, see *Remillard Brick Co. v. Remillard-Dandini Co.*, 109 Cal. App. 2d 405, 419-21, 241 P.2d 66, 74-76 (1952); *Fliegler v. Lawrence*, 361 A.2d 218, 221-22 (Del. 1976). *See generally* *Bulbolia & Pinto, Statutory Responses to Interested Directors' Transactions: A Watering Down of Fiduciary Standards?*, 53 NOTRE DAME LAW. 201 (1977).

24. *Cf. Treadway Cos. v. Care Corp.*, 638 F.2d 357, 381-83 (2d Cir. 1980). Under New Jersey law the business judgment rule should be applied when the issuance and sale of shares to a white knight is challenged, but after the plaintiff has shown that a majority of the issuer's directors either expected that the transaction would serve to perpetuate their own control, or approved the transaction under the domination or control of directors who had such a personal control interest, the burden of proof will shift to the directors who then must prove that the transaction was fair to the corporation. Plaintiff failed to meet the initial burden of proof, however, and so the burden did not shift. *Id.* *Cheff v. Mathes*, 199 A.2d 548, 554-55 (Del. 1964). Directors who authorized an issuer's repurchase of shares from a dissident shareholder necessarily had a conflict of interest when a threat to the directors' control was involved, and the burden of proof was upon them to show that the purchase was in the corporation's interest. Defendants whose interests were not clearly pecuniary were not held to as high a standard of proof as those with "personal and pecuniary interest in the transaction." *Id.* at 555.

If the approach recommended in the text is not adopted, at least courts should in-

One might note in this context that shareholders who are denied the opportunity to tender their shares at a substantial premium must find application of the business judgment rule to be egregiously unfair. Under Delaware law, for example, the presumption of good faith and care is rebuttable only by showing that management's sole or primary purpose for its conduct was to retain control.<sup>25</sup> Corporate fiduciaries who are given the benefit of the presumption almost always will be able to proffer a "legitimate" business purpose for their actions, including actions employed solely to perpetuate incumbent management's position.<sup>26</sup> This outcome is even more assured if management uses expert counsel and investment bankers to lay a foundation for and to structure its actions.<sup>27</sup>

Some may argue that the duties imposed upon corporate fiduciaries by state law counterbalance any potential conflict of interest on the part of target management, and thus make application of the business judgment rule appropriate.<sup>28</sup> This response is deficient in at least two respects. First, if the principles of corporate governance, shareholder welfare, and market integrity are to have practical meaning in this context, management cannot be permitted to invoke a presumption of disinterested decisionmaking in a situation in which its interests are so likely to conflict with those of the shareholders.<sup>29</sup> Second, certain investment decisions are to be made by shareholders, without undue manage-

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quire whether the decision to oppose the tender offer and to engage in defensive tactics was made primarily by disinterested directors or by those directors whose livelihoods and economic interests depended on the continued separate existence of the subject corporation. *See* Gelfond & Sebastian, *Reevaluating the Duties of Target Management in a Hostile Tender Offer*, 60 B.U.L. REV. 403, 468-69 (1980); Williams, *Role of Directors in Takeover Offers*, 13 REV. SEC. REG. 963, 965 (1980). Such an approach generally is not advised, however, for the reasons noted in *supra* notes 12-16 and accompanying text.

25. *See, e.g.*, *Panter v. Marshall Field & Co.*, 646 F.2d 271, 293-95 (7th Cir.), *cert. denied*, 454 U.S. 1092 (1981) (plaintiff must show either bad faith or predominance of an improper control motive to prevent application of the business judgment rule on a motion for directed verdict under Delaware law); *Johnson v. Trueblood*, 629 F.2d 287, 292-93 (3d Cir. 1980) (also construing Delaware law).

26. The rule's underlying presumption is especially likely to be a cover for abuse if management's consideration of noninvestor interests is deemed to be within the presumption. *See infra* note 41.

27. Lowenstein, *supra* note 11, at 314; Steinberg, *supra* note 8, at 906-07. As discussed earlier, target management usually is successful in fending off hostile offers. *See supra* note 7.

28. Certain actions taken by corporate managers which have the effect of perpetuating their control may be held invalid under state law. *See, e.g.*, *Lerman v. Diagnostic Data, Inc.*, 421 A.2d 906 (Del. Ch. 1980) (holding that a board of directors could not set the date of an annual stockholder meeting so as to leave insufficient time for submission of materials required of nominees under anti-takeover amendments to the corporation's by-laws). *See generally* Gelfond & Sebastian, *supra* note 24, at 433-49.

29. *See supra* notes 7-21 and accompanying text.



ment intervention, absent good reason otherwise. Two common examples are a shareholder's decision to sell shares in the open market,<sup>30</sup> and the decision to tender stock in response to a particular takeover bid.<sup>31</sup> Given the nature of the shareholder's traditional interest in disposing of his or her stock ownership, fiduciary duties do not entitle management to preempt such decisions absent foreseeable harm caused by the purchaser.<sup>32</sup> As one court has pointed out:

What is sometimes lost sight of in these tender offer controversies is that the shareholders, not the directors, have the right of franchise with respect to the shares owned by them . . . . The Directors are free to continue by proper legal means to express to the shareholders their objection and hostility to the [subject] proposal, but they are not free to deny them their right to pass upon this offer or any other offer for the purchase of their shares.<sup>33</sup>

Notwithstanding target management's inherent conflict of interest when faced with a hostile tender offer,<sup>34</sup> there may be circumstances in which incumbent management, in accord with its obligations to shareholders, employees, and affected communities,<sup>35</sup> ought to be entitled to take certain defensive actions to fend off detrimental takeover bids. State law provisions may be needed, moreover, to ensure that the risk of incurring potentially astronomical monetary liability will not lead tar-

30. See Lowenstein, *supra* note 11, at 266 ("In a routine market transaction, there is no room for management to inject its views as to the price at which shares should trade and there is no 'corporate interest,' it is said, that would justify the target company management's using the corporate treasury to influence the transaction.")

31. See generally *id.* at 266-67; Cohn, *Tender Offers and the Sale of Control: An Analogue to Determine the Validity of Target Management Defensive Measures*, 66 IOWA L. REV. 475, 509-24 (1981).

32. There are some exceptions. If a controlling shareholder sells out without making a reasonable investigation of its purchaser, for example, he may be held liable for damages incurred by the corporation and minority shareholders due to the purchaser's looting of the corporation. *E.g.*, *DeBaun v. First W. Bank & Trust Co.*, 46 Cal. App. 3d 686, 696-98, 120 Cal. Rptr. 354, 359-61 (1975); *Gerdes v. Reynolds*, 28 N.Y.S.2d 622, 650-51 (Sup. Ct. N.Y. Co. 1941).

33. *Conoco, Inc. v. Seagram Co.*, 517 F. Supp. 1299, 1303 (S.D.N.Y. 1981) (dictum). See also *infra* notes 54, 55 and accompanying text.

34. See *supra* notes 12-16 and accompanying text.

35. See *Herald Co. v. Seawell*, 472 F.2d 1081, 1094-95 (10th Cir. 1972) (applying Colorado law in a shareholder derivative suit, the court stated that management of a corporation engaged principally in the publication of a large metropolitan newspaper had duties to the stockholders, the employees, and the public); PA. STAT. ANN. tit. 15, § 408 (Purdon 1967), amended by Act No. 1983-92, 1983 Pa. Legis. Serv. 773, 774 (Purdon) (corporate fiduciaries "may, in considering the best interests of the corporation, consider the effects of any action upon employees, suppliers and customers of the corporation, communities in which offices or other establishments of the corporation are located and all other pertinent factors."). See *infra* notes 41, 82-85 and accompanying text.

get managements to avoid taking defensive actions even when they are appropriate. Two proposals are offered here: First, if otherwise appropriate, the business judgment rule may be applied in its entirety to actions that do not materially impede or preclude shareholders from tendering their stock. Hence, management may enjoy the benefit of the rule's presumption when it recommends that the hostile offer be rejected,<sup>36</sup> raises its dividend rate,<sup>37</sup> induces a "white knight" to enter the fray,<sup>38</sup> or takes other actions which do not interfere with the shareholders' freedom to accept any tender offer of their choice.<sup>39</sup> Second, if defensive maneuvers do materially impede or preclude shareholders from tendering their shares to a particular bidder,<sup>40</sup> management should be required to prove that its actions were fair to the corporation and its shareholders, subject to two provisos: management may take noninvestor interests into account,<sup>41</sup> and a ceiling may be placed on the amount of damages recoverable from corporate fiduciaries.<sup>42</sup> To protect ade-

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36. *Cf.* *Humana, Inc. v. American Medicorp, Inc.*, [1977-1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,286 (S.D.N.Y. Jan. 5, 1978) (applying a fairly lenient standard in determining whether the target's press releases were false or misleading).

