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CURRENT ISSUES IN TENDER OFFER REGULATION: LESSONS FROM THE BRITISH

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The recent submission to Congress of several proposed amendments to the Williams Act has again made tender offer regulation a controversial subject. Professor DeMott believes that the debate about regulatory reform can benefit from a comparative study of British and American tender offer regulation. She finds the British system instructive in three important respects. First, the British system specifically indentifies different kinds of transactions that resemble tender offers and regulates those transactions according to the hazards they create for investors. Unlike the American system, which imposes a single set of highly complex regulations only if a transaction qualifies as a tender offer under nebulous judicial definitions, the British system recognizes that certain acquisitions of a small percentage of a corporation's shares, while appropriately subject to some regulation, need not trigger application of the full panoply of rules. The author also notes that the bright line rules used by the British to define regulated transactions facilitate financial and legal planning and promote an orderly market for corporate control. Second, by enforcing a more rigorous view of fair and equal treatment of target shareholders than does the American system, the British system may discourage takeover attempts and bidding contests that benefit shareholders. For instance, the British require that a purchaser of thirty percent of target stock offer to buy out remaining shareholders at the highest price it paid for the stock. In the author's view, such a protective rule may be too costly: it may also be unnecessary in the United States, where minority shareholders may enjoy appraisal rights and may bring derivative suits against management more easily than their British counterparts. Third, by requiring that target management provide shareholders with an independent appraisal of each tender offer and obtain the shareholders' approval before engaging in defensive maneuvers that might defeat the offer, the British system provides a moderate solution to the problem of managerial conflicts of interest caused by hostile takeover efforts. Recognizing that some defensive role for target management may be appropriate, Professor DeMott argues that the British approach may be preferable to current proposals that defensive tactics be prohibited.

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INTRODUCTION

Tender offers for corporate stock frequently are contentious events. Likewise, the proper role for legal regulation of such transactions has long been sharply contested. In the United States, tender offers are regulated extensively by the federal and many state governments. Some commentators have argued that present regulation does not adequately protect the shareholders of a target corporation, in that it permits them to be too easily stampeded into accepting a bad deal and fails to assure that all shareholders benefit equally from a change in corporate control.[1] Others maintain that present regulatory

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[1] See, e.g., Securities and Exchange Commission Advisory Committee on Tender Offers, Report of Recommendations 22-23 (1983) (shareholders should have equal opportunity to share

schemes unduly burden the market for corporate control and disadvantage shareholders by discouraging potentially beneficial transactions.[2] Still other commentators criticize these schemes for giving the target corporation's management too much discretion in deciding how to respond to a bid and for permitting management to employ unfair tactics in opposing disfavored bids.[3]

This Article considers these varying criticisms in light of the British system of tender offer regulation.[4] Although the securities markets in the United States and Great Britain are similar,[5] the systems of tender offer regulation are sharply different. Consideration of the British system is thus helpful in assessing alternatives to the present American system. The Article begins with a sketch of American and British tender offer regulation, which describes the basic assumptions of the two systems and their essential differences. It then examines the British experience as it bears on three questions about American tender offer regulation: (1) What transactions should be subject to regulation as tender offers; (2) What are the desirable or practical limits to regulation aimed at assuring fair treatment for all target company

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in premium paid for control) [hereinafter Advisory Committee Report]; id. at 122-31 (separate statement of Arthur J. Goldberg) (proposing broad expansion of federal takeover regulation to address problems of shareholder inequality and stampedes); Lipton, Takeover Bids in the Target's Boardroom, 35 Bus. Law. 101, 113-14 (1979).

[2] See Fischel, Efficient Capital Market Theory, the Market for Corporate Control, and the Regulation of Cash Tender Offers, 57 Tex. L. Rev. 1, 13-15, 29 (1978); Grossman & Hart, Takeover bids, the free-rider problem, and the theory of the corporation, 11 Bell J. Econ. 42, 60 (1980); Jarrell & Bradley, The Economic Effects of Federal and State Regulations of Cash Tender Offers, 23 J. Law & Econ. 371, 398-99, 401-02 (1980).

[3] See generally Cohn, Tender Offers and the Sale of Control: An Analogue to Determine the Validity of Target Management Defensive Measures, 66 Iowa L. Rev. 475 (1981); Easterbrook & Fischel, The Proper Role of a Target's Management in Responding to a Tender Offer, 94 Harv. L. Rev. 1161 (1981); Gelfond & Sebastian, Reevaluating the Duties of Target Management in a Hostile Tender Offer, 60 B.U.L. Rev. 403 (1980); Gilson, A Structural Approach to Corporations: The Case Against Defensive Tactics in Tender Offers, 33 Stan. L. Rev. 819 (1981) [hereinafter Gilson, Defensive Tactics]; Note, Corporate Directors' Liability for Resisting a Tender Offer: Proposed Substantive and Procedural Modifications of Existing State Fiduciary Standards, 32 Vand. L. Rev. 575 (1979).

[4] Other commentary has already shown that analysis of British corporate and securities regulation can be useful in examining its American counterpart. See G. Benston, Corporate financial disclosure in the UK and the USA (1976); Gower, Some Contrasts Between British and American Corporation Law, 69 Harv. L. Rev. 1369, 1370 (1956) [hereinafter Gower, Some Contrasts]; cf. Tunc, A French Lawyer Looks at American Corporation Law and Securities Regulation, 130 U. Pa. L. Rev. 757 (1982) (comparing French and American law).

[5] See G. Benston, supra note 4, at 3-7. Both countries have public securities markets and fundamentally similar traditions in financial reporting and auditing. Id.

shareholders; and (3) What role should the target's management play in determining the target's response to an offer?

Any system of tender offer regulation is likely to be highly technical, but these technicalities will inevitably reflect significant policy choices. This Article shows that despite the superficial similarity of American and British tender offer regulation, the two systems differ in their policy goals and in the methods adopted to achieve those goals. For example, both systems discourage some kinds of transactions in order to promote more equal treatment of shareholders, but each system has adopted differing concepts of equality and thus disfavors different kinds of transactions. The two systems also vary in their sensitivity to the costs imposed by regulation and have reached different conclusions about the proper roles of target shareholders and managers in responding to a tender offer. Finally, neither system has developed a wholly satisfactory response to the phenomenon of risk arbitrage, which puts peculiar stresses on any regulatory scheme.

Specifically, the British experience strongly suggests that, in constructing a regulatory system, one must begin with a clear definition of the events that will trigger regulation, and that it is neither necessary nor desirable to apply all aspects of tender offer regulation to each regulated transaction. That experience also demonstrates that rules reducing the attractiveness of the two-tier structure for tender offers used so heavily in the United States may be desirable in theory and completely workable in practice. Finally, the British system forbids target company management to use certain evasive tactics designed to defeat hostile tender offers without the approval of the shareholders. The largely unfettered use of such tactics by management acting alone has created much controversy in the United States.

I

THE STRUCTURE OF REGULATION

A. A Survey of United States Regulation

The cornerstone of tender offer regulation in the United States is the Williams Act (the Act), enacted in 1968 and subsequently amended.[6] The Act imposes extensive disclosure requirements on ten-

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[6] Securities Exchange Act of 1934, §§ 13(d)-(f), 14(d)-(f), Act of July 29, 1968, Pub. L. No. 90-439, 82 Stat. 454 (1968), as amended by Act of Dec. 22, 1970, Pub. L. No. 91-567, 84 Stat. 1497 (1970-1971), as amended by Securities Acts Amendments of 1975, Pub. L. No. 94-29, § 10,

der offerors and on others who make substantial acquisitions of shares,[7] establishes timing rules for offers,[8] and grants some substantive protections to target company shareholders, including the right to

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89 Stat. 97, 119-21, as amended by Domestic and Foreign Investment Improved Disclosure Act of 1977, Pub. L. No. 95-213, § 202, 91 Stat. 1498, 1498-99 (codified at 15 U.S.C. §§ 78m(d)-(f), 78n(d)-(f) (1982)). These provisions are hereinafter cited as "Williams Act"; the section numbers given are those from the Securities Exchange Act of 1934, as amended.

[7] See Williams Act §§ 13(d), 14(d), 15 U.S.C. §§ 78m(d), 78n(d) (1982). Section 13(d)(1) of the Williams Act requires persons who acquire five percent or more of any class of securities registered under § 12 of the Securities Exchange Act of 1934, 15 U.S.C. § 78*l* (1982), or of certain other classes of securities, to disclose that holding in a report filed with the SEC within 10 days of the acquisition. This provision of the Williams Act thus applies to acquisitions that are not regarded as tender offers under the Act. The SEC Advisory Committee on Tender Offers concluded that the 10-day "window" could be abused by frenzied purchases within that period and recommended that acquirers be required to file the disclosure statement at least 48 hours before making an acquisition that leaves them with more than five percent of the security. Advisory Committee Report, supra note 1, at 21-22. Under § 14(d)(1) of the Williams Act, tender offerors seeking to purchase five percent or more of a class of equity securities registered under § 12 of the Securities Exchange Act of 1934, or of certain other classes of equity securities, must file a disclosure statement with the SEC and must include certain disclosures required by the SEC in solicitations to shareholders.

The registration requirements of § 12 of the Securities Exchange Act of 1934 apply to issuers that have registered their securities on a national securities exchange; that, subject to certain exemptions, have total assets exceeding $1,000,000 and a class of equity securities held of record by 500 or more persons; or that have voluntarily registered equity securities with the SEC. Securities Exchange Act of 1934, § 12(b), (g), 15 U.S.C. § 78*l*(b), (g) (1982). The SEC has exempted from the registration requirements any issuer with total assets not exceeding $3,000,000 on the last day of its most recent fiscal year. SEC rule 12g-1, 17 C.F.R. § 240.12g-1 (1983). Section 12(g)(4) of the Securities Exchange Act of 1934 permits an issuer to terminate registration of a class of securities if the class is held of record by fewer than 300 persons. The SEC has suspended the reporting obligations of any registered company whose securities are held of record by fewer than 500 persons at the beginning of a fiscal year other than the fiscal year during which the company's registration became effective and the two succeeding years, and which has had total assets not exceeding $3,000,000 at the end of its three most recent fiscal years. SEC rule 15d-6(a)(2), 17 C.F.R. § 240.15d-6(a)(2) (1983).

[8] Section 14(d)(5) of the Williams Act, 15 U.S.C. § 78n(d)(5) (1982), provides that securities deposited in response to a tender offer may be withdrawn by the depositors at any time up to the expiration of seven days after the first announcement of the offer, and at any time after 60 days from the date of the original offer. If the offer is for less than all the securities of a particular class, and more than the requested number of shares is tendered, the offeror must purchase the tendered shares on a pro-rata basis. Williams Act § 14(d)(6), 15 U.S.C. § 78n(d)(6) (1982). These provisions have been interpreted to mean that an offer must remain open for a minimum of seven days, or for 10 days in the case of a partial offer. See 1 M. Lipton & E. Steinberger, Takeovers and Freezeouts § 2.3.6 (1978). In addition, SEC rule 14e-1(a), 17 C.F.R. § 240.14e-1(a) (1983), requires that most tender offers be held open for a minimum of 20 days. The SEC Advisory Committee on Tender Offers has recommended that the minimum duration for an initial bid be lengthened to 30 days, and that subsequent bids remain open for 20 days or until the minimum period for the initial bid has expired, whichever is longer. Advisory Committee Report, supra note 1, at 28. The Committee would also require partial offers to remain open "approximately two weeks longer than [the period] prescribed for other tenders offers." Id. at 26.

withdraw tendered shares within stated periods of time.[9] The Act also includes a broad prohibition on fraudulent, deceptive, and manipulative practices in connection with tender offers.[10] It does not, however, define the term "tender offer." A conventional tender offer is generally regarded as one in which "the offeror typically offers to purchase all or a portion of a company's shares at a premium price, the offer to remain open for a limited time";[11] often the offeror need not purchase all tendered shares if more than a stated maximum or fewer than a stated minimum are tendered, and the tendering shareholder must agree to sell the tendered shares before it is known whether the conditions of the bid are met.[12] Whether transactions outside this definition should be regulated as tender offers has been left to the Securities and Exchange Commission (SEC) for rulemaking and to the federal courts for case-by-case determination.[13] The Act confers broad rulemaking authority on the SEC[14] but does not authorize the SEC to express any opinion on the merits of offers. The SEC may sue violators to enforce the Act,[15] and courts have permitted certain private plaintiffs to sue for damages or injunctive relief under some sections of the Act.[16] However, there is currently some doubt about the continued vitality of some private causes of action for tender offer violations.[17]

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[9] See note 8 supra. SEC rule 14d-7, 17 C.F.R. § 240.14d-7 (1983), grants withdrawal rights beyond those specified in the Williams Act itself to target company shareholders.

[10] Williams Act § 14(e), 15 U.S.C. § 78n(e) (1982).

[11] Smallwood v. Pearl Brewing Co., 489 F.2d 579, 597 n.22 (5th Cir.) (citations omitted), cert. denied, 419 U.S. 873 (1974).

[12] Id. (citations omitted).

[13] See W. Cary & M. Eisenberg, Cases and Materials on Corporations 1571-74 (5th ed. unabr. 1980).

[14] See, e.g., Williams Act § 13(d)(1), (d)(2), (d)(5), (d)(6)(D), (e)(1), (e)(2), 15 U.S.C. § 78m (d)(1), (d)(2), (d)(5), (d)(6)(D), (e)(1), (e)(2) (1982).

[15] The SEC may investigate violations of the Williams Act, Securities Exchange Act of 1934, § 21, 15 U.S.C. § 78u (1982), and may seek injunctive relief against violations in federal court, id. § 21(d), 15 U.S.C. § 78u(d) (1982).

[16] See note 115 and accompanying text infra. However, many potential plaintiffs may be unable to sue under the Williams Act. For example, defeated tender offerors have no cause of action for damages under § 14(e). Piper v. Chris-Craft Indus., 430 U.S. 1, 42 (1977).

[17] Earlier cases have held that only purchasers and sellers of a security, as defined in § 18(a) of the Securities Exchange Act of 1934, 15 U.S.C. § 78r(a) (1982), may recover in damages for violations of § 13(d) of the Williams Act. See, e.g., Wellman v. Dickinson, 497 F. Supp. 824, 835 (S.D.N.Y. 1980), aff'd, 682 F.2d 355 (2d Cir. 1982), cert. denied, 103 S. Ct. 1522 (1983); Stromfeld v. Great Atl. & Pac. Tea Co., 496 F. Supp. 1084, 1085 (S.D.N.Y.), aff'd mem., 646 F.2d 563 (2d Cir. 1980); cf. Indiana Nat'l Corp. v. Rich, 712 F.2d 1180, 1181 (7th Cir. 1983) (issuer has implied right of action for injunctive relief under § 13(d)); Equity Oil Co. v. Consolidated Oil & Gas, Inc., [Current] Fed. Sec. L. Rep. (CCH) ¶ 99,425, at 96,434-35 (D. Utah June 24, 1983) (issuer has no § 13(d) right of action). Moreover, in recent years the Supreme Court has been much more reluctant to imply private rights of action from statutory prohibi-

Once a tender offer has been made, the SEC regulates what statements the offeror and the target management may make to the target's shareholders.[18] In addition, SEC rules prohibit the offeror from purchasing any target shares except through the tender offer from announcement of the offer until its closing.[19]

The remainder of American tender offer regulation is contained in state statutes and in common law standards of acceptable management behavior. In the 1970's, many states enacted statutes regulating tender offers more stringently than the Williams Act,[20] but the constitutionality of many such statutes, which vary considerably, was cast into grave doubt by the Supreme Court's decision in *Edgar v. MITE Corp.*[21] While full description of these statutes is beyond the scope of

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tions. See, e.g., Transamerica Mortgage Advisors, Inc. v. Lewis, 444 U.S. 11, 24 & n.14 (1979) (Investment Advisers Act of 1940 creates only a limited private right of action for rescission of contracts declared void by the act); Touche Ross & Co. v. Redington, 442 U.S. 560, 571 (1979) (no private right of action exists under § 17(a) of the Securities Exchange Act of 1934). But see Herman & MacLean v. Huddleston, 103 S. Ct. 683, 686-87 & n.10 (1983) (Court reaffirmed existence of implied private right of action for damages under § 10(b) of the Securities Exchange Act of 1934 and SEC rule 10b-5).

[18] Section 14(e) of the Willliams Act, 15 U.S.C. § 78n(e) (1982), is a broad antifraud provision; it prohibits making an untrue statement of a material fact, or omitting to state any material fact necessary to make the statements made not misleading, in connection with any tender offer. The SEC may adopt rules to "define, and prescribe means reasonably designed to prevent, such acts or practices as are fraudulent, deceptive, or manipulative." Id.

[19] See SEC rule 10b-13, 17 C.F.R. § 240.10b-13 (1983).

[20] See generally Bartell, State Take-Over Laws: A Survey, in Ninth Annual Institute on Securities Regulation 499 (1978); Langevoort, State Tender-Offer Legislation: Interests, Effects, and Political Competency, 62 Cornell L. Rev. 213 (1977).

[21] 457 U.S. 624 (1982). In *Edgar*, an offeror challenged the constitutionality of the Illinois Business Take-Over Act, Pub. Act No. 80-1421, 1978 Ill. Laws 1581 (codified at Ill. Rev. Stat., ch. 121 ½, ¶¶ 137.51-.70 (1979)) (repealed 1983), on the grounds that it was preempted by the Williams Act and violated the commerce clause. The Court held that the burden on interstate commerce imposed by the statute was unconstitutionally excessive in relation to the local interests served by the statute. 457 U.S. at 643-46. Three justices would also have held that the statute substantially frustrated the objectives of the Williams Act and was therefore preempted by it. Id. at 630-40 (opinion of White, J.). The three dissenting justices would have dismissed the case as moot, id. at 655 (Marshall, J., dissenting), or nonjusticiable, id. at 664 (Rehnquist, J., dissenting); Justice Powell, who joined in the commerce clause holding, nonetheless agreed that the case was moot, id. at 646 (Powell, J., concurring in part).

The Illinois statute required the offeror to give the target company and the Illinois Secretary of State 20 days advance notice of a tender offer. During this 20-day period, the offeror was prohibited from communicating its offer to shareholders; the target company, however, was free to contact shareholders concerning the tender offer. Ill. Rev. Stat. ch. 121 ½, § 4 (1979). Within the 20-day period, the Secretary of State was empowered to call a hearing to adjudicate the equity of the offer and the adequacy of the offeror's disclosure. The statute directed the Secretary to deny registration to any offer found lacking in these respects. Id. § 7. The statute also provided for civil and criminal penalties for offerors who proceeded without first registering. Id. §§ 13, 15. The statute applied to offers for target companies if Illinois shareholders owned 10% of the class of securities subject to the offer, or if any two of three conditions were met: the target had

this Article, it should be noted that the apparent purposes of many state statutes depart markedly from the basic assumptions of the Williams Act. For example, some state statutes prohibit offers unless a state securities administrator has assessed the merits of the offer favorably.[22] These laws conflict with the premise of the Williams Act that, after full and fair mandated disclosure, the merits of an offer should be judged only by the target's stockholders and by the market.[23] Furthermore, some state statutes treat hostile offers—those made over the opposition of the target's management—differently from offers

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its principal executive office in Illinois, was incorporated in Illinois, or had at least 10% of its stated capital and paid-in surplus represented within the state. Id. § 2.10. The statute exempted a corporation's acquisition of its own shares. Id. § 2.09(4).

The Illinois Secretary of State could thus block a tender offer from proceeding anywhere in the nation upon a finding that the offer was inequitable or fraudulent, or that the offeror had not complied with the statute's disclosure requirements. This expansive reach was crucial to the Court's holding that the local interests promoted by the statute were outweighed by the burden it imposed on interstate commerce. See *Edgar*, 457 U.S. at 643. Many other state statutes attempt to regulate offers outside the state by prohibiting an offeror subject to the state's jurisdiction from making an offer anywhere before complying with the state statute. See 1 M. Lipton & E. Steinberger, supra note 8, § 5.4, at 245. Such statutes often also require that the offer be made to all shareholders residing within the state and be made to resident and nonresident shareholders "on the same terms" or on "substantially" the same terms. Id. The effect of such provisions is to force nationwide compliance with the state statute, even if the offeror is willing to forgo offering in the state. See id.; cf. *Edgar*, 457 U.S. at 641 (opinion of White, J.) (contrasting nationwide scope of Illinois Act with permissible intrastate securities regulation imposed by blue sky laws); Levmore, Interstate Exploitation and Judicial Intervention, 69 Va. L. Rev. 563, 622-24 (1983) (same). But *Edgar* asserted that a state "has no legitimate interest in protecting nonresident shareholders." 457 U.S. at 644. This statement strongly suggests that to be constitutional, a state tender offer statute must operate only against the tender offer as made to offerees in that state, at least if the target is incorporated and based outside the state seeking to regulate the offer. Cf. id. at 645-46 (internal affairs doctrine cannot support general tender offer regulation, and in any event cannot justify state regulation of offers for corporations incorporated and based outside state); id. at 646-47 & n.* (Powell, J., concurring in part) (implying that state may have legitimate interest in protecting the management of locally based corporations).

The *Edgar* Court was explicitly skeptical about the quality of protection the Illinois statute afforded target shareholders. The Court noted that the Williams Act itself is designed to protect shareholders and that the further disclosure requirements Illinois sought to impose "may not substantially enhance the shareholders' ability to make informed decisions." Id. at 645 (citation omitted).

In Martin-Marietta Corp. v. Bendix Corp., 690 F.2d 558 (6th Cir. 1982), the court held that the plaintiffs would probably succeed in showing that the commerce clause principles explained in *Edgar* invalidated the Michigan Take-Over Offers Act, even if that act were interpreted to apply solely to Michigan residents. Id. at 566-67. The court reasoned that because shares owned by Michigan residents might be crucial to the success of an offer, the statute indirectly burdened interstate commerce. Id. at 567.

[22] See Bartell, supra note 20, at 521-26.

[23] See *Edgar*, 457 U.S. at 639-40 (opinion of White, J.).

supported by the target's management. Typically, these statutes regulate only hostile offers.[24] This inconsistent treatment conflicts with another basic assumption of the Williams Act, that of neutrality towards the desirability of tender offers.[25] The assumption suggests that hostile offers should be treated in the same way as other offers, or at least that hostile offers should not be burdened by special regulations merely to discourage them. Finally, some state statutes adopt a definition of the event that triggers regulation, the making of a tender offer, different from the general definition that emerges from the federal cases deciding what constitutes a tender offer within the meaning of the Williams Act.[26]

While the directors and officers of a target corporation may generally decide in their discretion whether to resist a tender offer,[27] they have a fiduciary obligation, defined primarily by state law,[28] to act in the best interests of the corporation. They owe the corporation duties of care and loyalty: they must exercise their judgment on its behalf and must subordinate their interests to those of the shareholders. In enforcing these duties, courts will not penalize directors for errors of judgment unless they are shown to have acted in bad faith.[29]

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[24] See Bartell, supra note 20, at 513-15.

[25] See *Edgar*, 457 U.S. at 633 (opinion of White, J.) ("[I]t is also crystal clear that a major aspect of the effort to protect the investor was to avoid favoring either management or the takeover bidder."). For a description of some state tender offer laws that arguably upset the balance between management and bidder through measures intended to promote equality among target shareholders, see note 86 infra.

[26] See Bartell, supra note 20, at 509-15. Two courts have invalidated, on commerce clause grounds, state statutes that regulated open market purchases as tender offers. See Telvest, Inc. v. Bradshaw, 697 F.2d 576, 579-82 (4th Cir. 1983) (Virginia Take-Over Bid Disclosure Act); Esmark, Inc. v. Strode, 639 S.W.2d 768, 774-75 (Ky. 1982) (Kentucky Take-Over Act).

[27] See Panter v. Marshall Field & Co., 646 F.2d 271, 296-99 (7th Cir.) (discussed in text accompanying notes 307-21 infra), cert. denied, 454 U.S. 1092 (1981); Altman v. Knight, 431 F. Supp. 309 (S.D.N.Y. 1977); Northwest Indus. v. B.F. Goodrich Co., 301 F. Supp. 706, 712 (N.D. Ill. 1969); Lipton, Takeover Bids in the Target's Boardroom; An Update After One Year, 36 Bus. Law 1017, 1017-22 (1981); Lipton, supra note 1, at 120-24.

[28] See W. Cary & M. Eisenberg, supra note 13, at 552-53; cf. Burks v. Lasker, 441 U.S. 471, 477-80 (1979) (state corporation law creates powers of directors in first instance, although federal law may limit exercise of those powers).

[29] See Arsht, The Business Judgment Rule Revisited, 8 Hofstra L. Rev. 93 (1979). Although Mobil Corp. v. Marathon Oil Co., 669 F.2d 366 (6th Cir. 1981), suggests that the Williams Act prohibits management from using some defensive devices in fending off hostile takeover offers, the authority of *Mobil* is questionable. See text accompanying notes 351-60 infra. For a discussion of the relation between this prohibition and the general discretion granted to management in conducting corporate affairs, see text accompanying notes 307-61 infra.

B. A Survey of Tender Offer Regulation in Great Britain

1. The Panel and the City Code

Unlike the American system, most British tender offer regulation is extralegal. Apart from The Licensed Dealers Rules[30] and a single section of the Companies Act of 1948,[31] most British regulation stems from The City Code on Take-overs and Mergers.[32] The City Code is administered and periodically revised by the Panel on Take-overs and Mergers, a nongovernmental entity that functions under the auspices of the Council for the Securities Industry.[33] The Panel was established in 1968 by the London Stock Exchange, the Bank of England, and the private banking community in an effort to quiet widespread criticism of the tactics that had characterized the intense tender offer activity of the mid-sixties.[34] In establishing the Panel, the financial industry sought to prevent legislation that might create a regulatory agency with the legal authority and aggressiveness of the American SEC.[35]

The Panel currently includes representatives of the Stock Exchange, the Confederation of British Industry, the clearing house, investment banks, and the insurance, investment company, and pension fund industries.[36] Revised and expanded since its adoption, the Code is interpreted and applied on a day-to-day basis by the Panel's executive, which is headed by a Director General.[37] Although a few

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[30] See The Licensed Dealers (Conduct of Business) Rules, 1960 Stat. Inst. 386 (Stat. Inst. No. 1216). The Board of Trade issued the rules under authority granted in the Prevention of Fraud (Investments) Act, 1958, 6 & 7 Eliz. 2, ch. 45, § 7. That act prohibits the distribution of tender offer circulars except through persons authorized by the act or by the Board of Trade. See id. §§ 1, 2, 14 (as amended). The rules forbid dealers to handle circulars for tender offers in which the bidder might gain majority control, see rule 18(1), 1960 Stat. Inst. 390, 390-91, if the circular does not disclose specified facts or if the transaction does not meet certain fundamental substantive requirements, see rules 1(d), 3, 4, 5, 17 & sched. 1 pt. II, sched. 2 paras. 1(1)(b), 2, sched. 3, 1960 Stat. Inst. 387, 390, 392-96. Other rules apply more broadly to transactions in securities, including tender offers. See generally L. Gower, J. Cronin, A. Easson & Lord Wedderburn, Gower's Principles of Modern Company Law 359-61 (4th ed. 1979) [hereinafter L. Gower, Modern Company Law].

[31] See Companies Act, 1948, 10 & 11 Geo. 6, ch. 47, § 209 (amended 1976) (discussed at notes 222-23 and accompanying text infra).

[32] The City Code on Take-overs and Mergers (Council for the Securities Industry 5th rev. ed. 1981) [hereinafter City Code].

[33] Id. at 5.

[34] See A. Johnston, The City Take-over Code 30-31, 37 (1980); E. Stamp & C. Marley, Accounting Principles and the City Code: The Case for Reform 17-19 (1970).

[35] See A. Johnston, supra note 34, at 41.

[36] See City Code, supra note 32, at 5.