37. *Id.*

38. A "white knight" generally is a "friendly" party which comes to the aid of incumbent target management in its efforts to fend off a hostile takeover bid by, for example, purchasing a large block of the target's authorized but unissued stock or making a competing tender offer at a higher price.

39. *See* M. STEINBERG, *supra* note 6, at 225-28.

40. For examples of defensive maneuvers that materially impeded or precluded tender by shareholders to a particular bidder and were held to give rise to liability, see *Mobil Corp. v. Marathon Oil Co.*, 669 F.2d 366, 374-76 (6th Cir. 1981) (options to sell substantial block of the company's stock and its "crown jewel"); *Applied Digital Data Sys. v. Milgo Elec. Corp.*, 425 F. Supp. 1145, 1157-61 (S.D.N.Y. 1977) (issuance of substantial block of shares to a friendly third party); *Royal Indus. v. Monogram Indus.*, [1976-77 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 95,863 (C.D. Cal. Nov. 29, 1976) (acquisition of another enterprise to interpose antitrust obstacles to a tender offer). *But see* *Panter v. Marshall Field & Co.*, 646 F.2d 271, 297 (7th Cir.), *cert. denied*, 454 U.S. 1092 (1981) (acquisition of another enterprise in the context of a tender offer held to be protected by the business judgment rule); *Whittaker Corp. v. Edgar*, 535 F. Supp. 933 (N.D. Ill. 1982) (sale of an asset resulting in making target company less attractive to bidder held to be protected by the business judgment rule).

41. *See generally* PA. STAT. ANN. tit. 15, § 408 (Purdon 1967), *amended* by Act No. 1983-92, 1983 Pa. Legis. Serv. 773, 774 (Purdon); O'Boyle & Carey, *Gulf's Departing Pittsburgh Would Deal a Harsh Blow to City's Economy and Pride*, *Wall St. J.*, Mar. 9, 1984, at 33, col. 4 ("Standard Oil Co. of California's \$13.3 billion bid to acquire the oil giant has brought shudders to Pittsburgh charities, university presidents, tax officials, ministers and everyone else who benefits from Gulf's financial and civic might."). It is important that the burden of justification be placed on corporate fiduciaries when they take noninvestor interests into account. Otherwise, the presumption of the business judgment rule would be further extended, making it a nearly insurmountable barrier for an aggrieved party. Application of the business judgment rule in this context thus would represent an overly solicitous approach to target management. *See generally infra* notes 82-85 and accompanying text.

42. *Cf.* ALI DRAFT RESTATEMENT, *supra* note 8, at § 7.06(d), (e) (establishing a ceiling on damages in duty of care cases in the absence of culpability surpassing that of negligence).

quately the competing interests at stake, the ceiling on damages should be high enough to deter corporate malfeasance, but yet not so exorbitant as to dissuade courts from imposing liability.<sup>43</sup>

It should be evident that by taking the position that the business judgment rule should not be applied to certain defensive actions by target management, I am by no means urging the rule's abrogation. The business judgment rule serves important policy considerations when it is

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43. *See infra* notes 99-104 and accompanying text. *Cf.* ALI DRAFT RESTATEMENT, *supra* note 8, at § 7.06(e), which sets forth the following monetary limits for the maximum recovery available in duty of care cases where the defendant's culpability is no greater than negligence:

(i) in the case of a director who, at the time of the events giving rise to the action, was not otherwise an employee or officer of the corporation in whose name the action is brought, or of any corporation possessing control over, controlled by, or under common control with, such corporation, the ceiling shall not exceed (A) \$200,000, nor fall below (B) \$50,000; and

(ii) in the case of any other defendant whose liability is based upon a duty owed to the corporation as an employee or as a corporate fiduciary, the range shall not exceed (A) the higher of (1) \$200,000 or (2) twice such defendant's gross compensation from the corporation for the most recently ended calendar year, nor fall below (B) such defendant's gross compensation from the corporation for the same year; provided, however, that the court may utilize a different recent year if it finds that such compensation was artificially understated for the most recently ended year.

(citation omitted).

The question arises what standard should apply and what relief should be available when incumbent management, with disinterested shareholder approval, induces the corporation to adopt anti-takeover (or shark repellent) provisions prior to the presence of a hostile bid. It may be argued that disinterested shareholder approval accompanied by full disclosure should insulate the provisions from successful challenge. *Cf.* Rivoli Theatre Co. v. Allison, 152 A.2d 449, 451 (Pa. 1959) (conversation with a single stockholder fell short of the full and frank disclosure to all stockholders necessary for ratification of contracts); State *ex rel.* Hayes Oyster Co. v. Keypoint Oyster Co., 64 Wash. 2d 375, 385, 391 P.2d 979, 986 (1964). Within the framework set forth in this article, however, the business judgment rule should apply only to those shark repellent provisions that do not materially impede or preclude hostile bidders from coming forward with a viable offer. *See generally* Alcott v. Hyman, 208 A.2d 501, 506-07 (Del. 1965). To the extent such provisions materially impede or preclude the making of hostile offers, courts should scrutinize their terms to determine whether they are fair to shareholders. "Preclusive" shark repellent provisions may be analogized to certain self-dealing transactions that, by their very nature, involve constructive fraud, waste of corporate assets, or palpable overreaching. In such cases, shareholder approval does not inhibit the courts from evaluating the intrinsic fairness of the transaction. *See, e.g.*, Schreiber v. Bryan, 396 A.2d 512, 518 (Del. Ch. 1978) (only unanimous stockholder ratification is sufficient to justify a waste or gift of corporate assets); Pappas v. Moss, 393 F.2d 865, 868 (3d Cir. 1968) (under New Jersey law, there can be no effective ratification where a majority of shares is held by those "interested" in the transaction). Providing that no monetary losses have been incurred (which normally would be the case when suit is brought challenging the validity of anti-takeover provisions prior to the emergence of a hostile bidder), judicial relief normally should be limited to the invalidation of the subject provisions and the issuance of an injunction against enforcement of those and similar provisions which might otherwise be adopted in the future.

applied in appropriate settings,<sup>44</sup> and its continued use in those settings is desirable if this country's economy is to function efficiently. In the context of "show-stop" maneuvers in tender offers,<sup>45</sup> however, the rule serves as a sword to pierce legitimate shareholder interests rather than as a justifiable shield for management's conduct, and thus should not be applied.<sup>46</sup>

#### APPLICATION OF FEDERAL LAW TO TARGET MANAGEMENT

Under the Williams Act,<sup>47</sup> and SEC regulations implementing the Act,<sup>48</sup> both offeror and target managements must disclose certain information relevant to a subject tender offer.<sup>49</sup> An offeror must disclose, inter alia, certain prior transactions between the offeror and the target; the source of funds to be used in the acquisition; and if material, the applicability of anti-trust laws and pending legal proceedings related to the tender offer.<sup>50</sup> The target company must disclose, inter alia, any material contract, agreement, or "understanding" between the target company, its officers or directors, and the bidder company, its officers or directors.<sup>51</sup> The target company also must state whether it is advising its shareholders to accept or to reject the offer, whether it is remaining neutral with respect to the offer, or whether it is unable to take a position regarding the offer. Whatever the recommendation advanced, the

44. At least three policy considerations support appropriate application of the business judgment rule:

First, if management were liable for mere good faith errors in judgment, few capable individuals would be willing to incur the financial and emotional risks of serving in such roles. Second, courts are generally ill equipped to evaluate business judgments. Finally, management has the expertise to discharge the responsibility of making such determinations.

M. STEINBERG, *supra* note 6, at 236 (citing *Abramowitz v. Posner*, 672 F.2d 1025, 1032 (2d Cir. 1982), *Auerbach v. Bennett*, 47 N.Y.2d 619, 629, 393 N.E.2d 994, 1000, 419 N.Y.S.2d 920, 926-27 (1979), and *Corporate Director's Handbook*, 33 BUS. LAW. 1591, 1603-04, 1615 (1978)).

45. A "show-stop" maneuver is any action taken by target management, such as the sale of the company's crown jewel, which has the effect of materially impeding or precluding shareholders from tendering their stock to the "hostile" bidder.

46. *See* Steinberg, *supra* note 8, at 904-07, 915.

47. The Williams Act was enacted in 1968 as an amendment to the Securities Exchange Act of 1934. Pub. L. No. 90-439, 82 Stat. 454 (codified as amended at 15 U.S.C. §§ 781(i), 78 m(d), (e), 78n(d)-(f) (1982)).

48. *See, e.g.*, 17 C.F.R. § 240.14d-1 to .14d-101, 240.14e-1 to .14e-2 (1983).

49. 15 U.S.C. §§ 78n(d)(1), (4) (1982); 17 C.F.R. §§ 240.14d-3, .14d-6, .14d-9, .14d-100, .14d-101, .14e-2 (1983).

50. 17 C.F.R. § 240.14d-3(a)(1) (1983); SEC sched. 14D-1, items 3, 4, 10(c), 10(e) (codified at 17 C.F.R. § 240.14d-100 (1983)).