[37] Id. at 7.

members of the executive staff are permanent employees, most are temporarily assigned to the executive office from permanent positions with entities represented on the Panel.[38] An offeror or an aggrieved shareholder may appeal decisions of the executive to the Panel. Under certain circumstances, parties may in turn appeal Panel decisions to a separate Appeal Committee composed of Panel members who have not yet heard the case.[39]

The Code applies to all tender offers in which British public companies, whether listed or unlisted on the Stock Exchange, are targets,[40] and thus covers many transactions that would fall outside much of the regulation imposed by the Williams Act.[41] The City Code's enforcement mechanisms, which are of necessity extralegal, assume that most participants in tender offer battles wish to remain actively engaged in British securities markets after the battle is over.[42] Thus, the Panel relies primarily on the coercive forces of adverse publicity and industry peer pressure.[43] At least in theory, the Panel may recommend that the Stock Exchange delist an offending compa-

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[38] See A. Johnston, supra note 34, at 127.

[39] City Code, supra note 32, at 8-10. The Panel's findings of fact and interpretations of the Code may not be appealed. Parties do have a right of appeal, however, if the Panel has proposed disciplinary action against them or if the Panel has allegedly acted outside its jurisdiction. The Panel may also consent to an appeal if its decision, although not strictly disciplinary in nature, would nonetheless inflict "serious hardship." Id. at 9.

[40] See City Code, supra note 32, at 6; A. Johnston, supra note 34, at 189-90. The fact that the City Code does not reach private target companies, some of which may be very large, has prompted criticism. See L. Gower, Review of Investor Protection 38 (1982) [hereinafter L. Gower, Investor Protection]. This general exclusion of private targets is subject, however, to one exception, namely, certain attempts by a small public company to take over a large private company. Such acquisitions are deemed "reverse takeovers" and are typically motivated by the desire to appropriate the publicly held company's listing on the London Stock Exchange for the merged enterprise. This exception applies when the offeror and those acting in concert with it will hold 30% or more of the voting rights of the public company if the offer is successful. A. Johnston, supra note 34, at 190.

[41] For discussion of what securities are covered by the reporting requirements of § 13(d) and § 14(d) of the Williams Act, 15 U.S.C. §§ 78m(d), 78n(d) (1982), see note 7 supra. Some other sections of the Act have broader application; § 14(e), 15 U.S.C. § 78n(e) (1982), for example, is a general prohibition on fraudulent, deceptive, or manipulative practices in connection with any tender offer.

[42] See Hew, The Anatomy of Regulation in the Securities Industry, in The Regulation of the British Securities Industry 9 (B. Rider ed. 1979).

[43] See A. Johnston, supra note 34, at 56-57. The Panel has not hesitated to reprimand, generally by public statement, individuals found to have violated the Code. Panel on Take-overs and Mergers, Report to the Committee to Review the Functioning of Financial Institutions 35 (1978) [hereinafter Panel Report]. Indeed, recognizing its dependence on adverse publicity as a sanction, the Panel has been forced to purchase libel insurance. A. Johnston, supra note 34, at 160.

ny's securities[44] or that other institutions which participated in the development of the Code refuse the use of their facilities to the offender.[45]

Most criticism of the Code and the Panel has focused on the Panel's lack of legal authority rather than on the substantive content of any of the Code's requirements.[46] For example, some critics have argued that the Panel failed in its efforts to regulate trading prompted by inside information about impending tender offers.[47] Rather than rely on the Panel's limited investigative and sanctioning authority, Parliament passed legislation making insider trading a crime.[48] The Panel has also met difficulty in controlling the conduct of individuals who are not deterred by available sanctions because they have little stake in their future ability to participate in the British financial industry.[49] Finally, the Panel has usually prohibited an abusive practice only after it has become a problem, and thus those who first devise a method to frustrate the purposes of regulation may be rewarded.[50]

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[44] Panel Report, supra note 43, at 35-36. Because the London Stock Exchange permits the listing of companies which are too small to be listed on major American exchanges, the threat of delisting is more broadly effective in Britain than it would be in the United States. Compare The [London] Stock Exchange, Requirements for Admission to the Official List § A, pt. I, para. 1 (minimum listing standards for most domestic companies requiring, inter alia, corporate market value of £500,000), reprinted in 2 C. Schmitthoff, M. Kay & G. Morse, Palmer's Company Law para. C-149 (22d ed. 1976) [hereinafter Palmer's Company Law] with New York Stock Exchange, Listed Company Manual § 102.01 (1983) (minimum listing standards for domestic companies requiring, inter alia, aggregate market value of publicly held shares of at least $16,000,000).

[45] Panel Report, supra note 43, at 34-36; see City Code, supra note 32, at 5-6.

The threatened use of private or informal sanctions to reinforce "public" regulation is not restricted to Britain. In Japan, although the Ministry of International Trade and Industry has only limited statutory enforcement authority, informal incentives and disincentives can induce companies to follow the Ministry's suggestions because it passes on applications for new facilities and influences decisions about government contracts and subsidies, tax deductions, and loans made by the Bank of Japan. See Ramseyer, Japan's Myth of Litigiousness, Nat'l L.J., July 4, 1983, at 13, col. 3.

[46] See Committee to Review the Functioning of Financial Institutions, Report 314 (1980); P. Davies, The Regulation of Take-overs and Mergers 45 (1976); L. Gower, Investor Protection, supra note 40, at 36; B. Rider & H. Ffrench, The Regulation of Insider Trading 207 (1979); Kempe, London Exchange Moves to Curb Cads, Wall St. J., June 4, 1981, at 31, col. 1.

[47] See A. Johnston, supra note 34, at 161-63.

[48] Companies Act, 1980, ch. 22, §§ 68-73. See generally M. Weinberg, M. Blank & A. Greystoke, Weinberg and Blank on Take-overs and Mergers paras. 2301-2304 (4th ed. 1979) [hereinafter Weinberg & Blank].

[49] See Kempe, supra note 46.

[50] See T. Hadden, Company Law and Capitalism 387 (2d ed. 1977). Since the City Code may be amended easily, however, its rules can be tailored to respond to specific abuses, thereby reducing the risk of regulatory overkill. See Prentice, Take-Over Bids and the System of Self-Regulation, 1 Oxford J. Legal Stud. 406, 412 (1981).

In response to these criticisms, the Panel's defenders have argued that comprehensive systems of governmental regulation modeled on the United States securities laws would sacrifice the chief virtues of the City Code. The Panel's reluctance to pass broad prohibitions addressing potential problems that have not yet arisen or caused substantial market difficulties has enabled the Panel to respond flexibly and specifically to questionable practices, in light of actual knowledge of the market disruption involved.[51] Similarly, the cumbersome and expensive governmental proceedings that would almost inevitably be required to impose fines or other official penalties might compromise the efficiency and speed that characterize Panel deliberations. Moreover, the Panel takes the position that, as an extralegal entity, it can insist on compliance with the spirit as well as the letter of the Code.[52] By contrast, "[i]n a statutory system those concerned are entitled to exercise their ingenuity in so ordering their affairs as to avoid the application of prohibitory or inconvenient rules."[53] To discourage the employment of counsel for the purpose of devising evasions of the Code, the Panel has recently emphasized that the Code is not a statute and that the Panel, rather than private counsel, is the only reliable source of interpretations of the Code.[54]

Tensions are inevitable in a private entity like the Panel that regulates the industry from which its members are drawn. To maintain the confidence of the investing public and to forestall direct governmental regulation, the Panel must appear independent and vigorous in policing industry practices. On the other hand, the Panel's ability to operate flexibly and cheaply is derived from its position in the industry, and that very position may undermine its ability to further goals beyond the short-run interests of industry participants. Similarly, the Panel's informal procedures, although useful in many respects, may make its independence and regulatory vigor appear to be more the traits of particular personnel than of the Panel as an institution.[55]

The extragovernmental character of British takeover regulation has also affected the interplay between takeover rules and the legal

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[51] See A. Johnston, supra note 34, at 176. But see Davies, An Affair of the City: A Case Study in the Regulation of Take-overs and Mergers, 36 Mod. L. Rev. 457, 476-77 (1973).

[52] The Panel on Take-overs and Mergers, Report on the Year ended 31st March 1973, at 3.

[53] Id.

[54] The Panel on Take-overs and Mergers, Report on the Year ended 31st March 1980, at 12-13.

[55] See Self-Control in the City, The Economist, July 2, 1983, at 18 (attributing Panel's reputation for independence, in part, to individual officers).

system. As a private association, the Panel cannot seek injunctions in British courts to enforce compliance with its rules and directives.[56] Further, a British authority on the City Code views it as "unlikely in the extreme" that English courts would impose civil liability to compensate parties injured by violations of the Code.[57] Although the courts have found the Code to represent "a convenient statement of the best City practice,"[58] the view English courts take of the City Code is simply not analogous to that which federal courts take of the securities laws and SEC rules they enforce. Indeed, the Panel in interpreting and enforcing the Code appears to operate with nearly total autonomy from the English judicial system.

Unsurprisingly, lawyers play a modest role in British takeovers. In proceedings before the Panel, parties may be accompanied by advisers of their choice and may call witnesses, but the Panel's "normal practice [does not] allow full representation by legal advocates," and its proceedings are informal with no formal rules of evidence.[59] The Panel's insistence that it is the only reliable interpreter of the City Code[60] limits the usefulness of advice that lawyers might give clients concerning the applicability of Code provisions to proposed transactions. Finally, the Panel's manifest distaste for lawyers' ability to maneuver around rules is inconsistent with vigorous advisory or advocacy roles for lawyers in takeover transactions.[61]

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[56] P. Davies, supra note 46, at 43; see also note 381 infra.

[57] P. Davies, supra note 46, at 43.

[58] A. Johnston, supra note 34, at 148 (referring to Hinchcliffe v. Crabtree, 1972 A.C. 725, 730 (1971) (opinion of Lord Reid), and Dunford & Elliott Ltd. v. Johnson & Firth Brown Ltd., [1977] 1 Lloyd's L.R. 505, 510 (C.A. 1976) (opinion of Lord Denning, M.R.)).

[59] City Code, supra note 32, at 9.

[60] See text accompanying note 54 supra.

[61] In contrast, in the United States the lawyer's role in takeovers is much more prominent. There are many anecdotal accounts of lawyers acting as strategic quarterbacks during tender offers and earning munificent fees in the process. See, e.g., J. Stewart, The Partners 248-50 (1983); Brill, Inside the Conoco Fight, Am. Law., Nov. 1981, at 39; Kohn, DuPont Takeover: Lawyers' Big Pay Day, N.Y.L.J., Aug. 7, 1981, at 1, col. 2. The conventional wisdom is that top securities lawyers possess business acumen as well as legal skills. See Wise, A Who's Who of Securities Lawyers, N.Y.L.J., July 19, 1983, at 1, col. 2. All the same, lawyers' work to advance or defeat a takeover may be for naught, because "[n]ot even the best, and most expensive lawyers can stop the resolute flow of cash." J. Stewart, supra, at 282.

The less prominent role played by lawyers in British financial transactions has been attributed to a number of factors, including the education received by prospective solicitors and the profession's persistent distaste for mastering the intricacies of taxation and corporate finance. Accountants and bankers, but usually not lawyers, became business advisors of the first order. See, e.g., M. Birks, Gentlemen of the Law 280-81 (1960); A. Sampson, Anatomy of Britain Today 163 (1965); cf. Report of the Committee on Legal Education 174 (1971) ("[F]ar more than in this country, the American law schools have seen their role as the formation of a public and commercial *élite* . . . ."). Another cause may be the British profession's historical conservatism;

The structure of the City Code is straightforward. It begins with fourteen general principles[62] intended to delineate basic standards of acceptable commercial conduct.[63] These are followed by thirty-nine rules,[64] which demonstrate application of the general principles and explain the procedures to be followed in initiating a tender offer.[65] Where no rule explicitly covers a particular circumstance, individuals are expected to conform their conduct to the general principles and the overall spirit of the Code.[66]

2. *The Basic Goals of the City Code*

Although the Panel has never adopted a definitive statement of the City Code's purposes, the Code appears to be structured around four basic goals: (1) assuring disclosure to shareholders and the investing public of information relevant to their financial decisions; (2) achieving equality in the treatment of target company shareholders; (3) preventing target management from frustrating the offer; and (4) assuring that the market in target shares is not restricted.

a. Disclosure. Apart from the basic disclosure requirements of the Companies Acts,[67] most corporate disclosure in Britain is mandated by the City Code and the London Stock Exchange, and not by statute. For example, all listing agreements with the Stock Exchange impose substantial periodic reporting requirements comparable, in many respects, to those of the Securities Exchange Act.[68] The City Code, like the Williams Act, requires extensive disclosure by tender offerors to encourage informed decisions by target company shareholders and reliable pricing of the target stock by the market.[69] The offering document sent to target shareholders must contain "all the

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solicitors were so intensely concerned to maintain their traditional monopoly over home conveyancing that more lucrative opportunities in taxation and corporate finance went by default to the bankers and accountants. See A. Sampson, The Changing Anatomy of Britain 151 (1982).

[62] See City Code, supra note 32, at 14-16.

[63] Id. at 6. To aid the securities industry in its understanding of the City Code, in 1969 the Panel began publishing practice notes explaining the Panel's "current interpretation" of the more difficult Code provisions. See The Panel on Take-overs and Mergers, Report on the Year ended 31st March 1970, at 7. The Panel stressed, however, that the practice notes are not intended to supplant the Code and that the Panel will not be bound by the notes in its future application of the rules. Id.

[64] See City Code, supra note 32, at 17-36.

[65] Id. at 6.

[66] Id. at 14; see A. Johnston, supra note 34, at 195-96.

[67] See generally L. Gower, Modern Company Law, supra note 30, at 350-59, 368-69, 386-91; note 48 and accompanying text supra.

[68] See L. Gower, Modern Company Law, supra note 30, at 505-06.

[69] See City Code, supra note 32, general principle 3 & rules 8, 13-15, 17, 19.

facts necessary for the formation of an informed judgment as to the merits or demerits of an offer."[70] In addition, offerors must normally disclose any existing holdings in the target company at the time of the bid, their plans for the offeree's business and employees, and their "long-term commercial justification for the proposed offer."[71] Like the SEC, the Panel is not permitted to pass on the merits of offers.[72]

Despite these similarities, the Panel's attitude towards disclosure of two items of information, profit forecasts and asset valuations, has differed markedly from the SEC's historic squeamishness about such disclosure.[73] The City Code does not require the target management to prepare or to disclose previously prepared profit forecasts. Management may, however, disclose this information to its shareholders, provided that the target's auditors examine and report on the forecasts, and that the forecasts are prepared with "the greatest possible care" and are accompanied by statements of the assumptions upon which they are based.[74] Similarly, statements about the value of assets must clearly describe the basis of valuation and must include both the name of the appraiser and a statement that the appraiser still agrees that the valuation may be publicly attributed to it.[75]

b. Shareholder Equality and Mandatory Bids. The Code goes much further than the Williams Act in attempting to promote equality among target company shareholders. Several Code provisions are designed to accomplish this end. Rule 34 requires that, if any person or any persons acting in concert accumulate thirty percent or more of a company's voting securities—whether through a formal tender offer or any other transactions—that person or those persons must offer to purchase all of the remaining shares.[76] The mandatory bid must be at the highest price paid for target shares by the offeror within the preceding twelve months, even if the market price of the shares has

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[70] Id. rule 15(1).

[71] Id. rules 8, 15(2), 17(1).

[72] Id. at 5.

[73] See H. Kripke, The SEC and Corporate Disclosure 75-82 (1979). SEC rule 175(a), 17 C.F.R. § 230.175(a) (1983), provides a safe harbor protecting against liability for disclosure of projections and other forward-looking information unless they are made "without a reasonable basis or . . . disclosed other than in good faith." Id.

[74] See City Code, supra note 32, rule 16. In contrast, the safe-harbor provision of SEC rule 175, 17 C.F.R. § 230.175 (1983), does not always require the disclosure of supporting assumptions, although disclosure of key assumptions may sometimes be necessary. See SEC Securities Act Release No. 6084, 44 Fed. Reg. 38,810, 38,812 & n.13 (1979) (adopting rule 175).

[75] City Code, supra note 32, rule 16(3).

[76] Id. rule 34. The Panel may excuse a purchaser from the mandatory bid obligation. Id. rule 34(1).

since dropped.[77] If consideration other than cash is offered, such as securities of the offeror entity, a cash alternative equal to the highest price paid over the preceding twelve months must be offered.[78] Rule 36 prohibits, except with the Panel's consent, an offeror from purchasing target stock during an offer on favorable terms not available to all stockholders.[79]

The enforcement of shareholder equality under rule 34 is strengthened by the Code's treatment of partial bids, i.e., bids for less

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The extension of the mandatory bid obligation to persons acting in concert with the offeror means that persons who do little actual purchasing and who have very small holdings may nonetheless be required to make an offer, which can be an extremely onerous financial obligation. The City Code's definition of "acting in concert" covers "persons who, pursuant to an agreement or understanding (whether formal or informal), actively co-operate, through the acquisition by any of them of shares in a company, to obtain or consolidate control." Id. at 11. Persons presumed by the Code to have such a relationship with an offeror company include its subsidiaries, directors, or pension funds. Id. The rule 34 obligation does not normally apply to persons who have purchased shares without the knowledge of other shareholders or potential shareholders and subsequently agree to act in concert. Id. practice note no. 15. If the combined shareholdings of such persons, before they agreed to act in concert, were below 30%, the rule 34 obligation applies if after agreement the group buys enough additional shares to reach 30%. Id. practice note no. 15(1)(a). If the previous shareholdings were between 30% and 50%, the obligation applies if the group buys more than a further 2% in any 12 month period. Id. practice note no. 15(1)(b).

In GAF Corp. v. Milstein, 453 F.2d 709 (2d Cir. 1971), cert. denied, 406 U.S. 910 (1972), the court of appeals held that shareholders who combine to seek corporate control may be subject to the disclosure requirements applicable to groups under § 13(d)(3) of the Williams Act, even if no group member agreed to purchase or purchased any additional shares after joining the group. See 453 F.2d at 715-19. But see Bath Indus. v. Blot, 427 F.2d 97, 109 (7th Cir. 1970). See generally Advisory Committee Report, supra note 1, at 24 (recommending that SEC "strengthen the concept and definition of 'group' or concerted activity").

[77] City Code, supra note 32, rule 34(4).

[78] Id.

A related City Code provision states that if an offeror has acquired, through any means, more than 15% of a target's securities during the 12 months preceding an offer, its offer must be in cash or with a cash alternative to other consideration offered, at the highest price paid for the prior acquisitions. Id. rule 33. The Panel normally will not allow the deduction of shares sold over the 12-month period from those purchased in calculating whether the rule has been triggered. See id. practice note no. 14(1). The Panel may, however, sometimes consent to deduction of "shares sold some considerable time before the beginning of the offer period." Id.

[79] City Code, supra note 32, rule 36. In one situation, the responsibility of assuring that the purchaser fulfills its rule 34 mandatory bid obligation falls on the directors of the target corporation. If the directors sell 30% or more of the target's shares to the purchaser and thus are conclusively presumed to have transferred effective control, the sale must be conditioned on the purchaser's compliance with the mandatory bid requirement imposed by rule 34. Id. rule 11. Such a sale is termed a "shut-out" bid. See A. Johnston, supra note 34, at 79, 96. In addition, selling directors may not, without the Panel's consent, resign from the target board until the offer to the other shareholders is completed. City Code, supra note 32, rule 11. This prohibition was added to the City Code to assure that target stockholders are not left to fend entirely for themselves if the directors sell their effective control to a purchaser who is disinclined or unable to make the mandatory bid for the remaining shares. See A. Johnston, supra note 34, at 227.

than all of the target's shares. Under rule 27, the Panel's consent is required for any partial bid, and it is most likely to consent to bids that would result in the offeror acquiring less than thirty percent of the target's securities.[80] Consent is unlikely to be granted if the offeror proposes to acquire thirty percent or more and has acquired significant numbers of target shares in the preceding twelve months or has acquired shares "selectively,"[81] such as from directors of the target. Any bid for more than thirty percent of the target's shares must be approved by a majority of the shares not held by the offeror or persons acting in concert with it.[82] The City Code thus particularly disfavors bids for between thirty and fifty percent of a target's stock. Both rule 34 and rule 27 assume that an acquisition of thirty percent is ordinarily sufficient to transfer effective control of the target, unless another shareholder or group of shareholders controls enough stock to enable it or them to defeat the thirty percent holder's nominees for the board.[83] Voting or legal control requires a holding of more than fifty percent of the shares, unless the company's charter or bylaws require a greater percentage. The exercise of effective control by a shareholder owning less than a majority thus requires the assent of sufficient stockholders to make up the difference. The City Code's hostility to partial bids that would result in effective control but not in voting control may be rooted in a distaste for divorcing working control over the company's assets from the majority vote norm of corporate governance,[84] while reflecting as well the opposition to cheap sales of control implicit in rule 34.

The effect of the mandatory bid and partial bid rules is to limit drastically the availability of premium prices for control stock. Once thirty percent has been acquired, all target stockholders must be given the opportunity to sell at the highest price realized by prior sellers, whether the thirty percent was acquired through a formal tender offer

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[80] City Code, supra note 32, rule 27. The City Code's drafters originally believed that partial bids should be prohibited because "a shareholder should not be left locked into a company in a minority position without his consent." See Panel Report, supra note 43, at 39. The City Code has since been modified, however, in response to the view that partial bids might be the only ones feasible for some offerors. See A. Johnston, supra note 34, at 254.

[81] City Code, supra note 32, rule 27(3).

Acquisitions of between 30% and 50% of the target's stock may be approved if the offeror can give good reasons for not making an offer for statutory voting control. A possible example is an offer made by a foreign concern wishing to acquire a stake in a British company while retaining existing management. See Weinberg & Blank, supra note 48, para. 991.

[82] City Code, supra note 32, rule 27(7).

[83] See Weinberg & Blank, supra note 48, paras. 905-906.

[84] For an expression of this distaste in an American case, see Essex Universal Corp. v. Yates, 305 F.2d 572, 581 (2d Cir. 1962) (Friendly, J., dissenting) (contract for sale of 28.3% of public company's stock with clause permitting purchasers to require directors' resignation "violates basic principles of corporate democracy").

or through stock market or private purchases. Once the thirty percent threshold has been reached, target stockholders who are closer to the market, or who own large blocks of stock, enjoy no price advantage over their co-owners. Coupled with the City Code's treatment of partial bids, rule 34 increases the cost of acquiring control, by opening the opportunity to sell to all stockholders, and by discouraging the transfer of effective voting control through the sale of less than a majority of the target's shares.

In contrast to rules 27 and 34, the provisions in the Williams Act that appear to reflect similar concerns for equal treatment of target shareholders are of more modest import. Section 14(d)(6) requires that if a partial bid is oversubscribed, shares must be accepted from each tendering shareholder on a pro-rata basis, according to the number of shares tendered within the first ten days after publication of the offer.[85] The pro-rata acceptance requirement prevents the offeror from discriminating among shareholders who tender within the first ten days based on the order in which they tendered (a "first come, first served" principle) or on the relative number of shares tendered by individual stockholders. The requirement thus preserves an important purpose of the mandate that the offer remain open for a minimum period: By preventing the stampede effect of a first come, first served partial offer, the pro-rata requirement prevents offerors from penalizing shareholders who need the initial ten-day period to consider all the disclosed information before deciding whether to tender. The pro-rata requirement also discourages discrimination in favor of large and well-informed shareholders, who can respond promptly to first come, first served offers and who are obviously favored as well if an offeror accepts the largest blocks of stock tendered first.[86] In addition, section

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[85] Williams Act § 14(d)(6), 15 U.S.C. § 78n(d)(6) (1982). The City Code requires proration in the event of oversubscribed partial bids, but without any time limitation. See City Code, supra note 32, rule 27(4).

For a discussion of the SEC's adoption of a rule requiring proration throughout the duration of an offer, see note 230 and accompanying text infra.

[86] Some state tender offer statutes go beyond the Williams Act in attempting to require equality of treatment for target shareholders. See A. Johnston, supra note 34, at 177. For example, a Hawaii statute prohibits offers for less than all the shares of a class, thereby outlawing partial bids. Hawaii Rev. Stat. § 417E-2(3) (1976). Massachusetts formerly required that all shares tendered in response to a partial offer be accepted. Mass. Ann. Laws ch. 110C, § 7 (1976). The statute, as amended, now merely requires prorated treatment in oversubscribed partial bids. Mass. Ann. Laws ch. 110C, § 7 (Michie/Law. Coop. Supp. 1982). In Unitrode Corp. v. Dynamics Corp. of Am., 379 Mass. 487, 399 N.E.2d 5 (1980), the Supreme Judicial Court of Massachusetts held that this statute did not confer a private cause of action on a target corporation. A recently enacted Maryland statute requires that specified transactions between a Maryland corporation and an "interested stockholder," which the statute defines to include the beneficial owner of shares conferring 10% or more of the voting power, be subject to the approval of the board of directors and of both 80% of the corporation's shareholders and two-thirds of the shareholders other than the interested shareholder and his associates. See Act of June

14(d)(7) requires that shareholders who have tendered must be paid any increase if the offeror subsequently raises its price.[87]

Despite these provisions, the Williams Act clearly does not promote shareholder equality nearly so vigorously as does the Code.[88] Although the Code's more aggressive measures obviously burden tender offers, those offers have nonetheless been made in large numbers under the Code. One cannot, of course, determine how many potential bids were stifled by the Code's requirements. But in assessing the practical consequences of similar reforms in the United States, one should remember that the costs the Code exacts to further shareholder equality have clearly not eliminated incentives to seek control.[89]

c. Target Management. The City Code contains provisions designed to increase the likelihood that the shareholders of the target corporation will have the opportunity to decide independently of management whether the offer is meritorious. The Code promotes independent shareholder review by significantly reducing the target

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21, 1983, sec. 1, §§ 3-601(E), (J)(1)(I), 3-602, 1983 Spec. Sess. (to be codified at Md. Corps. & Ass'ns Code Ann. §§ 3-601(E), (J)(1)(I), 3-602). Shareholder and director approval is not required if the transaction meets a complex formula set forth in the statute to determine whether a fair price is being offered. Id. § 3-603(B) (to be codified at Md. Corps. & Ass'ns Code Ann. § 3-603(B)). The statute generally requires successful tender offerors who become interested stockholders to pay remaining shareholders in any subsequent merger-type transaction at least the value per share paid in the tender offer. In contrast, an Ohio statute requires, in the absence of a contrary charter provision, the prior consent of a public corporation's shareholders for "control share acquisitions." Ohio Rev. Code Ann. § 1701.831(A) (Page Supp. 1982). Control share acquisitions are those which, when added to any shares that the acquirer may already vote, would entitle the acquirer to exercise at least one fifth of the corporation's voting power in the election of directors. See id. § 1701.01(Z)(1). Recent Pennsylvania legislation requires any person acquiring 30% or more of a company's stock without the approval of its directors to offer to buy the remaining stock at market value. Act of Dec. 23, 1983, P.N. 1597, Act No. 92; see 16 Sec. Reg. & L. Rep. (BNA) No. 2, at 88 (1984) (reporting enactment). This statute differs from the buy-out provision of the City Code in its exception for acquisitions approved by the target's directors and in its pricing mechanism. See City Code, supra note 32, rule 34.

[87] Williams Act § 14(d)(7), 15 U.S.C. § 78n(d)(7) (1982).

[88] See A. Johnston, supra note 34, at 178. The SEC has proposed a rule that would enforce the assumptions of the Williams Act favoring equality by requiring, except in certain offers by the issuer of the securities sought, that all tendering shareholders be paid the same price for their shares, and that a tender offer be made to all owners of the class of securities that is the target of the offer. See SEC Securities Act Release No. 16,385, 44 Fed. Reg. 70,349, 70,355, 70,359 (1979) (proposing SEC rule 14e-4).