51. 17 C.F.R. §§ 240.14d-9(a)(1), (c) (1983); SEC sched. 14D-9, item 3(b) (codified at 17 C.F.R. § 240.14d-101 (1983)).

target corporation must disclose the reasons for its position.<sup>52</sup>

The disclosure provisions of the Williams Act were intended by Congress to ensure that shareholders, after hearing from both the offeror and target corporations with neither side having an unfair advantage over the other, would have sufficient information to make informed decisions in determining whether to tender their shares.<sup>53</sup> As former SEC Chairman Cohen testified, the Act's purpose was "to 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."<sup>54</sup> As noted elsewhere "[d]isclosure, no matter how extensive, matters little if the target's management can employ defensive tactics that deprive or otherwise materially impede the investor's freedom of choice."<sup>55</sup> It follows logically that target management properly should be permitted to take defensive actions under the Williams Act that do not preclude or materially impede shareholders from tendering their stock so long as there is full disclosure.<sup>56</sup> On the other hand, maneuvers by target management that deny shareholders an opportunity to tender their shares should be held

52. 17 C.F.R. §§ 240.14d-9(a)(1), (c), (d)(1)(i), .14e-2(a) (1983); SEC sched. 14D-9, item 4 (codified at 17 C.F.R. § 240.14d-101 (1983)).

53. See HOUSE COMM. ON INTERSTATE AND FOREIGN COMMERCE, DISCLOSURE OF CORPORATE EQUITY OWNERSHIP, H.R. REP. NO. 1711, 90th Cong., 2d Sess. 4, reprinted in 1968 U.S. CODE CONG. & AD. NEWS 2811, 2813; SENATE COMM. ON BANKING AND CURRENCY, FULL DISCLOSURE OF CORPORATE EQUITY OWNERSHIP AND IN CORPORATE TAKEOVER BIDS, S. REP. NO. 550, 90th Cong., 1st Sess. 3 (1967) [hereinafter cited as CORPORATE TAKEOVER BIDS]. See also *Edgar v. MITE Corp.*, 457 U.S. 642 (1982) (Illinois Business Takeover Act held unconstitutional under the commerce clause), in which Justice White stated:

We . . . agree with the Court of Appeals that [in passing the Williams Act] Congress sought to protect the investor not only by furnishing him with the necessary information but also by withholding from management or the bidder any undue advantage that could frustrate the exercise of an informed choice.

. . . Looking at [the history of the Act] as a whole, it appears to us, as it did to the Court of Appeals, that Congress intended to strike a balance between the investor, management, and the takeover bidder. The bidder was to furnish the investor and the target company with adequate information but there was no "intent[ion] to do . . . more than give incumbent management an opportunity to express and explain its position." Once that opportunity was extended, Congress anticipated that the investor, if he so chose, and the takeover bidder should be free to move forward within the time frame provided by Congress.

*Id.* at 634 (citations omitted) (quoting *Rondeau v. Mosinee Paper Corp.*, 422 U.S. 49, 58 (1975)).

54. CORPORATE TAKEOVER BIDS, *supra* note 53, at 15 (statement of Manuel F. Cohen, Chairman, SEC). For additional legislative history supporting this view, see the sources gathered in Lynch & Steinberg, *The Legitimacy of Defensive Tactics in Tender Offers*, 64 CORNELL L. REV. 901, 911-12 (1979).

55. Lynch & Steinberg, *supra* note 54, at 911.

56. *Id.* at 927.

to violate the Williams Act, absent evidence that the offeror would inflict some clearly foreseeable harm upon the target corporation.<sup>57</sup>

The Williams Act may be applied in either of two ways to ensure that target shareholders normally have an opportunity to accept or reject a tender offer. First, conduct by management that deprives shareholders of an opportunity to tender may be held to constitute "constructive fraud" within the meaning of section 14(e) of the Williams Act.<sup>58</sup> Although the Supreme Court held in *Santa Fe Industries, Inc. v. Green*<sup>59</sup> that "mere" breaches of fiduciary duty not amounting to "manipulation" or "deception" do not violate section 10(b) of the Exchange Act and rule 10b-5 promulgated thereunder,<sup>60</sup> section 14(e) ought to be interpreted differently. Unlike section 10(b), section 14(e) by its own terms prohibits "fraudulent" acts or practices.<sup>61</sup> This difference in statutory language and the legislative history of section 14(e)<sup>62</sup> support giving it a broader reach than section 10(b).<sup>63</sup> Second, defen-

57. *Cf. Mobil Corp. v. Marathon Oil Co.*, 669 F.2d 366, 376-77 (6th Cir. 1981)(grant of lock-up options to a white knight held to be manipulative within § 14(e) of the Williams Act); *Joseph E. Seagram & Sons v. Abrams*, 510 F. Supp. 860 (S.D.N.Y. 1981)(temporary restraining order granted to prevent possibly improper manipulation under § 14(e) in the form of selling off target's assets or destroying its corporate charter to defend against a hostile offer). *But see* cases cited *infra* note 65.

58. 15 U.S.C. § 78n(e) (1982). *See* Loewenstein, *Section 14(e) of the Williams Act and the Rule 10b-5 Comparisons*, 71 GEO. L.J. 1311, 1345-52 (1983); Steinberg, *Fiduciary Duties and Disclosure Obligations in Proxy and Tender Contests for Corporate Control*, 30 EMORY L.J. 169, 226 (1981). *Cf. SEC v. Capital Gains Research Bureau*, 375 U.S. 180, 185 (1963) ("scalping" by registered investment advisor held to constitute a "fraud" upon clients within the Investment Advisors Act).

59. 430 U.S. 462 (1977).

60. *Id.* at 471-74. Section 10(b) is codified at 15 U.S.C. § 78j (1982) and provides in part that it is unlawful "[t]o use or employ, in connection with the purchase or sale of any security . . . any manipulative or deceptive device or contrivance . . ." The statute, to a significant degree, has been interpreted and enforced by the SEC under 17 C.F.R. § 240.10b-5 (1983), known as rule 10b-5. For discussion of *Santa Fe* and its ramifications, see Ferrara & Steinberg, *A Reappraisal of Santa Fe: Rule 10b-5 and the New Federalism*, 129 U. PA. L. REV. 263 (1980).

61. 15 U.S.C. § 78n(e) (1982) (making it unlawful for any person, inter alia, "to engage in any fraudulent, deceptive, or manipulative acts or practices" in connection with a tender offer). Although rule 10b-5 does include fraudulent conduct within its prohibition, the Supreme Court held in *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 212-14 (1976), that the scope of the rule is subject to the reach of the statute upon which it is based, namely, section 10(b).

62. *See supra* notes 53-57 and accompanying text.

63. *See* Loewenstein, *supra* note 58, at 1348:

In light of the meticulous attention the [Supreme] Court has paid to statutory language in its recent securities law decisions, one can easily imagine the Court saying that if Congress wanted section 14(e) to be construed identically to section 10(b), it could have easily done so by utilizing identical language. Failing to do this, and having purposefully used the ambiguous term "fraudulent," Congress "intended" the courts to give broader meaning to section 14(e) than to section 10(b).

(Footnotes omitted). Although Professor Loewenstein ultimately rejects the above argument,

sive tactics, the practical effect of which is to prevent shareholders from tendering in response to a bid, may be viewed as "manipulative" under section 14(e). Under this rationale, target management may be found to have engaged in "manipulative" practices proscribed by section 14(e) when it undertakes maneuvers that artificially impede the operation of a fair market for the corporation's stock, such as granting options on valuable corporate assets to friendly third parties.<sup>64</sup> Unfortunately, a number of courts have declined to adopt either of the above rationales.<sup>65</sup> Congress therefore should consider enacting additional legislation to make more explicit the protective policies of the Williams Act.

Even absent Congressional action, the Act's legislative history suggests that the SEC could exercise its broad rulemaking power under section 14(e) to the same effect. Section 14(e) grants the SEC authority to promulgate rules and regulations which are "reasonably designed to prevent such acts and practices as are fraudulent, deceptive or manipulative."<sup>66</sup> Although the Commission has used this authority to promulgate a number of rules,<sup>67</sup> it thus far has declined to address the serious "fraudulent, deceptive, [and] manipulative" misconduct that prevails in the tender offer context.<sup>68</sup>

because "it presumes too much regarding congressional intent," he concludes that, based on legislative intent, section 14(e) has a broader reach than section 10(b). *Id.* at 1349-52.

64. See *Mobil Corp. v. Marathon Oil Co.*, 669 F.2d 366 (6th Cir. 1981); *Jordan v. Global Natural Resources*, [1982-1983 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 99,179 (S.D. Ohio Apr. 19, 1983); *Hanna Mining Co. v. Norcen Energy Resources Ltd.*, 574 F. Supp. 1172 (N.D. Ohio 1982); *Joseph E. Seagram & Sons v. Abrams*, 510 F. Supp. 860 (S.D.N.Y. 1981); Weiss, *Defensive Responses to Tender Offers and the Williams Act's Prohibition Against Manipulation*, 35 VAND. L. REV. 1087 (1982); Note, *Target Defensive Tactics as Manipulative Under Section 14(e)*, 84 COLUM. L. REV. 228 (1984); see also Prentice, *Target Board Abuse of Defensive Tactics: Can Federal Law be Mobilized to Overcome the Business Judgment Rule?*, 8 J. CORP. L. 337 (1983); Silberberg & Pollack, *Are the Courts Expanding the Meaning of "Manipulation" Under the Federal Securities Laws?*, 11 SEC. REG. L.J. 265 (1983); Note, *Lock-up Options: Toward A State Law Standard*, 96 HARV. L. REV. 1068, 1069-72 (1983).

65. See, e.g., *Schreiber v. Burlington Northern, Inc.*, [current Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 91,407 (3d Cir. 1984); *Data Probe Acquisition Corp. v. Datatab, Inc.*, 722 F.2d 1, 4-5 (2d Cir. 1983), *cert. denied*, 104 S. Ct. 1326 (1984); *Buffalo Forge Co. v. Ogden Corp.*, 717 F.2d 757, 760 (2d Cir.), *cert. denied*, 104 S. Ct. 550 (1983); *Panter v. Marshall Field & Co.*, 646 F.2d 271, 283-87 (7th Cir.), *cert. denied*, 454 U.S. 1092 (1981); *Martin Marietta Corp. v. Bendix Corp.*, 549 F. Supp. 623, 628-30 (D. Md. 1982); *Berman v. Gerber Products Co.*, 454 F. Supp. 1310, 1317-18 (W.D. Mich. 1978); *Marshall Field & Co. v. Icahn*, 537 F. Supp. 413 (S.D.N.Y. 1982); *Altman v. Knight*, 431 F. Supp. 309, 314 (S.D.N.Y. 1977).

66. 15 U.S.C. § 78n(e) (1982).

67. See, e.g., 17 C.F.R. §§ 240.14e-1 to .14e-3 (1983). For discussion of these rules, see M. STEINBERG, *supra* note 1, at §§ 3.06, 11.07; Bloomenthal, *The New Tender Offer Regimen, State Regulation, and Preemption*, 30 EMORY L.J. 35, 35-57 (1981).

68. Indeed, the Commission recently asserted that the business judgment rule should not be the principal governor of decisions made by target management in the midst of a tender offer. See *SEC Faults Advisory Panel's Reliance on Business Judgment Rule in Takeovers*, 16 SEC. REG. & L. REP. (BNA) No. 11, at 495-96 (Mar. 16, 1984).

On the other hand, recent SEC actions may indicate that the Commission is becoming more cognizant of its responsibility to mandate more meaningful disclosure of potentially abusive target managerial practices. For example, Commission rules now require that the terms of "golden parachute" agreements be disclosed.<sup>69</sup> In a recent enforcement action, the SEC also emphasized the need for management to disclose the material effects of anti-takeover proposals.<sup>70</sup> These actions are laudable, but much information within the possession of target management and important to shareholders remains undisclosed.<sup>71</sup> It is to be hoped that the SEC will continue to exercise its rulemaking and adjudicatory authority under the Act to fill the disclosure gap.<sup>72</sup>

Another potential problem associated with the use of defensive ma-

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69. See SEC Exchange Act Release No. 20,220 (Sept. 23, 1983), Amendment to Item of Regulation S-K, Item 402, 48 Fed. Reg. 44,467 (1983) (to be codified at 17 C.F.R. § 229.402)(requiring disclosure in Item 402(e) of any remuneration plan exceeding \$60,000 for any corporate fiduciary included in the "cash compensation table," where such plan becomes effective on the resignation, retirement, or other termination of employment of such person, a change in control of the company, or a change in such person's responsibilities subsequent to a change in control).

70. See SEC v. Dorchester, [1983-1984 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 99,613 (D.D.C. Jan. 9, 1984); accord SEC Securities Act Release No. 6,504 (Jan. 13, 1984), 3 FED. SEC. L. REP. (CCH) ¶ 23,120B. There, the Commission stated:

The Commission again wishes to emphasize the need for adequate and accurate disclosure with respect to anti-takeover and other defensive measures ("anti-takeover measures"). Such measures are designed to deter contests for control or unfriendly takeovers, by making the subject company unattractive as a potential target and by making it more difficult to change a majority of the board of directors or to remove management. The anti-takeover measures also may help management to insulate a proposed corporate transaction, such as a merger or acquisition, from unwanted competition.

Companies must disclose all the material effects of anti-takeover measures, including their impact on any proposed corporate transaction, whether hostile or friendly. It is also important that management's interest in the corporate transaction (including the existence of any actual or potential conflicts of interests) and the ultimate effect of the anti-takeover measures on shareholders be disclosed. Absent such disclosure, shareholders will be unable to make informed voting decisions on the matters being proposed. It is especially important, when management is considering or pursuing a leveraged buy-out with its attendant serious conflicts of interest, that full and fair disclosure of the impact of the anti-takeover measures on the proposed transaction be made.

(footnotes omitted).

71. For example, specific SEC rules and regulations should require disclosure of the underlying purposes and ultimate effects of defensive maneuvers taken both prior to and during a takeover bid, the existence of any managerial policy designed to maintain the corporation as an independent entity, and the costs of conducting and defending takeover bids, including attorney and investment banker fees.

72. Certain SEC rules and regulations require that "purpose" be disclosed. See, e.g., Schedule 13D, 17 C.F.R. § 240.13d-101c, Item 4 (1983); 17 C.F.R. § 240.13e-1(a)(2) (1983); Schedule 13E-3, 17 C.F.R. § 240.13e-100H, Item 7(a) (1983). As to disclosing the "effect" of the transaction, see SEC Exchange Act Release No. 15,230 (Oct. 13, 1978) [1978 Transfer



neuers by subject corporation management is the ready access to the courts that is granted to management on both sides of a takeover struggle. Despite the Supreme Court's holding in *Piper v. Chris-Craft Industries*<sup>73</sup> that a defeated tender offeror does not have standing under section 14(e) to bring an action for damages,<sup>74</sup> a majority of lower federal courts have permitted actions for injunctive relief under sections 13(d)<sup>75</sup> and 14(e).<sup>76</sup> This approach, on the whole, seems correct. The target corporation often may be the only party with the readily available resources and motivation necessary to maintain a successful injunctive action against a bidder that would harm the company and its shareholders.<sup>77</sup> Granting standing to an issuer therefore may be a prac-

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Binder] FED. SEC. L. REP. (CCH) ¶ 81,748. For further discussion, see M. STEINBERG, *supra* note 1, at § 1.04.

73. 430 U.S. 1 (1977).

74. *Id.* at 24-42.

75. Courts have permitted actions brought by target managements for injunctive relief under section 13(d). *See, e.g.*, *Indiana Nat'l Corp. v. Rich*, 712 F.2d 1180 (7th Cir. 1983); *Treadway Cos. v. Care Corp.*, 638 F.2d 357, 380 (2d Cir. 1980); *Dan River, Inc. v. Unitex, Ltd.*, 624 F.2d 1216, 1222-24 (4th Cir. 1980), *cert. denied*, 449 U.S. 1101 (1981); *Chromalloy Am. Corp. v. Sun Chem. Corp.*, 611 F.2d 240, 246 (8th Cir. 1979). *But see* *Schnell v. Schnell*, [1981 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 97,927 (S.D.N.Y. Mar. 30, 1981). *See generally* Note, *An Implied Right of Action for Issuers Under Section 13(d) of the Securities Exchange Act of 1934*, 61 B.U.L. REV. 933 (1981) [hereinafter cited as Note, *An Implied Right of Action*]; Note, *Private Litigation Under the Williams Act: Standing to Sue, Elements of a Claim and Remedies*, 7 J. CORP. L. 545, 559-61 (1982) [hereinafter cited as Note, *Private Litigation*]; Note, *Implied Private Rights of Action for Equitable Relief under Section 13(d) of the Williams Act*, 1981 UTAH L. REV. 869 [hereinafter cited as Note, *Implied Private Rights of Action*]; Note, *Section 13(d) of the '34 Act: The Inference of a Private Cause of Action for a Stock Issuer*, 38 WASH. & LEE L. REV. 971 (1981).

Generally, section 13(d)(1) of the Exchange Act and rule 13d-1 promulgated thereunder require any person or group of persons who acquire beneficial ownership of more than five percent of a class of equity securities registered under section 12 of the Act to disclose, within ten days, specific information by filing a schedule 13D with the SEC and by sending copies to the issuer and to each exchange on which the security is traded. For further discussion of section 13(d), see M. STEINBERG, *supra* note 1, at § 9.03[5].