[89] The Panel maintains records of the volume of bids subject to its regulation which are made each year. Between 1969 and 1979, offer documents for a total of 2,936 bids were circulated. The largest number of bids, 420, was made in 1969, the smallest, 139, in 1976. See A. Johnston, supra note 34, at 126. Ideally, one would want to compare these figures with statistics concerning bids made before the City Code took effect. However, the information available about pre-Code bids does not distinguish among transactions on the basis of whether they would have been governed by the Code had it been in effect at the time. See id. at 8-18; Stewart, Mergers and the Institutional Environment in the United Kingdom 1960-1970, 6 Acct. & Bus. Research 57 (1976).

management's discretion to engage in defensive maneuvers that effectively keep the offer away from the stockholders. If the target board receives a communication proposing a negotiated takeover, it need not respond.[90] However, once a potential purchaser makes an offer directly to the target shareholders, or once such an offer appears imminent, rule 38 prohibits the target board from taking specified actions without shareholder approval. The prohibited actions include issuing authorized but previously unissued shares; granting options on unissued shares; issuing convertible securities; agreeing to sell or acquire assets in any material amount; or entering into contracts outside the ordinary course of business, unless any of these transactions are conducted pursuant to a previously incurred contractual obligation, itself a circumstance subject to Panel review.[91]

Furthermore, once an offer is made, rule 4 requires that the target company's board obtain competent independent advice about the offer and disclose the substance of that advice to shareholders.[92] The Code does not prohibit the target board from seeking a more acceptable bidder—a "white knight"—and encouraging it to bid, but rule 12 requires that information given by the target to the white knight be made available to less welcome but bona fide offerors.[93] However, all of these restrictions apply only when an offer has been made or appears to be imminent; the target's ability to construct defensive fortifications prior to battle is almost as unrestrained in Britain as it is in the United States.

Despite this limitation, these rules substantially restrict the target management's ability to ward off hostile tender offers. The Code's approach to defensive transactions contrasts sharply with the American common law treatment, in which courts examine such transactions only to determine whether their consummation would constitute a breach of the fiduciary duty owed by the target board and management to shareholders.[94]

d. Market Purchases. The City Code does not generally restrict trading in a target corporation's securities during a tender offer, on the theory that the market price will indicate the value of the shares

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[90] The provisions of the City Code that restrict the discretion of target directors apply only after an offeror makes a "bona fide offer" or announces its intention to do so. See text accompanying note 91 infra. Many preliminary contacts or inquiries are insufficiently definite to qualify as offers.

[91] City Code, supra note 32, rule 38.

[92] Id. rule 4.

[93] Id. rule 12.

[94] For a discussion of the American and British treatment of defensive tactics, see text accompanying notes 300-421 infra.

more accurately if they are actively traded.[95] To encourage accurate market valuation, the Code permits stock market transactions in the target's stock by all parties to the offer, including the offeror and its associates.[96] Thus, unlike the American practice, the offeror is not restricted to acquiring target shares under the offer once an offer has been made. It may purchase target securities in the market and is merely required to disclose the amount of the purchases by the next day to the Panel, the stock exchange, and the press.[97] However, if in any market purchase the offeror pays a price per share higher than the offer price, the offeror must raise the offer to that price.[98] In addition, offerors who make partial bids and persons acting in concert with them are prohibited from making market purchases during the offer period.[99]

Permitting the offeror to make market acquisitions while its offer remains open obviously enhances its strategic flexibility. The offeror can increase its holding of target stock more quickly and surely than it could if it were restricted to acquisitions solely under the tender offer.[100]

Together, these City Code rules produce a system of regulation more aggressively committed to shareholder control and equality among shareholders than is tender offer regulation in the United States. In the following three Parts, this Article explores these differences as they manifest themselves in three central and highly controversial areas of tender offer regulation: in the British and American definitions of a tender offer, in the extent to which the two systems seek to assure fair treatment of shareholders, and in their toleration of target management's efforts to defeat offers through certain defensive maneuvers.

II

THE DEFINITION OF TENDER OFFERS

How to determine whether a particular transaction constitutes a tender offer is a central issue for any tender offer regulatory scheme,

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[95] See A. Johnston, supra note 34, at 66-69.

[96] City Code, supra note 32, rule 31(1).

[97] Compare id. rule 31 with SEC rule 10b-13, 17 C.F.R. § 240.10b-13 (1983), which prohibits an offeror from purchasing target securities "otherwise than pursuant" to its tender offer once the offer has been publicly announced or been made known to its offerees, until after the offer expires.

[98] City Code, supra note 32, rule 32(1).

[99] Id. rule 27(5). Rule 27(5) also prohibits successful partial offerors and persons acting in concert with them from making market purchases of target shares within 12 months after the close of the offer period except with the Panel's consent. Id.

[100] See Weinberg & Blank, supra note 48, para. 13111.

since this determination establishes when compliance with the regulatory provisions is required. In the United States, the penalties for noncompliance can be formidable,[101] making the definitional question one of substantial practical as well as analytic import. This Part argues that unlike the City Code, the Williams Act makes the process of determining whether a transaction is a tender offer unnecessarily awkward.

A. Defining "Tender Offer" Under the Williams Act

Under the Williams Act, three consequences follow from a determination that an offer to purchase securities constitutes a tender offer. First, if the tender offer is to purchase an equity security subject to registration under the Securities Exchange Act and the offeror would thereby become the owner of more than five percent of a class of such security, the offeror must file a disclosure statement contemporaneously with the communication of the offer to stockholders.[102] Second, a tender offer is subject to the antifraud provision of the Williams Act[103] in addition to the general antifraud protections of the Securities Exchange Act.[104] Third, shareholders who accept a tender offer have protective rights not granted to other sellers by the securities laws. They have the right to withdraw tendered shares within the time periods specified by the statute and SEC rules.[105] Tendering shareholders also have the right to receive the highest price paid by the offeror if the consideration for the offer is increased after they have tendered their shares.[106] In addition, the offeror must purchase a pro-

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[101] American courts have a powerful remedial arsenal to correct violations of the Williams Act. Under certain circumstances, they may, for example, require amendment of offering documents, extend the minimum duration and withdrawal period of an offer, or even enjoin an offer altogether and require a new offer with proper disclosure, possibly after some minimum interval from the improper offer. See generally 1 M. Lipton & E. Steinberger, supra note 8, §§ 3.1.3, at 180-81, 3.4 (citing cases and discussing equitable relief for disclosure violations). In Mosinee Paper Corp. v. Rondeau, 500 F.2d 1011, 1017 (7th Cir. 1974), rev'd on other grounds, 422 U.S. 49 (1976), the court of appeals instructed the district court to enjoin a purchaser from voting stock for five years to remedy a violation of § 13(d). The Supreme Court held that the court of appeals erroneously failed to apply the traditional standards for equitable relief, including a showing of irreparable harm, to a private action under § 13(d). 422 U.S. at 64-65. The Court thus declined to decide the general propriety of the relief ordered by the court below. Id. at 59 n.9.

[102] Williams Act § 14(d)(1), 15 U.S.C. § 78n(d)(1) (1982).

[103] Id. § 14(e), 15 U.S.C. § 78n(e) (1982).

[104] Securities Exchange Act of 1934, § 10(b), 15 U.S.C. § 78j(b) (1982).

[105] Williams Act § 14(d)(5), 15 U.S.C. § 78n(d)(5) (1982); SEC rule 14d-7, 17 C.F.R. 240.14d-7 (1983).

[106] Williams Act § 14(d)(7), 15 U.S.C. § 78n(d)(7) (1982).

rata portion of shares tendered by each stockholder.[107] Since the definition of a tender offer will determine what events trigger the operation of these provisions, that definition should reflect the underlying policies of the Williams Act. These policies, then, should be examined and their potential inconsistencies understood.

The disclosure provisions[108] recognize the significance, to target shareholders and to the market generally, of information about large purchases of shares and about plans to seek control of the target corporation. This information obviously affects the market price of the target's stock.[109] Furthermore, by requiring disclosure at the time a tender offer is first communicated, information becomes available to the public and to shareholders before they must decide the merits of an offer. The availability of the information facilitates informed decisionmaking by target company stockholders, who may decide to tender their shares, to sell them in the market, or to retain them.[110] The publicity given the disclosed information may also attract other bidders for the target, if only by informing potential rivals that they must move immediately to prevent another from acquiring the target, and by advertising the fact that at least one bidder considers the target attractive. In short, the offeror must make specific disclosures at the outset of the offer—a requirement that is justified by the usefulness of the disclosed information to individual stockholders and to the investment market generally.[111]

The justifications for the Williams Act prohibition on fraudulent, deceptive, or manipulative activity in connection with tender offers[112] are similar. Typically, fraud involves materially false or misleading

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[107] Id. § 14(d)(6), 15 U.S.C. § 78n(d)(6) (1982).

[108] See note 102 and accompanying text supra.

[109] The legislative history of the Williams Act reflects the assumption that this kind of information is significant to the target's market price. See S. Rep. No. 550, 90th Cong., 1st Sess. 3 (1967).

[110] See S. Rep. No. 550, 90th Cong., 1st Sess. 3 (1967); see also Rondeau v. Mosinee Paper Corp., 422 U.S. 49, 58 (1975).

[111] Some doubt has been cast on the usefulness of the information disclosed to target shareholders. See H. Kripke, supra note 73, at 267-71. Nonetheless, the justification for the disclosure provisions of the securities laws, e.g., Securities Act of 1933, § 5, 15 U.S.C. § 77e (1982); Securities Exchange Act of 1934, § 12(a), 15 U.S.C. § 78*l*(a) (1982), clearly stems from the presumed benefits to stockholders and to the market. Informed investor decisionmaking is the cornerstone of the entire federal securities law scheme. See SEC v. Ralston Purina Co., 346 U.S. 119, 124 (1953) ("The design of the statute is to protect investors by promoting full disclosure of information thought necessary to informed investment decisions."(footnote omitted)); S. Rep. No. 550, 90th Cong., 1st Sess. 3 (1967).

[112] Williams Act § 14(e), 15 U.S.C. § 78n(e) (1982).

statements by the offeror to target shareholders.[113] Although the case law is inconsistent and unsettled concerning the proper definition of manipulation under the Williams Act, the cases agree that the evil of manipulative activity is in its artificial distortion of the market's pricing actions.[114] Individual stockholders who decide to tender or not to tender in consequence of a violation of this provision may apparently recover damages.[115] The provision also promotes the less direct interest of the investment community at large as potential purchasers of target shares.

Unlike the disclosure and antifraud provisions of the Williams Act, the special protective rights granted to shareholders appear to be motivated by a concern peculiar to large-scale takeover bids: the fear that target company shareholders may make improvident and hasty decisions if they are given too little time to evaluate the offer. When an offer is first made, target shareholders do not know whether the bid will succeed, whether the bidder will raise its offering price, or whether other bidders will create an auction for the target company's shares.[116] The right to withdraw shares permits shareholders to correct unwise decisions within the stated time period. The right of withdrawal thus allows shareholders time to benefit from disclosed information. Moreover, withdrawal rights effectively lengthen the time the offer must remain open, and thus slow down the offer process. This delay may encourage an auction by giving competing bidders time to enter the market and by enabling shareholders to withdraw tenders from the first offeror and to commit those shares to the later bidder.[117]

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[113] See, e.g., Grumman Corp. v. LTV Corp., 527 F. Supp. 86, 98-99 (E.D.N.Y.), aff'd on other grounds, 665 F.2d 10 (2d Cir. 1981); cf. Santa Fe Indus. v. Green, 430 U.S. 462, 474-76 (1976) (discussing what practices are deceptive under § 10(b) of the Securities Exchange Act of 1934).

[114] Compare Data Probe Acquisition Corp. v. Datatab, Inc., [Current] Fed. Sec. L. Rep. (CCH) ¶ 99,569, at 97,240 (2d Cir. Nov. 22, 1983) (§ 14(e) does not authorize federal courts "to review the substantive validity of corporate actions undertaken during the course of a tender offer"; misrepresentation is essential element of § 14(e) claim), petition for cert. filed, 52 U.S.L.W. 3512 (U.S. Dec. 21, 1983) (No. 83-1023) and Buffalo Forge Co. v. Ogden Corp., 717 F.2d 757 (2d Cir.), cert. denied, 104 S. Ct. 550 (1983) with Mobil Corp. v. Marathon Oil Co., 669 F.2d 366, 375-77 (6th Cir. 1981) (even fully disclosed devices that place an "artificial ceiling on the value [target] shareholders can receive for their shares" may violate § 14(e)).

[115] See Smallwood v. Pearl Brewing Co., 489 F.2d 579, 596 & n.20 (5th Cir.) (private plaintiff in § 14(e) action need not be purchaser or seller of securities, but "may gain standing if he has been injured by fraudulent activities of others perpetrated in connection with a tender offer" (citations omitted)), cert. denied, 419 U.S. 873 (1974); see also Piper v. Chris-Craft Indus., 430 U.S. 1, 26-32 (1977) (apparently accepting, without expressly ruling on issue, implied cause of action under § 14(e) by target company shareholders).

[116] See S. Rep. No. 550, 90th Cong., 1st Sess. 2, 10 (1967).

[117] See Bebchuk, The Case for Facilitating Competing Tender Offers, 95 Harv. L. Rev. 1028, 1052-53 (1982).

The minimum duration requirements imposed by the Act and SEC rules also encourage auctions.[118]

Some of the protective rights also appear to be motivated by a concern for equal treatment of target company shareholders. Both the pricing provision[119] and the requirement that shares tendered in connection with an oversubscribed partial bid be taken up pro rata[120] promote equality of treatment for tendering stockholders, regardless of the sequence in which they tendered or the size of the holdings tendered. These provisions are obviously in tension with the traditional common law of contracts, which makes the offeror absolute master of the offer's terms and timing;[121] they also restrict the usual freedom of action that a buyer enjoys in purchasing shares on the open market. Conversely, these provisions reduce the risks that sellers face in typical market transactions. For instance, sellers typically risk losing a higher price by waiting for a buyer willing to pay it. They also risk losing a sale entirely because of competition with another seller who holds a larger block of shares or offers to sell sooner, and thus is more desirable to the buyer. Yet in the context of a tender offer, Congress has found these normal risks to be unacceptable.[122] Thus, to effect the legislative purpose in giving sellers special protective rights in a tender offer, sellers should be accorded those rights in transactions having the special characteristics of a tender offer that prompted congressional concern: characteristics that alter the ordinary buyer-seller relationship by placing the seller in an unusually weak bargaining position.[123]

The cases applying the Williams Act have recognized that its provisions are not applicable to stock market transactions generally, but they have been less successful in explaining what characteristics a market transaction must have to be a tender offer. One district court noted the provisions were "unworkable" as applied to an acquisition plan including stock market purchases, unless the provisions mean the acquirer may not make such purchases except through a general tender offer.[124] The Second Circuit has concluded that "it seems un-

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[118] See note 105 and accompanying text supra.