76. Courts have permitted both target and offeror managements to bring actions for injunctive relief under Section 14(e). *See, e.g.*, *Mobil Corp. v. Marathon Oil Co.*, 669 F.2d 366, 376 (6th Cir. 1981); *Weeks Dredging & Contracting, Inc. v. American Dredging Co.*, 451 F. Supp. 468, 475-76, 486 (E.D. Pa. 1978); *Humana, Inc. v. American Medicorp, Inc.*, 445 F. Supp. 613, 614-16 (S.D.N.Y. 1977). *See generally* Comment, *Preliminary Injunctive Relief and Tender Offers: An Analysis Under the Williams Act*, 49 GEO. WASH. L. REV. 563 (1981).

77. The SEC is a proper party to seek injunctive relief for disclosure violations under sections 13(d) and 14(e). Given the Commission's heavy workload and its manpower shortages, however, the SEC often lacks the resources to act on a timely basis. *See* *J.I. Case Co. v. Borak*, 377 U.S. 426, 432-33 (1964). It may well be necessary to grant standing to competing bidders seeking injunctive relief, particularly if target management is aligned with the friendly offeror. In such a situation, a competing offeror may well be the only available party willing to bring a suit for injunctive relief which will ultimately benefit the target corporation and its shareholders. *See* *Mobil Corp. v. Marathon Oil Co.*, 669 F.2d 366, 371 (6th Cir. 1981); *see also* Lowenstein, *supra* note 11, at 301; The Business Roundtable, *The Role and Composition of the Board of Directors of the Large Publicly Owned Corporation*, 33 BUS. LAW. 2083, 2099-2101 (1978).

tical approach to protecting the integrity of the marketplace and the interests of shareholders.<sup>78</sup>

It should not be presumed, however, that noble motives always lie behind subject companies' suits for injunctive relief. Target managements may seek access to the courts not to vindicate shareholder interests but rather to seek delay, thereby gathering the time needed to develop successful strategies for defending and perpetuating their control.<sup>79</sup> Indiscriminately granting standing to such parties to bring actions for injunctive relief may be detrimental, rather than helpful, to the shareholders who are the primary beneficiaries of the Williams Act. Courts therefore should grant standing only after independently determining that the party seeking to invoke injunctive relief is acting for the target corporation's and shareholders' benefit.<sup>80</sup>

As set forth above, the primary beneficiaries of the Williams Act are the target corporation's shareholders who are entitled to make informed investment decisions without being unduly hampered by techniques and maneuvers employed by the offeror(s)' and subject corporation's managements. There ought, however, to be a narrow, implicit exception to such an interpretation of the Williams Act. That exception would permit target management to take appropriate action to defeat a hostile offer if it could demonstrate affirmatively that the offeror represented a clear threat to the corporation's business, including the equity interests of its shareholders. Although not apparently permitted under the Act,<sup>81</sup> Congress should also allow target management to

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78. *See, e.g.*, *Mobil Corp. v. Marathon Oil Co.*, 669 F.2d 366, 371 (6th Cir. 1981); *Treadway Cos. v. Care Corp.*, 638 F.2d 357, 380 (2d Cir. 1980); *Dan River, Inc. v. Unitex, Ltd.*, 624 F.2d 1216, 1225 (4th Cir. 1980), *cert. denied*, 449 U.S. 1101 (1981); *Chromalloy Am. Corp. v. Sun Chem. Corp.*, 611 F.2d 240, 248 (8th Cir. 1979); *Weeks Dredging & Contracting, Inc. v. American Dredging Co.*, 451 F. Supp. 468, 476 (E.D. Pa. 1978); *Humana, Inc. v. American Medicorp, Inc.*, 445 F. Supp. 613, 616 (S.D.N.Y. 1977); *see also* Note, *An Implied Right of Action*, *supra* note 75, at 963-64; Comment, *supra* note 76, at 576-77; Note, *Private Litigation*, *supra* note 75, at 561; Note, *Implied Private Rights of Action*, *supra* note 75, at 881.

79. *Cf.* Easterbrook & Fischel, *Antitrust Suits by Targets of Tender Offers*, 80 MICH. L. REV. 1155 (1982). "When managers face the sort of conflict that every tender offer presents, a conflict between investors' interests and managers' continued employment, it is altogether too easy for managers to find—to their delight—that some ethical principle enables them to take the high road of defending against the acquisition." *Id.* at 1176.

80. *Cf.* *Zapata Corp. v. Maldonado*, 430 A.2d 779 (Del. 1981), *discussed supra* note 21.

81. The Williams Act has been interpreted as intended solely for the benefit of investor shareholders. *See, e.g.*, *Piper v. Chris-Craft Indus.*, 430 U.S. 1, 26-35 (1977) ("[T]he sole purpose of the Williams Act was the protection of investors who are confronted with a tender offer."); *Rondeau v. Mosinee Paper Corp.*, 422 U.S. 49, 58 (1975) ("The purpose of the Williams Act is to insure that public shareholders who are confronted by a cash tender offer for their stock will not be required to respond without adequate information regarding the qualifications and intentions of the offering party."). Given this judicial interpretation of the Act,

consider noninvestor concerns that merit protection such as the job security of the corporation's employees and the viability of the communities in which it primarily operates.<sup>82</sup> Because the individual shareholder is concerned principally with his or her own investment, management may be deemed the most appropriate decisionmaker to assess these larger societal concerns.<sup>83</sup>

If enacted, such an exception must be carefully limited. If the statutory language of an exception based on noninvestor interests were unduly broad, target management, in practically all instances, could argue plausibly that a takeover bid would harm employees, customers, suppliers, and the community. Legislative or judicial acceptance of the asserted protection of such noninvestor interests without careful scrutiny would provide a smoke screen masking target management's actual motives. To reconcile the competing considerations, the framework proposed permits the subject corporation's management to undertake defensive maneuvers based on noninvestor interests but only if such maneuvers are warranted. That is, management must prove that the tender offeror presents a clear threat to deserving societal interests.<sup>84</sup>

The expansive construction given by many courts to the business judgment rule,<sup>85</sup> in conjunction with state anti-takeover statutes that protect incumbent management,<sup>86</sup> strongly suggest that any meaningful shareholder protection and reforms in the tender offer area must come from existing federal law and the implementation of further Congressional and SEC action. Thus, the unduly narrow interpretation given by a number of federal courts to the Williams Act<sup>87</sup> is unfortunate. By

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allowing target management to take action based upon non-shareholder interests could well be viewed as antithetical to the Act's purpose and thus not permitted.

82. These interests may include the stake of loyal employees in continued employment, the corporation's responsibility to the environment, and the community's reliance on the corporation as a local employer. See, e.g., *Herald Co. v. Seawell*, 472 F.2d 1081, 1094-96 (10th Cir. 1972) (applying Colorado law), discussed *supra* notes 35, 41 and accompanying text.

83. See, e.g., Lipton, *Takeover Bids in the Target's Boardroom*, 35 BUS. LAW. 101, 130 (1979); Williams, *supra* note 24, at 963; *supra* notes 77-80 and accompanying text. Lipton goes so far as to argue that, regarding management's response to a hostile tender offer, "[n]ational policy is a proper consideration." Lipton, *supra*, at 130. Directly opposed to the views of Lipton are those of Professors Easterbrook and Fischel who contend that, because cash tender offers are beneficial and lead to more efficient management, any attempt by the subject corporation's management to impede such an offer should be proscribed. Easterbrook & Fischel, *supra* note 15, at 1164. See Gilson, *A Structured Approach to Corporations: The Case Against Defensive Tactics in Tender Offers*, 33 STAN. L. REV. 819, 862-65 (1981).

84. A lesser standard would only increase the opportunities for corporate malfeasance, thereby conflicting with the rationale underlying the Williams Act as well as with management's fiduciary duties under state law. See Lynch & Steinberg, *supra* note 54, at 913 n.55.

85. See *supra* notes 6-12 and accompanying text.

86. See statutes cited *infra* note 90.

87. See cases cited *supra* note 65.

construing section 14(e) as solely a disclosure statute, those courts are ignoring the Act's legislative history: its provisions are to have a broader reach.<sup>88</sup> As important, by relegating aggrieved shareholders to state court processes when it is unnecessary to do so, the federal courts are ensuring that shareholders' meritorious claims are left without a viable remedy.

#### ADDITIONAL LEGISLATIVE PROPOSALS

In addition to the foregoing suggestions, it would be appropriate for Congress to act to remedy other deficiencies in the tender offer process. Two-tier offers, for example, have not been viewed as "fraudulent" or "manipulative" by the few courts to have considered the issue.<sup>89</sup> Such offers nevertheless constitute a coercive tactical ploy that enables an offeror to acquire control through a partial tender offer at one price and then to squeeze-out minority shareholders at a substantially lower price.<sup>90</sup> Partial tender offers may have become too firmly established to be eliminated, even if their elimination were desirable,<sup>91</sup> but basic prin-

88. See *supra* notes 53-72 and accompanying text.

89. See, e.g., *Martin Marietta Corp. v. Bendix Corp.*, 549 F. Supp. 623, 630-31 (D. Md. 1982); *Radol v. Thomas*, 534 F. Supp. 1302, 1314 (S.D. Ohio 1982).

90. One justification sometimes given for the higher front-end tender offer price is that the differential between the first and second tiers represents a premium paid for control. *Easterbrook & Fischel, Corporate Control Transactions*, 91 YALE L.J. 698, 727 (1981). The payment and receipt of premiums for control have received judicial approbation in non-tender contexts. See, e.g., *Zetlin v. Hanson Holdings*, 48 N.Y.2d 684, 397 N.E.2d 387, 421 N.Y.S.2d 877 (1979) (controlling interest may be purchased and sold at a premium over market price). Front-end loaded offers nonetheless provide potential for abusive tactics and practices, since shareholders recognize that they must either tender or be relegated to a substantially lower second-step squeeze-out merger price if the takeover bid is successful. See ADVISORY COMMITTEE REPORT, *supra* note 14, at 24-26; *Brudney & Chirelstein, Fair Shares in Corporate Mergers and Takeovers*, 88 HARV. L. REV. 297, 336-37 (1974); *Finkelstein, Antitakeover Protection Against Two-Tier and Partial Tender Offers: The Validity of Fair Price, Mandatory Bid, and Flip-Over Provisions Under Delaware Law*, 11 SEC. REG. L.J. 291, 293 (1984). At least three states, Maryland, Ohio, and Pennsylvania, have enacted statutes that address the potential abuses associated with second-step squeeze-out mergers. See MD. CORPS. & ASS'NS. CODE ANN. §§ 3-202, 3-601-03, 8-301(12)-(14) (1975); OHIO REV. CODE ANN. §§ 1701.01, 1701.831 (Page Supp. 1983); PA. STAT. ANN. tit. 15, §§ 408, 409.1, 910 (Purdon 1983). In connection with the constitutional concerns raised by these statutes, see *Edgar v. MITE Corp.*, 457 U.S. 624 (1982) (Illinois Business Takeover Act declared unconstitutional on interstate commerce grounds; Justices White and Blackmun and Chief Justice Burger also would have held the state act unconstitutional under the supremacy clause). See generally *Sargent, On the Validity of State Takeover Regulation: State Responses to MITE and Kidwell*, 42 OHIO ST. L.J. 689 (1981); *Scriggins & Clarke, Takeovers and the 1983 Maryland Fair Price Legislation*, 43 MD. L. REV. 266 (1984); *Steinberg, The Pennsylvania Anti-Takeover Legislation*, 12 SEC. REG. L.J. 184 (1984).

91. Justice Goldberg, pointing to the English regulatory framework, recommends that the two-tier offer be prohibited, unless there are exceptional circumstances present. Goldberg, *supra* note 1 at 233-34. Although there is merit to this suggestion, such an approach would preclude an offeror from making a tender offer for an inefficiently managed target corpora-

ciples of fair dealing should be applied to the takeover process. Fairness requires that an offeror who obtains control pursuant to a partial tender offer normally be permitted to acquire no additional equity securities of the subject corporation unless (1) the offeror proves that changed economic circumstances justify the lower price, or (2) the offeror pays the same or a higher price for the shares in the second step as it paid for the shares tendered.<sup>92</sup>

Another inequity under current law is that a beneficial owner of more than five percent of a subject security need not disclose such ownership until ten days after attaining that status.<sup>93</sup> Persons are free to seek additional acquisitions through privately negotiated transactions and open market purchases during that ten day period as long as the acquisitions do not constitute a "tender offer."<sup>94</sup> This makes possible the rapid accumulation of securities representing a potential shift in corporate control without notification and disclosure of pertinent informa-

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tion if the offeror lacked the funds necessary to acquire the entire company. I believe that society, on the whole, benefits from permitting the acquisition of controlling interests in these and related circumstances. See ADVISORY COMMITTEE REPORT, *supra* note 14, at 24-25. Moreover, shareholders wishing to tender in a partial offer can be adequately protected by (1) having their shares accepted on a pro rata basis throughout the duration of the offer, and (2) requiring that any second-step squeeze-out transaction be at the same price. See SEC Rule 14d-8, 17 C.F.R. § 240.14d-8 (1983).

92. Maryland recently passed legislation designed to protect non-tendering minority shareholders from being unfairly squeezed out in second-tier transactions. Act of June 2, 1983, ch. 1, Sp. Sess. (codified at MD. CORPS. & ASS'NS CODE ANN. §§ 3-202, 3-601 to 3-603, 8-301 (12)-(14) (1975 & Supp. 1983)). Under the new legislation, most second-tier transactions must be approved by a supermajority vote (4/5 of all votes entitled to be cast and 2/3 of votes entitled to be cast by shareholders who are neither "interested" nor "affiliated" with interested shareholders). *Id.* at § 3-602. The supermajority vote requirement does not apply, however, if non-tendering minority shareholders receive at least as much for their shares as tendering shareholders received for theirs, and if certain additional conditions are met, or if the corporation otherwise qualifies for an exemption. *Id.* at § 3-603(b)-(e). See generally Scriggins & Clarke, *supra* note 90.

93. 15 U.S.C. § 78m(d)(1) (1982); 17 C.F.R. § 240.13d-101 (1983). See M. STEINBERG, *supra* note 1, at § 9.03[5]. The information required by schedule 13D includes the identity of the issuer and the security, the identity, background and citizenship of the reporting persons, the source and amount of funds used to acquire the securities, the purpose of the transaction, the reporting person's interest in the securities including trading history for the last 60 days and any contracts, arrangements, understandings or relationships with respect to the securities to which the reporting person or group is a party.

Bialkin, Attura & D'Alimonte, *Why, When and How to Conduct a Proxy Fight for Corporate Control*, in PROXY CONTESTS AND BATTLES FOR CORPORATE CONTROL 117 (Practising Law Institute 1981).

94. A number of courts have addressed the question of what constitutes a tender offer. See, e.g., *Wellman v. Dickinson*, 475 F. Supp. 783, 818-24 (S.D.N.Y. 1979), *aff'd on other grounds*, 682 F.2d 355 (2d Cir. 1982), *cert. denied*, 103 S. Ct. 1522 (1983); *Kennecott Copper Corp. v. Curtiss-Wright Corp.*, 584 F.2d 1195, 1206-07 (2d Cir. 1978); *Brascan Ltd. v. Edper Equities, Ltd.*, 477 F. Supp. 773, 789-92 (S.D.N.Y. 1979); *Financial Gen. Bankshares, Inc. v. Lance*,

tion to the marketplace, and is inconsistent with the purpose of section 13(d).<sup>95</sup> Congress should close this loophole by either (1) prohibiting additional accumulations above the five percent level unless there has been prior disclosure of the requisite information,<sup>96</sup> or (2) deeming acquisition of more than ten percent or some other appropriate level of beneficial ownership of a security, with certain exceptions, to constitute a tender offer, thereby triggering the disclosure and dissemination requirements of the Williams Act.<sup>97</sup>

"Greenmail" is another practice which merits congressional atten-

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[1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,403 (D.D.C. Apr. 27, 1978); *S-G Securities, Inc. v. Fuqua Inv. Co.*, 466 F. Supp. 1114, 1126-27 (D. Mass. 1978).

In determining whether a tender offer was made, the general criteria utilized by the courts include: "(1) whether the transactions place pressure on the solicited shareholders to sell without deliberation; (2) the sophistication of the selling shareholders; (3) the opportunity for negotiation; and (4) access of the solicitees to the kind of information generally available in connection with a tender offer." Bloomenthal, *supra* note 67, at 42. The SEC proposed for comment rules which sought to define the term "tender offer". See SEC Exchange Act Release No. 16385, Proposed Amendments to Tender Offer Rules, 44 Fed. Reg. 70, 349 (1979). The Commission, however, thus far has declined to take further action.

95. See, e.g., *Treadway Cos. v. Care Corp.*, 638 F.2d 357, 380 (2d Cir. 1980).

96. See SENATE COMM. ON BANKING, HOUSING, AND URBAN AFFAIRS, 96th CONG., 2d SESS., SECURITIES AND EXCHANGE COMMISSION REPORT ON TENDER OFFER LAWS 55, 56 (Comm. Print 1980) [hereinafter cited as TENDER OFFER LAWS]. Cf. ADVISORY COMMITTEE REPORT, *supra* note 14, at 21-22. The Advisory Committee would prohibit additional purchases above the five percent level unless the requisite information has been on file with the SEC for at least a forty-eight hour period. This position is unwise. Pre-acquisition delay of that sort would provide target management with substantial time to implement defensive maneuvers, thereby undermining the neutrality as between offeror and target that Congress built into the Williams Act. See *Edgar v. MITE Corp.*, 457 U.S. 624, 633-39 (1982). See also *Piper v. Chris-Craft Indus.*, 430 U.S. 1, 29-31 (1977); *Rondeau v. Mosinee Paper Corp.*, 422 U.S. 49, 58-59 (1975).