[119] See text accompanying note 106 supra.

[120] See text accompanying note 107 supra.

[121] See Restatement (Second) of Contracts § 29(1) & comment a, § 30(1) & comment a, § 52 & comment a, § 58 & comment a, § 60 (1981).

[122] See S. Rep. No. 550, 90th Cong., 1st Sess. 1 (1967).

[123] See id. at 2-3.

[124] Brascan Ltd. v. Edper Equities Ltd., 477 F. Supp. 773, 790-91 (S.D.N.Y. 1979).

likely . . . Congress intended tender offer to be so broadly interpreted as to make these provisions unworkable."[125]

In struggling to define a tender offer, most cases have focused on the injury that an unregulated transaction might cause an investor. If the transaction is of a kind to which a provision of the Act seems directed, then the transaction is treated as a tender offer and the Act is applied.[126] The cases do not agree, however, as to which protective provisions should be emphasized in determining whether a transaction should be viewed as a tender offer. In *Cattlemen's Investment Co. v. Fears*,[127] one of the first cases to apply the Act to an unconventional tender offer, the district court emphasized the disclosure requirements of the Act when analyzing whether the defendant's activities posed the dangers addressed by the statute.[128] The defendant had purchased 177,004 shares of the National Pioneer Insurance Co. after soliciting the sales in person through telephone calls and by letter in an "active and widespread" campaign.[129] After these purchases, the defendant owned about twelve percent of the company's stock. The court examined whether the solicitations had the effect of forcing shareholders "into making a hurried investment decision without access to information, in circumvention of the statutory purpose," concluded that they did, and therefore declared them to be a tender offer.[130]

In defining a tender offer, other cases have taken a narrower view of the injuries the statute was designed to prevent. In *Smallwood v. Pearl Brewing Co.*,[131] the Fifth Circuit held that a tender offer had occurred when Southdown, Inc., which was interested in merging with Pearl Brewing Co., sent letters to Pearl's stockholders concerning their right to sell shares they would receive in the merger exchange.[132] Although the court stated that "the immediate purpose of the Williams Act was to protect investors from unscrupulous corporate raiders

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[125] Kennecott Copper Corp. v. Curtiss-Wright Corp., 584 F.2d 1195, 1207 (2d Cir. 1978).

[126] See, e.g., Wellman v. Dickinson, 475.F. Supp. 783, 822, 825 (S.D.N.Y. 1979), aff'd, 682 F.2d 355 (2d Cir. 1982), cert. denied, 103 S. Ct. 1522 (1983); S-G Sec., Inc. v. Fuqua Inv. Co., 466 F. Supp. 1114, 1120 (D. Mass. 1978); see also E. Aranow, H. Einhorn & G. Berlstein, Developments in Tender Offers For Corporate Control 1 (1977).

[127] 343 F. Supp. 1248 (W.D. Okla. 1972).

[128] Id. at 1251.

[129] Id. at 1252.

[130] Id. Although it has been argued that the tender offer regulations of the Williams Act were intended to apply to transactions that might cause a shift in corporate control, see text accompanying note 134 infra, the *Cattlemen's Inv. Co.* court did not consider whether the transactions in the case affected control of the corporation.

[131] 489 F.2d 579 (5th Cir.), cert. denied, 419 U.S. 873 (1974).

[132] Id. at 586-87, 596.

who could force shareholders into making a hasty, uninformed decision to sell by offering to buy a portion of the target corporation's securities at a premium price,"[133] the court limited application of the Act to situations in which some change in corporate control was contemplated.[134]

Of course, even absent possible changes in control, the shareholder's investment decision might well be made more soundly if the shareholder knows about the plans of other investors active in the market for that stock. The *Smallwood* court assumed that the risk of making a poor investment decision because one lacks access to this sort of information is simply a normal market risk. The court thus embraced a much less expansive definition of the statutory purpose to be served by disclosure in connection with tender offers than did the *Cattlemen's Investment Co.* court.

Wellman v. Dickinson[135] explained the statutory concern with disclosure in yet another manner. In *Wellman*, the defendants acquired thirty-four percent of the target's stock in a short period of time through purchases from thirty-three individuals and institutions. These purchases were negotiated over the telephone, with the buyer's agents following a carefully prepared script for the solicitation, and were executed off the stock exchange.[136] The district court addressed the question whether these acquisitions constituted a tender offer by examining whether they resembled a privately negotiated transaction—assumed to be outside the scope of the Williams Act—involving informed sellers with sufficient access to information to fend for themselves.[137] The court concluded that the solicitation was essentially public in character: the solicitation involved an integrated plan of acquisition executed secretly and quickly with nothing distinguishing the solicitees from other shareholders except the size of their holdings.[138] Unlike *Smallwood*, *Wellman* first examined the features that typically characterize a private transaction and then asked whether

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[133] Id. at 597 (footnote omitted).

[134] Id. at 599; see also Wellman v. Dickinson, 475 F. Supp. 783, 817 (S.D.N.Y. 1979), aff'd, 682 F.2d 355 (2d Cir. 1982), cert. denied, 103 S. Ct. 1522 (1983). But see Note, The Developing Meaning of "Tender Offer" under the Securities Exchange Act of 1934, 86 Harv. L. Rev. 1250, 1258 n.49 (1973) (arguing that § 14(d)(5)-(7) should apply when a tender offer is for less than five percent of a class of registered equity securities).

[135] 475 F. Supp. 783 (S.D.N.Y. 1979), aff'd, 682 F.2d 355 (2d Cir. 1982), cert. denied, 103 S. Ct. 1522 (1983).

[136] Id. at 806-10.

[137] Id. at 817.

[138] Id. at 821.

the transaction at issue exhibited those features. In short, *Wellman* defined a tender offer in terms of what it is not.

Rather than focusing on the need of shareholders for information, other cases have defined a tender offer by asking whether a transaction creates the special pressures on sellers typical of tender offers. In *S-G Securities, Inc. v. Fuqua Investment Co.*,[139] the defendant announced that it might make a tender offer for the shares of the plaintiff company.[140] The defendant then purchased large blocks of the plaintiff company's stock on the American Stock Exchange and in privately negotiated transactions with shareholders.[141] The district court held that the defendant's actions constituted a tender offer because the pre-acquisition publicity "created a risk of the pressure on sellers that the disclosure and remedial tender offer provisions of the Williams Act were designed to prevent."[142] The court was evidently concerned that shareholders receive both full disclosure of the required information and the other special protections extended by the Williams Act.[143] In light of this broad concern, the *S-G Securities* court designed its remedy to give the shareholders benefits similar to those that the Williams Act, had it initially been followed, would have afforded. The defendant was ordered to offer rescission to shareholders who had sold to it on the open market and to refrain from purchasing additional shares of the target except through a conventional general tender offer. The defendant was also enjoined from voting the shares it had acquired on the open market until it made the offer of rescission.[144]

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[139] 466 F. Supp. 1114 (D. Mass. 1978).

[140] Id. at 1120.

[141] Id.

[142] Id. at 1126. An SEC administrative law judge has held that a large block purchase of shares on a stock exchange from numerous sellers at a premium price constitutes a tender offer. See In re Paine Webber Jackson & Curtis, Inc., [1982-1983 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,310 (SEC 1982). In addition to various factors the SEC has recommended to determine whether a transaction should be regarded as an unconventional tender offer subject to the Williams Act, see id. at 85,710-14, the judge relied on the "additional and separate reason" that the purchase was made while another party's competing tender offer was outstanding, id. at 85,714-15.

[143] See *S-G Sec.*, 466 F. Supp. at 1126 n.11 (referring generally to the "protections of the tender offer provisions of the Williams Act").

[144] Id. at 1130-31 (citing Financial Gen'l Bankshares, Inc. v. Lance, [1978 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 96,403, at 93,428 (D.D.C. 1978)). These protections may well be unworkable as applied to the defendant's open market purchases. See text accompanying note 124 supra. A potential offeror's announcement that a tender offer is under consideration may thus prevent the offeror from purchasing target company stock on the open market.

The remedies ordered in *S-G Sec.* were substantially more extensive than those ordered in the cases discussed in text accompanying notes 127-38 supra. In *Cattlemen's Inv. Co.*, the defendant was enjoined from voting stock he had acquired without complying with § 14(d) of

The failure of the Williams Act to define "tender offer," combined with its varied purposes, has led the courts to emphasize different goals of the Act and to adopt different methods of identifying a tender offer. The cases have reached these different conclusions about the breadth of the Williams Act's mandate for disclosure, the relevance of a proposed shift in corporate control to the statutory requirements, and the feasibility of regulating open market transactions. These disparities may have been inevitable, given the vagueness of the statute,[145] but they scarcely encourage careful planning by providing some certainty about the legal consequences of various transactions.[146]

B. The Scope of Regulation Under the City Code

The City Code's treatment of the definitional problem is more straightforward. Rather than defining "tender offer" on the basis of the effect that a particular transaction has on target shareholders, the Code imposes heightened regulation on offers and share acquisitions according to bright line standards. Under the Code, particularly rigorous rules apply when offers are made for specified percentages of the target's shares, or when specified percentages are acquired. Other rules apply to all "offers," which include "wherever appropriate, take-over and merger transactions howsoever effected, including reverse take-overs, partial offers and also offers by a parent company for shares in its subsidiary."[147] Enforcement of the City Code has thus not been accompanied by the definitional disputes that have plagued American efforts to regulate tender offers.[148]

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the Williams Act, 15 U.S.C. § 78n(d) (1982). 343 F. Supp. 1248, 1253 (W.D. Okla. 1972). In *Smallwood*, the Fifth Circuit affirmed the district court's judgment, based upon jury findings on specially submitted issues, that the defendants were not liable for any losses incurred by the plaintiff class. 489 F.2d 579, 588, 608 (5th Cir. 1974), aff'g Smallwood v. Southdown, Inc., 382 F. Supp. 1106 (N.D. Tex. 1972), cert. denied, 419 U.S. 873 (1974). In *Wellman*, the defendants agreed to a settlement requiring the acquiring corporation to make a public offering of debentures that would be exchangeable for the target stock acquired through the unconventional tender offer, thereby divesting itself of that stock. 497 F. Supp. 824, 828-29 (S.D.N.Y. 1980), aff'd, 647 F.2d 163 (2d Cir. 1981), cert. denied, 103 S. Ct. 1522 (1983).

[145] See text accompanying notes 124-25 supra.

[146] Cf. Brascan Ltd. v. Edper Equities Ltd., 477 F. Supp. 773, 791 (S.D.N.Y. 1979) (stressing the importance of predictable application of the Williams Act to avoid deterring persons from legal securities transactions because of "crippling uncertainty in an area in which practitioners should be entitled to be guided by reasonably clear rules of the road").

[147] City Code, supra note 32, at 13 (defining "offer").

[148] The Code, like the Williams Act, does not contain a definition of a takeover bid. See A. Johnston, supra note 34, at 194. Because of the Code's structure, however, this omission has not been a source of difficulty.

The "Dawn Raids" in 1979 and 1980 tested the adequacy of the City Code's coverage of corporate takeovers. In these transactions, one company, through its stock exchange brokers, rapidly acquired an interest in another at an above-market premium. The percentage of shares acquired was less than the thirty percent that triggers the obligation under rule 34 to make an offer to all remaining stockholders.[149] The major objection to such acquisitions was that they were unfair. Small shareholders, "at least those whose shares were not held by banks or brokers under discretionary management, [were denied] the opportunity of selling their shares at the attractive price being held out."[150] Furthermore, the speed with which Dawn Raids were executed deprived the target's management of any opportunity to respond.[151]

The Council for the Securities Industry responded in late 1980 with rules designed to address these problems.[152] In their present form, these rules regulate acquisitions of five percent or more of the target's shares within any seven-day period, provided that the acquisition gives the buyer a total holding of fifteen percent or more of the target's stock.[153] The rules require that any such acquisition be accomplished either through a partial offer subject to the rules of the City Code, or through an offer on the Stock Exchange announced at least seven days before the offer closes.[154] This seven-day requirement, coupled with the minimum duration requirements imposed by the City Code on partial offers,[155] prevents acquisitions subject to the

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[149] See U.K. Watchdog Imposes Freeze On 'Dawn Raids,' Wall St. J., August 8, 1980, at 16, col. 3. This series of transactions acquired its name because the raids were initiated when the stock exchange opened in the morning and were often concluded in a matter of minutes. See Raiders at 9.30, The Economist, Aug. 2, 1980, at 13-14 (editorial).

[150] Panel on Take-overs and Mergers, Report on the Year ended 31st March 1980, at 4.

[151] Britain looks for rules to foil fast takeovers, Bus. Wk., June 16, 1980, at 63.

[152] Rules Governing Substantial Acquisitions of Shares (Council for the Securities Industry 1981), reprinted in 2 Palmer's Company Law, supra note 44, paras. C-993 to -1029 [hereinafter Rules Governing Substantial Acquisitions]. These rules have been supplemented by the recent addition of rules 40 and 41 to the City Code, which prevent an offeror from obtaining 30% or more of the voting rights of a company through acquisitions apart from its offer prior to the first closing date of the offer. Rules 40 and 41 apply to acquisitions of options as well as to those of shares, and are designed to prevent an offeror from acquiring a controlling holding shortly after the announcement of its offer, thus leaving the target's board powerless. Offers that have been accepted by the target board and acquisitions from single shareholders are exempted from the rules. See New Rules Added to the City Code, J. Bus. Law, July 1982, at 314-15.

[153] Rules Governing Substantial Acquisitions, supra note 152, rule 1, reprinted in 2 Palmer's Company Law, supra note 44, para. C-1008.

[154] Id. rule 2, reprinted in 2 Palmer's Company Law, supra note 44, para. C-1009.

[155] The City Code requires that all offers be kept open a minimum of 21 days after their initial posting and a minimum of 14 days after the posting of any revision of the offer. City Code, supra note 32, rule 22(1).

Dawn Raid rules from ambushing management and leaving small shareholders behind in the dust. If the bidder proceeds through an offer on the Stock Exchange, shareholders' tenders are irrevocable, and shareholders are not entitled to withdraw their shares unless the minimum number of shares specified in the bid is not tendered.[156] Offers may be at a fixed price or a maximum price; if a fixed price bid is oversubscribed, shares must be accepted pro rata from tendering shareholders. Oversubscribed maximum price bids are filled by starting with the lowest price at which shares were tendered and proceeding upward.[157] Just as the City Code prohibits an offeror from making market purchases of target stock while its partial offer is open, so a buyer with an offer open on the Stock Exchange that is governed by the Dawn Raid rules may not purchase any of the target's shares except through its offer.[158] Of course, inequality between well-advised institutional investors and small individual shareholders persists under the rules.[159] For example, the rules do not reach the rapid acquisition of 14.9% of the target's shares, leaving the small shareholder at the same disadvantage as before.[160] This failing, however, is simply a consequence of the bright line test for application of the rules.

The drafters of the Dawn Raid rules considered proposing a requirement that any acquisition of shares in excess of a stated percentage be made by public tender offer, but the idea was rejected as too expensive.[161] Such a requirement would have imposed on offerors the costs of preparing the documents required for a public offer; furthermore, acquisitions under a tender offer would have been delayed beyond those made through the Stock Exchange because of the

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[156] Rules Governing Substantial Acquisitions, supra note 152, rule 5(e)-(f), reprinted in 2 Palmer's Company Law, supra note 44, para. C-1012.

[157] Id. rule 10, reprinted in 2 Palmer's Company Law, supra note 44, para. C-1017.

[158] Id. rule 9, reprinted in 2 Palmer's Company Law, supra note 44, para. C-1016.

[159] Cf. Panel on Take-overs and Mergers, Report on the Year ended 31st March 1980, at 4-5 (referring to the inequity that "[o]rdinary shareholders . . . without previous knowledge of the intended buying plans would have had no opportunity of offering their shares and the proverbial maiden aunt at Lands End with a small nest egg was out of the picture").

[160] One notorious Dawn Raid that preceded these rules involved a miscounting incident. DeBeers and companies associated with it secretly bought about 14% of the shares of Consolidated Gold Fields prior to staging a market raid. To assure secrecy, it was important to avoid application of the statutory requirement that a single entity which owns 5% or more of the shares of a company must disclose its holding to that company. See Companies Act, 1967, ch. 81, § 33(1), repealed by Companies Act, 1981, ch. 62, § 83(I), superseded by Companies Act, 1981, ch. 62, §§ 63-82. Thus, none of the associated companies was to buy more than 4.99%. One, however, inadvertently bought more than 5% of Gold Fields, a mistake attributed by DeBeers to "a failure of communications." The Economist, Aug. 9, 1980, at 81. Such gaffes may be even more common among less sophisticated participants.

[161] See The Economist, Aug. 9, 1980, at 82.

longer minimum duration requirements imposed by the City Code on offers.

The potential impact of requiring that Dawn Raids be executed as partial tender offers is suggested by the history of the equivalent American transaction, the special bid. In a special bid, the bidder offers to purchase a block of shares on a securities exchange at a specified price during a fixed period of time; typically, the price offered is at a substantial premium above market.[162] Shortly after the enactment of the Williams Act, the SEC took the position that special bids were tender offers subject to the Act, including its withdrawal and proration requirements.[163] At least for the acquisition of securities in companies subject to registration under the Securities Exchange Act and thus to regulation under the Williams Act,[164] the SEC's treatment of special bids eliminated them as a practical matter; it was simply not possible to comply with the proration and withdrawal requirements of the Williams Act in exchange transactions.[165]

Clearly, the Dawn Raid rules are the product of efforts to make the opportunity to sell at a market premium available to shareholders on a more equal basis. The rules slow the acquisition process and may therefore also encourage competing offers, although the likelihood of this possibility is difficult to gauge. Both of the alternatives possible under the rules—a formal partial offer subject to the City Code or an offer on the Stock Exchange announced seven days in advance—impose notice and minimum duration requirements on acquirers. These requirements generally make it possible for potential offerors who place a higher value on the target's shares to counter with offers at higher prices. Indeed, the rules might well be justified by their ability to stimulate auctions, quite apart from their protection of small shareholders.[166]

Of course, not all purchases delayed by these rules are likely to attract competing bidders. Some do not for the same reason that many tender offers do not provoke higher bids: no potential competitor wishes to pay more for the target's stock.[167] Purchases that result in a

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[162] See E. Aranow & H. Einhorn, Tender Offers for Corporate Control 71 (1973).

[163] See SEC Exchange Act Release No. 8392, 33 Fed. Reg. 14,109 (1968).

[164] See Securities Exchange Act of 1934, § 12(a), (g)(1), 15 U.S.C. § 78*l*(a), (g)(1) (1982).

[165] See E. Aranow & H. Einhorn, supra note 162, at 71; Barash, Corporate Takeovers and Freezeouts: Tender Offers, Seminar on Delaware Corporation Law Today, 6 Del. J. Corp. L. 574, 575 (1981) ("since that early day, nobody has ever made a special bid").

[166] Cf. Bebchuk, supra note 117, at 1051-52 ("[T]he regulation of [tender] offerors should provide the time necessary for realizing the potential benefits from competition among acquirers.").

[167] For example, other potential offerors may simply think the first purchaser is offering too great a premium over market price.

holding of close to fifteen percent, the threshold for application of the Dawn Raid rules, may not attract competing higher bids because their small size makes it feasible for other prospective purchasers to buy a similar number of shares through the Stock Exchange or through a partial bid. In this situation, the second purchaser must decide whether the upward pressure, if any, of the first purchaser's acquisition on the target's subsequent market price is likely to be greater than the additional premium required to best the first purchaser through a competitive bid.[168] Larger acquisitions, i.e. those which give the purchaser only slightly less than thirty percent and thus just avoid the application of rule 34,[169] seem more likely to attract competing bids, both because they may place the purchaser in effective control of the target and within tantalizingly close reach of legal control, and because they represent a weightier force to be dealt with by any subsequent purchaser of another large block of shares.[170] Thus, depending on the distribution of share ownership within a particular target, larger purchases delayed by the Dawn Raid rules appear more likely to provoke auctions than do smaller acquisitions.[171]

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[168] This analysis presupposes that the supply curve for the target's stock does not begin to slope sharply upward until some potential purchaser is within striking distance of acquiring control. Cf. Carney, Shareholder Coordination Costs, Shark Repellents, and Takeout Mergers: The Case Against Fiduciary Duties, 1983 A.B. Found. Research J. 341, 385-86 (demonstrating that supply curve for target stock is to some degree inelastic); Gilson, The Case Against Shark Repellent Amendments: Structural Limitations on the Enabling Concept, 34 Stan. L. Rev. 775, 796 & n.81 (1982) (discussing other implications of upward-sloping supply curve for target stock) [hereinafter Gilson, Shark Repellent Amendments].

[169] City Code, supra note 32, rule 34.

[170] Consistent with this analysis, most of the explanations for why tender offers occur, and thus for why competing bids are made, presuppose that the offeror is seeking either effective or legal control. The acquirer's ability to achieve synergistic gains by combining its facilities with those of the target requires control, as does the possibility of increasing the target's profits by replacing its incumbent management. Similarly, if the bid is motivated by the desires of the managers of the offeror to increase the size of the firm they control, these motivations cannot be fully realized unless control of the target itself is achieved. Finally, some takeovers are motivated by the offeror's belief that the target's shares are undervalued by the market; the offeror may therefore hope that the target's shares will be a good investment in the sense that, after the acquisition, the offeror's market value will increase by an amount greater than the cost of its acquisition. If the offeror is correct in believing that the target is undervalued, the purchase may be a good investment even if it does not give the offeror control of the target. But it has long been recognized that shares conferring control are more valuable than noncontrol shares, and thus an offeror might well seek control of a target solely to improve its investment prospects.

[171] Some competing bids may follow purchases of shares by persons who had no intention of eventually attempting a takeover. If an initial purchaser does flush out others interested in acquiring target shares, that purchaser may achieve significant speculative gain by selling its target shares to the other purchasers. See Gilson, Defensive Tactics, supra note 3, at 872 n.187. In addition, if management views the initial purchaser as undesirable and consequently proposes that the target corporation repurchase the shares at a premium price, the purchaser also profits.

C. Some Suggestions

The contrast between British regulation of Dawn Raids and American regulation of special bids, like the more general contrast between the varying degrees of British regulation applied to specific transactions and the single American regulatory scheme applied to "tender offers," suggests several responses to the present structure of the Williams Act and to the definitions of a tender offer incorporated in proposed revisions of the Act. Whether or not Congress acted reasonably in 1978 when it failed to define the term "tender offer" in the Williams Act, legal and financial practitioners should not now be kept guessing about its meaning. After fifteen years of experience with tender offer regulation, the linchpin of the system should not be a question mark.

Before deciding to regulate transactions other than conventional tender offers as tender offers, policymakers should consider the potentially high costs of such a step. Those costs may be so high or compliance with regulation may be so unwieldy that treating some transactions as tender offers effectively forbids them, as the history of the SEC's treatment of special bids illustrates.[172] Facing a similar problem in drafting the Dawn Raid rules, British policymakers were admirably sensitive to problems of cost. Rather than requiring that acquisitions previously made through the Dawn Raids be carried out as partial tender offers with all the accompanying costs in time and money, the Dawn Raid rules permit the less drastic alternative of market bids subject to notice and duration requirements.[173] For example, the Dawn Raid rules do not require Dawn Raiders to offer to buy *all* shares at the raid price,[174] and thus involve a significantly lighter burden than that imposed by rule 34 of the City Code on somewhat larger accumulations of shares.[175]

Unless one believes that all acquisitions of large blocks of stock should be made through general tender offers, it is difficult to understand why market acquisitions should be subject to the full panoply of tender offer regulation. Such a broad sweep for full tender offer

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Such transactions are more difficult to effect in Britain because of the statutory requirement that three-quarters of the shareholders approve any corporate repurchase of shares. See note 372 infra.

[172] See text accompanying notes 162-65 supra.

[173] See text accompanying notes 152-60 supra.

[174] Of course, rule 34 of its own force governs stock market acquisitions of a 30% interest or more in a company subject to the City Code. See text accompanying notes 76-78 supra.

[175] See City Code, supra note 32, rule 34(1)(a) (acquisitions that would entitle acquirer to exercise 30% or more of voting rights).

regulation could be justified only by a showing that less drastic regulatory treatment is inadequate to address the dangers created by substantial market acquisitions. The British experience in regulating Dawn Raids by imposing minimum duration requirements, but without extending buy-out or withdrawal rights, suggests that more flexible and moderate regulation can deal successfully with those dangers.

The most sensible approach may be to abandon the notion that the imposition of a monolithic regulatory system should always turn on the question whether a transaction is or is not a tender offer. Instead, regulators should assess the risks present in a particular kind of transaction specifically and narrowly. Although the Williams Act, as construed by the judiciary, has prevented this approach, the success of the City Code demonstrates its feasibility.

From this perspective, the revisions to the Williams Act proposed by the drafters of the Federal Securities Code and the regulations proposed by the SEC are not entirely satisfactory. The proposed Federal Securities Code (FSC) retains the key requirements of the Williams Act, while adding an advance publication requirement: any tender offer that would make the offeror the beneficial owner of more than five percent of a class of equity securities must be preceded by publication of notice of the offer at least ten days in advance.[176] Unlike the Williams Act, the FSC does expressly define "tender offer," as

> an offer to buy a security, or a solicitation of an offer to sell a security, that is directed to more than thirty-five persons, unless—(i) it (I) is incidental to the execution of a buy order by a broker, or to a purchase by a dealer, who performs no more than the usual function of a broker or dealer, or (II) does no more than state an intention to make such an offer or solicitation; and (ii) it satisfies any additional conditions that the Commission imposes by rule.[177]

The accompanying comment suggests that this provision, like the Williams Act, does not impose tender offer regulation on "an approach to a few controlling shareholders by a person who desires to buy them out" or on "routine" market transactions.[178] Once the threshold of thirty-five solicitees is passed, however, the FSC would evidently subject the transactions to the full range of tender offer regulation, regardless of any other characteristics of the transactions. Because all the shareholder protective devices the Code retains from the Williams Act would apply to all transactions that fall under the

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[176] Federal Securities Code § 606(a), (d)(2) (Official Draft 1980).

[177] Id. § 202(166)(A).

[178] Id. § 202(166) comment 1.

FSC's definition of a tender offer, the FSC could be satisfied only by recasting a campaign of acquisition from more than thirty-five persons as a conventional tender offer. The FSC does not address the cost or inherent desirability of this result.[179]

The SEC's proposed regulations under the Williams Act define "tender offer" differently. Tender offers would include offers to purchase or solicitations of offers to sell which "[d]uring any 45-day period are directed to more than 10 persons and seek the acquisition of more than 5%" of a class of securities.[180] Offers effected through a broker or a dealer at the current market price or in the over-the-counter market are exempt if three conditions are met: (1) no order for securities is solicited by the broker, dealer, or offeror; (2) the broker or dealer performs only "customary functions"; and (3) only the customary commission or mark-up is received by the broker or dealer.[181] Offers would also be considered tender offers under a second and independent definition if they "(A) are disseminated in a widespread manner, (B) provide for a price which represents a premium in excess of the greater of 5% of or $2 above the current market price and (C) do not provide for a meaningful opportunity to negotiate the price and terms."[182] Like the FSC, these provisions appear to have the practical consequence that transactions defined as tender offers could be executed only through general offers and not through stock exchange transactions.

It is not apparent why both the FSC and the proposed Williams Act regulations assume that, in all transactions covered by their definitions of tender offer, shareholders invariably require the protection of proration and withdrawal rights. An equally plausible assumption underlies the Dawn Raid rules: that shareholders are adequately protected against unfair treatment by requiring that offers to purchase the specified quantities of shares remain open for a stated minimum period.