97. Although the ten percent level of beneficial ownership proposed in the text is arbitrarily set, a shareholder with that percentage of voting shares may exercise what amounts to a controlling or a substantial influence in some publicly-held corporations. This is especially true when stock ownership is combined with the persuasive authority of, for example, a position as a corporate officer. See generally L. LOSS, FUNDAMENTALS OF SECURITIES REGULATION 445-56 (1983). Of course, certain transactions, such as purely privately negotiated purchases, should be permitted without requiring the prospective acquiror to make a tender offer. In 1980, the SEC proposed legislation to require that acquisition of more than ten percent of a subject corporation's shares generally be made only by means of a tender offer. See TENDER OFFER LAWS, *supra* note 96, at 62 ("The Commission proposes to amend section 14(d) by defining the term 'statutory offer' to mean all offers to acquire the beneficial ownership of equity securities of a public issuer by a person who is or could thereby become the beneficial owner of more than 10 percent of the class. Exceptions to the definition are made for: (1) offers pursuant to a statutory merger or acquisition, (2) the solicitation of voting proxies, (3) acquisitions of 2 percent per year, (4) acquisition from the issuer, (5) acquisitions from no more than 10 persons in any 12 months pursuant to privately negotiated transactions."). Cf. ADVISORY COMMITTEE REPORT, *supra* note 14, at 22-23 (acquisitions which would give the acquiror more than 20% of the voting power in a corporation should be permitted only if obtained from the offeror or by means of a tender offer).

tion.<sup>98</sup> When a subject corporation's incumbent management causes the corporation to repurchase, at a substantial premium, the stock acquired by a potential bidder, management should be deemed to have a conflict of interest that precludes application of the business judgment rule. Unfortunately, present law is not clear on this point.<sup>99</sup> Congress therefore should consider adopting legislation which requires incumbent management to prove affirmatively that such a stock repurchase was in the corporation's best interests and at a fair price.<sup>100</sup> Shareholders should be provided a cause of action similar to that available under section 36(b) of the Investment Advisers Act to enable them to challenge these repurchases.<sup>101</sup>

As a policy matter, Congress also should establish a ceiling on monetary damages assessed against corporate fiduciaries under the Williams Act, except where there has been egregious misconduct. In all practicality, courts have declined to construe the Williams Act and state fiduciary law restrictively whenever a finding of liability would result in astronomical monetary damages.<sup>102</sup> The Seventh Circuit's unduly nar-

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98. "Greenmail" has been defined as "[t]he practice of buying a portion of a company's stock and threatening the company with a hostile takeover fight unless management agrees to buy back [the] shares at a premium." *SEC Faults Advisory Panels' Reliance on Business Judgment Rule in Takeovers*, 16 SEC. REG. & L. REP. (BNA) No. 11, at 496 (Mar. 16, 1984).

99. Compare *Panter v. Marshall Field & Co.*, 646 F.2d 271, 293-94 (7th Cir.), *cert. denied*, 454 U.S. 1092 (1981) (broad application of the business judgment rule in the context of a tender offer), and *Johnson v. Trueblood*, 629 F.2d 287, 292-93 (3d Cir. 1980) (same), with *Crane Co. v. Harsco Corp.*, 511 F. Supp. 294 (D. Del. 1981) (the burden is on directors to justify the issuer's repurchase of shares in a hostile tender offer situation).

100. Alternatively, Congress should adopt the Advisory Committee's recommendation that "[r]epurchase of a company's shares at a premium to market from a particular holder or group that has held such shares for less than two years should require shareholder approval." ADVISORY COMMITTEE REPORT, *supra* note 14, at 46. Although this alternative is an improvement on the application of the business judgment rule, particularly if the shareholder vote is required to be disinterested and informed, a court's careful scrutiny of the fairness of the transaction arguably will better protect the integrity of the takeover process and shareholder interests. See generally *supra* notes 22, 23 and accompanying text.

101. See 15 U.S.C. § 80a-36(b) (1982). Section 36(b) generally permits an action to be brought by the SEC, or by a security holder of a registered investment company on behalf of such company, to recover from the investment adviser, any person affiliated with such investment adviser, and certain other persons any compensation or payments, "for breach of fiduciary duty in respect of such compensation or payments paid by such registered investment company or by the security holders thereof to such investment adviser or person." See also *Daily Income Fund, Inc. v. Fox*, 104 S. Ct. 831, 842 (1984) (demand on board of directors of registered investment company not required in suit brought by shareholders pursuant to section 36(b)).

102. See, e.g., *Panter v. Marshall Field & Co.*, 646 F.2d 271, 286 (7th Cir.), *cert. denied*, 454 U.S. 1092 (1981); *Lewis v. McGraw*, 619 F.2d 192 (2d Cir. 1980); *Berman v. Gerber Products Co.*, 454 F. Supp. 1310 (W.D. Mich. 1978); see also *Mobil Corp. v. Marathon Oil Co.*, 669 F.2d 366, 374-75 (6th Cir. 1981) (court's construction of "manipulation" was formulated where no monetary liability recovered).

row interpretation of federal and state law in *Panter v. Marshall Field & Co.*,<sup>103</sup> for example, might best be viewed in light of the fact that plaintiffs sought damages exceeding \$200 million.<sup>104</sup> A finding of liability in such an amount could not only bankrupt the subject company and its management,<sup>105</sup> but also wreak havoc upon our system of corporate governance. Few corporate directors would be willing to mount even minimal opposition to detrimental takeover bids; indeed, outside directors could be expected to resign their positions rather than risk financial catastrophe.

Congress should recognize the importance of the policy considerations involved in this unique context by enacting an appropriate ceiling on damages. Such a ceiling must be high enough to deter target management from viewing violation of the law as a mere business expense. To further inhibit management from pursuing its own survival at all costs,<sup>106</sup> the limit on damages should not be applicable in cases of egregious misconduct.<sup>107</sup>

Justice Goldberg's provocative article suggests a number of other, more fundamental changes that Congress might make in the tender offer regulatory framework.<sup>108</sup> Imposition of substantially longer time periods for offers to remain open, appointment of an independent reviewer to evaluate the fairness of tender offers, and provision of a "freeze" period sufficient to enable shareholders to make informed decisions are

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103. 646 F.2d 271 (7th Cir.), *cert. denied*, 454 U.S. 1092 (1981).

104. 646 F.2d at 283. Plaintiffs in *Marshall Field* apparently were seeking the benefit of their bargain. For recent application of the benefit-of-the-bargain measure of damages in securities litigation, see *Hackbart v. Holmes*, 675 F.2d 1114, 1121-22 (10th Cir. 1982); *Osofsky v. Zipf*, 645 F.2d 107, 111-15 (2d Cir. 1981). For further discussion of *Marshall Field* see *supra* note 2; M. STEINBERG, *supra* note 6, at 212-16.

105. The extent of adverse consequences for the subject parties would depend on whether the defendant corporate fiduciaries were entitled to be indemnified by the corporation and whether insurance was available to cover the damages assessed. See MODEL BUSINESS CORP. ACT § 5 (1982); DEL. CODE ANN. tit. 8, § 145 (1983); Bishop, *Sitting Ducks and Decoy Ducks: New Trends in the Indemnification of Corporate Directors and Officers*, 77 YALE L.J. 1078 (1968); Johnson, *Corporate Indemnification and Liability Insurance for Directors and Officers*, 33 BUS. LAW. 1993 (1978); Hill, *Lloyd's Offers U.S. Concerns Insurance for Costs of Fighting Hostile Takeovers*, Wall St. J., May 12, 1980, at 14, col. 2 ("A policy will pay 80% of most costs associated with fending off an unwanted takeover up to \$1 million. One big catch: A company must win to collect on the insurance.").

106. See Nagelvoort, *Kudos for Management, Not Darts*, N.Y. Times, April 1, 1984, at F3, col. 1 (referring to criticism leveled against Gulf's failure to use all defensive options in its arsenal to ward off offerors, including Standard Oil Co. of California, as "distorted because it focuses on 'survival at all costs' rather than on the proper responsibilities of managers in public corporations.").

107. It is beyond the scope of this article to propose an appropriate ceiling. Note, however, the ceiling built into the ALI DRAFT RESTATEMENT, set forth *supra* note 43.

108. Goldberg, *supra* note 1, at 229-235.



meritorious concepts which deserve congressional attention.<sup>109</sup> Justice Goldberg also astutely perceives that for too long the interests of the offeror's shareholders have been overlooked.

Tender offers frequently resemble mergers in their practical effect, yet the rights of the offeror's shareholders vary greatly depending upon which form a transaction takes.<sup>110</sup> Shareholders normally have the right to approve mergers,<sup>111</sup> and federal legislation assures that the proxy disclosure process will provide them with sufficient information to do so knowledgeably.<sup>112</sup> In contrast, the offeror's shareholders usually have neither voting nor disclosure rights in connection with tender offers. One might argue that this is a matter of internal corporate governance that should be left to state regulation,<sup>113</sup> but in the analogous proxy setting Congress has recognized that the disclosure and dissemination of adequate information to shareholders is a proper subject of federal regulation.<sup>114</sup> Hence, Congress should consider requiring offerors to disclose

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109. *Id.* at 229-30, 232-33. Some of these concepts are not as novel as they may appear. For example, the Advisory Committee itself recommended that the bid time periods be lengthened, but not to the extent suggested by Justice Goldberg. ADVISORY COMMITTEE REPORT, *supra* note 14, at 27-28 (recommending a minimum offering period of 30 days for an initial bid, 20 days for a subsequent one). Under current SEC rules tender offers must be held open for at least twenty business days. 17 C.F.R. § 240.14e-1(a) (1983). The concept of a "freeze" period also has been advanced by Lowenstein, *supra* note 11, at 317-18. The concept of a special review person has received approbation from both the Supreme Court of Delaware and the SEC in the going private context. *See* Weinberger v. UOP, Inc., 457 A.2d 701, 709 n.7 (Del. 1983); *In re* Spartek, Inc., SEC Exchange Act Release No. 15,567 (Feb. 14, 1979).

110. Somewhat analogously and apparently without good reason, there are significantly more regulatory impediments to undertaking an exchange offer (in lieu of a cash tender offer) than to making a cash tender offer. *See* ADVISORY COMMITTEE REPORT, *supra* note 14, at 16. Because of this inequality of regulation, there are far more cash tender offers than exchange offers. *See* Austin, *supra* note 7, at 15, 36. The SEC Advisory Committee concluded that the more extensive regulation of exchange offers is unnecessary for shareholder protection and recommended that "[c]ash and securities tender offers should be placed on an equal regulatory footing so that bidders, the market and shareholders, and not regulation, decide between the two." ADVISORY COMMITTEE REPORT, *supra* note 14, at 16.

111. *See, e.g.*, DEL. CODE ANN. tit. 8 §§ 251(c), (f), 252(c), (e) (1983); MD. CORPS & ASS'NS CODE ANN. § 3-105(d) (1975 & Supp. 1983); MODEL BUSINESS CORP. ACT § 73 (1982).

112. 15 U.S.C. § 78n(a) (1982); 17 C.F.R. §§ 240.14a-1 to .14a-102 (1983). *See* Mills v. Electric Auto-Lite Co., 396 U.S. 375, 381 (1970) (noting that the underlying purpose of section 14(a) of the Exchange Act is to promote "the free exercise of the voting rights of stockholders" by ensuring that proxies [are] solicited with 'explanation to the stockholder of the real nature of the questions for which authority to cast his vote is sought.'") (quoting H.R. REP. NO. 1383, 73d Cong., 2d Sess. 14 (1934) and S. REP. NO. 792, 73d Cong., 2d Sess. 12 (1934)); *see also* TSC Indus. v. Northway, Inc., 426 U.S. 438, 444 (1976); J.I. Case Co. v. Borak, 377 U.S. 426, 431 (1964).

113. *See generally* Ferrara, Starr & Steinberg, *Disclosure of Information Bearing on Management Integrity and Competency*, 76 NW. U.L. REV. 555, 563 (1981).

114. *See* M. STEINBERG, *supra* note 6, at 77, 83, 103; Ferrara, Starr & Steinberg, *supra* note 113, at 559; authorities cited *supra* note 112.

to their shareholders, at the time that a tender offer is publicly announced, information sufficient to allow them to determine whether the takeover bid is in the corporation's best interests from both a short- and long-term perspective.<sup>115</sup>

#### SOME FINAL THOUGHTS

The analysis and proposals set forth in this Article are a response to current judicial and SEC thinking on tender offers, which frequently presumes that subject corporations' managements are acting in their shareholders' best interests. Unfortunately, the converse is all too often true. Management, when anticipating or in the midst of a tender offer, sometimes acts in its own interests, neglecting the valid interests of shareholders, employees, and affected communities. Judicial and SEC deference to managerial processes and decisionmaking therefore is unwarranted. If the courts and the SEC choose not to face this stark reality, then Congress should act to reaffirm that the primary beneficiaries of the Williams Act, the subject corporation's shareholders, normally are entitled to make their investment decisions without being preempted by defensive maneuvers.

Consideration also ought to be given to whether the entire administrative and judicial framework for the resolution of tender offer disputes needs restructuring. It may be argued that federal district courts, on the whole, have little expertise in dealing with the complicated issues surrounding tender offers. In any given tender offer situation, furthermore, suits may well be brought in a number of district courts situated throughout the country.<sup>116</sup> The net result is potentially inefficient, time-consuming, costly, and non-uniform litigation. In light of these problems, Congress should consider vesting with the SEC exclusive orig-

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115. Failure to make a truthful and accurate disclosure of information would be actionable in suits for injunctive relief and actions for damages pursuant to section 14(e). Moreover, if shareholders receive adequate information, they could seek an injunction against the tender offer in state court based on management's alleged breach of fiduciary duty, or take other appropriate measures to protect themselves from financial injury. Federal courts have found nondisclosures to be material where adequate disclosure would have enabled shareholders to obtain state court relief or take other protective measures. *See, e.g.*, *United States v. Margala*, 662 F.2d 622, 625-27 (9th Cir. 1981); *Healey v. Catalyst Recovery of Pa., Inc.*, 616 F.2d 641, 647-48 (3d Cir. 1980); *Goldberg v. Meridor*, 567 F.2d 209, 219-20 (2d Cir. 1977), *cert. denied*, 434 U.S. 1069 (1978). As an alternative measure, albeit frequently a futile one, aggrieved shareholders may bring an action against management for waste or seek to vote the "rascals" out in the next election. For a restrictive view, see *Gaines v. Haughton*, 645 F.2d 761, 776-79 (9th Cir. 1981) *cert. denied*, 102 S. Ct. 1006 (1982).

116. During the Bendix-Martin Marietta struggle, for instance, actions were brought in two federal courts in New York, the federal court in Maryland, a federal and a state court in Michigan, and two state courts in Delaware. *Martin Marietta Corp. v. Bendix Corp.*, 549 F. Supp. 623, 626 (D. Md. 1982).

inal jurisdiction to bring administrative enforcement actions<sup>117</sup> and to resolve disputes arising between private parties in the tender offer setting, except where a damages remedy or injunctive relief is sought after a takeover bid has been consummated or defeated.<sup>118</sup> As with administrative matters under present law, legislation could provide for appeal of the Commission's decisions to the United States Courts of Appeals.<sup>119</sup> The suggested approach, if successful, would provide the SEC with a meaningful enforcement mechanism to protect the investing public and the integrity of the securities markets in this fast-moving context. It also would provide corporations and their shareholders with expeditious and uniform decisions by an expert body and the right to federal appellate court review. In theory, implementation of the proposal would result in a significant improvement over our present system.

In order for this proposal to be successfully implemented, the SEC would have to be provided with sufficient resources to enable the agency to adjudicate these matters on an expedited basis. This approach is based on a number of underlying assumptions which, although not tested empirically, appear plausible. Those assumptions include that the SEC's expanded oversight and adjudicatory authority in the tender offer area would not be unduly expensive, would result in more expeditious, uniform, and sound interpretations, and would be administratively feasible. Admittedly, all of these propositions are subject to challenge. The proposal is offered nonetheless as an arguably attractive alternative to the present system, and a useful vehicle for considering how the present tender offer regulatory system can be improved.

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117. The SEC recently asked Congress for legislation which would, inter alia, provide the Commission with authority to bring administrative proceedings against persons who file misleading statements with the SEC in connection with the making of a tender offer. See *SEC to Seek Expansion of Authority to Bring Administrative Proceedings*, 16 SEC. REG. & L. REP. (BNA) No. 7, at 267 (Feb. 17, 1984). The proposal has generated opposition. See Nelson, *Legislative Efforts Dominate Spring Meeting*, *Legal Times of Wash.*, Apr. 16, 1984, at 2, col. 1.

118. Unless Congress legislates to preempt state regulation of takeovers, as the SEC Advisory Committee recommended, ADVISORY COMMITTEE REPORT, *supra* note 14, at 17, suits could be brought in the state courts even if the SEC obtains exclusive original jurisdiction in the federal regulatory setting. See *supra* note 116. The propriety of preempting state tender offer regulation by means of federal legislation is beyond the scope of this Article. Nonetheless, while such state regulation continues in effect, the proposal advanced here offers a more attractive approach than the present federal regulatory framework.

119. See, e.g., Securities Act of 1933, § 9, 15 U.S.C. § 77i(a) (1982); Securities Exchange Act of 1934, § 25, 15 U.S.C. § 78y(a) (1982).