Furthermore, the small size of some of the acquisitions reached by the definitions of tender offer in the FSC and the proposed SEC

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[179] A similar failure to consider that costs imposed by a particular regulatory structure, as well as by alternatives to that structure, characterized the SEC's response to Senator Williams's first proposal that tender offers be regulated. See J. Seligman, The Transformation of Wall Street 431 (1982).

[180] SEC Exchange Act Release No. 16,385, 44 Fed. Reg. 70,349, 70,358 (1979) (proposed rule 14d-1(b)(1)(i) (to be codified at 17 C.F.R. § 240.14d-1(b)(1)(i)) (proposed Nov. 29, 1979)).

[181] Id.

[182] Id. (proposed rule 14d-1(b)(1)(ii) (to be codified at 17 C.F.R. § 240.14d-1(b)(1)(ii)) (proposed Nov. 29, 1979)).

amendments raises additional concerns. For example, while some of the American cases defining a tender offer have focused on the potential of a transaction to cause a shift in corporate control as a key fact,[183] the statutory concern with control is obviously weak when the proposed acquisition involves a small proportion of the outstanding stock. This observation suggests that the proposed definitions are overinclusive in that they would regulate transactions outside one of the principal purposes of the Williams Act. Furthermore, such small transactions, if delayed in their execution through tender offer regulation, are not likely to attract competing bids for the same shares. If another purpose of the Act is to encourage auctions after an initial bid has been made,[184] defining small transactions as tender offers fails to further this policy as well. These concerns are reflected in the recent recommendations of the SEC Advisory Committee on Tender Offers, which proposed requiring that any acquisition that would make the acquirer owner of more than twenty percent of a corporation's voting securities be made only by tender offer or by purchase from the issuer itself.[185] The Committee's recommendation is based on the view that twenty percent is the threshold for transferring effective control of a corporation[186] and appears to be more in accord with the purposes of the Williams Act than the FSC or the SEC proposals on this point.

III

THE LIMITS OF FAIRNESS

Although some aspects of national tender offer regulation in the United States and Britain govern the fairness of the treatment received by the target's stockholders, neither system provides for direct regulatory approval of the terms of a transaction. This Part will discuss provisions of the Williams Act and the City Code that are designed to assure equal treatment of target shareholders and to encourage the best price and the best selling environment for shareholders. The likely costs of these regulatory measures will also be examined.

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[183] See text accompanying notes 132-34 supra.

[184] See text accompanying notes 111, 116-17 supra and 252-57 infra.

[185] Advisory Committee Report, supra note 1, at 22-23.

[186] Id. at 23. The Committee also recommended that the SEC "retain broad exemptive power" from the recommended provision, id., apparently because the Committee recognized that effective control might not pass at 20%, see id. at xxi, 23.

A. *Shareholder Equality*

A key question in tender offer regulation is the extent to which the opportunity to sell at a premium price should be made available to all target stockholders. The most severe enforcement of shareholder equality would prohibit tender offers for fewer than all of the target's shares, would prohibit the offeror from buying shares outside the offer at a higher price, and would require that all nontendering shareholders be permitted to redeem or sell their shares to the offeror at the offer price. This view would also require that all shareholders who tender or otherwise sell their shares to the offeror be paid the same price, regardless of whether they tender early or late in the offer process. As will be demonstrated, the City Code comes much closer to achieving this form of equality than does the Williams Act, which compromises on most questions of equality.

Any argument in favor of requiring some degree of equal treatment for shareholders must confront the response that shareholders need not be treated equally in particular transactions because by diversifying their investment portfolios, investors may protect against the risk of consistently falling on the losing side of unequal treatment.[187] If the market can even out apparent inequality in this way, the costs of unneeded regulation to promote equality might well be thought socially wasteful.[188] The persuasiveness of this view turns in part on an empirical question, namely, the degree to which shareholders are able to diversify their investments.[189] The available evidence strongly suggests that the total portfolios of most individual investors are so small that they are unlikely to achieve adequate diversification through direct investment in shares; furthermore, diversification through investment in equity mutual funds requires careful selection of the appropriate funds.[190] Adequate diversification is also difficult to achieve in light of the difficulty of determining in advance what investments might be subject to some degree of unequal treatment in an acquisition transaction.[191] More fundamentally, it is

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[187] See Easterbrook & Fischel, Corporate Control Transactions, 91 Yale L.J. 698, 712-14 (1982).

[188] See id. at 708-11; Advisory Committee Report, supra note 1, at 76-84 (separate statement of Frank H. Easterbrook & Gregg A. Jarrell).

[189] See Brudney, Equal Treatment of Shareholders in Corporate Distributions and Reorganizations, 71 Calif. L. Rev. 1072, 1099-102 (1983).

[190] Id. at 1099 & n.81.

[191] For example, one might think that an investor could protect against this risk by investing in an equity fund that mimics the composition of the market as a whole. But even this kind of broadly diversified fund may not gain as often as it loses when corporate control is sold on terms that treat shareholders unequally. To emerge from such transactions as a winner, either the fund

not clear why investors should be required to bear the costs of diversification, including the sacrifice of other investment goals, in order to avoid unequal and unfair treatment. In short, the empirical justification is weak for discarding out of hand the necessity of requiring some forms of equality in some transactions.

The City Code and the Williams Act differ sharply in their treatment of offers for fewer than all of a target's outstanding shares. The Williams Act does not attempt to discourage such offers,[192] although it does attempt to make shareholders formally equal in their ability to sell at a premium by requiring proration of oversubscribed offers.[193] In contrast, the earliest version of the City Code stated that partial bids were generally undesirable and required the Panel's consent, which would be granted only in "very exceptional circumstances."[194] This hostility toward partial bids was apparently prompted by profound suspicion of sales of corporate control without the acquisition of all or a majority of the company's shares, coupled with the realization that the position of minority shareholders under British company law was relatively weak.[195] Subsequent amendments to the Code that accommodate some partial offers reflect qualified acceptance of the idea that if target shareholders are given an equal opportu-

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must hold shares in an acquired company that are bought on more favorable terms than regulation requiring equality would permit, or the fund must hold shares in an acquiring company that buys control more cheaply than regulation would permit. However, there is no reason to suppose that the distribution of such opportunities would parallel the selection of investments for a broadly representative fund. To justify investing in some shareholding vehicle other than such a fund, the investor concerned with the risks of unequal treatment would need to assess the ability of the vehicle's managers to predict the incidence of takeover activity and the terms of takeover transactions as they would affect potential investments. Many investors may not be sanguine about the ability of financial managers to make these predictions accurately.

[192] The SEC Advisory Committee on Tender Offers considered recommending restrictions on partial offers similar to those of the City Code, but settled on a recommendation that would subject partial offers to a longer minimum duration requirement than bids for all shares of a class of stock. Advisory Committee Report, supra note 1, at 26. The Advisory Committee evidently adopted this recommendation in part as "a regulatory disincentive for partial offers," id. at 25, and in part to lessen the potential of partial offers for coercion and other abusive tactics associated with short duration, see id. The committee stated that "[i]n the event that the recommendations of the Committee do not have the desired effects, however, the Committee suggests that the [SEC] reconsider incorporation of some features of the British system." Id. at 26.

[193] See note 230 and accompanying text infra. However, certain large shareholders have been able to evade the proration requirements and thus frustrate this formal equality. See text accompanying notes 290-98 infra.

[194] See A. Johnston, supra note 34, at 40.

[195] See id. at 254; Weinberg & Blank, supra note 48, paras. 902-903. For further discussion of the position of minority shareholders in Britain, see text accompanying notes 245-51 infra.

nity to have their tendered shares ultimately purchased, they should be allowed to decide for themselves whether to accept a partial bid.[196]

The City Code now distinguishes among partial bids based on the percentage of shares sought by the offeror. Under earlier versions of the Code, the Panel decided on a case-by-case basis whether the offeror would actually achieve de facto control of the company through the bid.[197] In the interest of administrative ease, rule 27 now regulates all transactions in which thirty percent of the target's shares are acquired as though the acquisition transferred effective control, whether or not that assumption is actually true.[198] Although rule 27 requires the Panel's consent for any partial offer, offers for less than thirty percent are normally approved, since the offeror is free to buy up to 29.9% on the stock market or in private transactions without any restriction under the Code.[199] The Panel's review of approved partial offers for less than thirty percent is limited to the adequacy of the offer documents, their transmission to target shareholders, and equality of treatment among accepting shareholders, including enforcement of the pro-rata requirement.[200]

More significant limitations are imposed on offers for more than thirty percent. Before a partial offer for more than thirty percent becomes effective, it must be approved by shareholders, other than the offeror and persons acting in concert with it, who have over fifty percent of the voting rights.[201] Shareholders may thus vote to disapprove an offer without losing the ability to tender shares if the offer is approved.[202] The Panel's consent is needed for partial offers that would result in the offeror holding more than fifty percent of the shares of the target. These offers will not be approved, however, if the offeror or persons acting in concert with it have acquired shares in the target during the preceding twelve months on a widespread or selective basis,[203] or if an offer for all of the target's shares has been previously announced.[204] These restrictions are evidently based on the Panel's desire to treat shareholders equally,[205] and on its view of the

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[196] See A. Johnston, supra note 34, at 254; Weinberg & Blank, supra note 48, para. 984.

[197] See Weinberg & Blank, supra note 48, paras. 905-906.

[198] See id.

[199] See A. Johnston, supra note 34, at 256.

[200] See Weinberg & Blank, supra note 48, para. 987.

[201] City Code, supra note 32, rule 27(7).

[202] The mechanics of rule 27(7) involve a "Form of Acceptance" and "Transfer" with a separate box to check for approval of the offer. Id.

[203] City Code, supra note 32, rule 27(3).

[204] A. Johnston, supra note 34, at 255.

[205] Id.

difficulties shareholders experience in weighing the relative merits of partial and full offers.[206]

Only in "exceptional circumstances" will the Panel approve offers that would result in the offeror holding between thirty and fifty percent of the target's voting rights. Because these offers also require the approval of over fifty percent of the voting shares not held by the offeror or persons acting in concert with it,[207] they are rare.[208] Once a partial offer has been completed, rule 27 prohibits subsequent purchases of the target's shares by the offeror and persons acting in concert with it for twelve months,[209] unless the Panel consents to the purchases. Despite this prohibition on further purchases, rule 34 requires that once the offeror acquires thirty percent of the target shares, it must offer to buy all the remaining shares at the highest price it paid over the preceding twelve months, unless the Panel agrees to dispense with the requirement.[210] Finally, like the Williams Act, the City Code requires proration when partial offers are oversubscribed. Unlike the Williams Act, however, the Code requirement that tendered shares be accepted pro rata is not limited to its first ten days, but extends throughout the offer period.[211]

Very few partial offers for more than thirty percent of a target's shares have been made in Britain,[212] and therefore some of the most vexing issues arising from partial offers in the United States have not been significant in Britain. For example, the fairness of transactions following a partial offer, such as two-step transactions, cashouts, and freezeouts, has attracted far more concern in the United States[213] than

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[206] See Weinberg & Blank, supra note 48, para. 998.

[207] City Code, supra note 32, rule 27(7). Such bids must also be made as an offer for a precise number of shares; they cannot be declared unconditional unless acceptances are received for at least a certain number of shares. Id. rule 27(6).

[208] A. Johnston, supra note 34, at 256.

[209] City Code, supra note 32, rule 27(5).

[210] City Code, supra note 32, rule 34(1), (4). See generally Weinberg & Blank, supra note 48, paras. 942-956. In general, Panel dispensations require approval by a majority vote of shareholders not affiliated with the stockholder who is subject to the rule 34 obligation. A typical situation in which dispensation might be sought is an issuance of new shares giving a person or group 30% or more of the company's voting rights. City Code, supra note 32, practice note no. 15(9). The Panel may waive compliance with rule 34, even if no vote of independent shareholders is taken, when the issue of new shares is part of an "urgent rescue operation" by an issuer in serious financial straits. Id. practice note no. 15(5).

[211] Compare City Code, supra note 32, rule 27(4) with Williams Act § 14(d)(6), 15 U.S.C. § 78n(d)(6) (1982). But see note 230 and accompanying text infra (discussing SEC rule requiring proration throughout duration of an offer).

[212] See A. Johnston, supra note 34, at 256. See generally Lawrie, Corporate Freezeouts: A Comparison of Controls in the United States and England, 14 N.Y.U. J. Int'l L. & Pol. 595 (1982).

[213] For some of the extensive literature addressing these questions, see, e.g., Brudney & Chirelstein, A Restatement of Corporate Freezeouts, 87 Yale L.J. 1354 (1978); Carney, Funda-

in Britain. Further, the requirement that shares tendered in an oversubscribed partial bid be accepted pro rata has been enforced through more complex regulation in the United States, at least in part because of the greater number of these bids.[214] In effect, the City Code avoids the problems of regulating partial bids in detail by sharply discouraging them through its general provisions.

Another consequence of the City Code's approach, and perhaps its major drawback, is its inhibiting effect. Not all potential offerors have the desire or the financial ability to make an offer for all the shares of a particular target, and there are doubtless cases in which the target's shareholders benefit from the shift in effective control that often follows a partial bid.[215] Even if a successful partial bidder does not gain effective control, small shareholders may benefit from the presence of a large minority shareholder with very high incentives to monitor the performance of management aggressively. In short, some desirable offers may not be made at all because the Code's restrictions on partial bids raise the cost of making such an offer. The more lenient stance recently adopted by the Code may reflect this concern.[216] Moreover, toleration of partial bids in the United States despite the regulatory complexities they produce[217] suggests an unwillingness to promote shareholder equality at the cost of inhibiting many shifts in control.

B. Post-Offer Transactions

The City Code's most aggressive measures to further shareholder equality are the provisions governing transactions that follow certain offers or other stock purchases that result in substantial holdings. Rule 34 requires that any person who acquires thirty percent or more of a company's voting securities must offer to purchase all outstanding stock at a price not less than the highest price paid by the offeror during the preceding twelve months.[218] As in its treatment of partial

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mental Corporate Changes, Minority Shareholders, and Business Purposes, 1980 A.B. Found. Research J. 69; Carney, supra note 168; Vorenberg, Exclusiveness of the Dissenting Stockholder's Appraisal Right, 77 Harv. L. Rev. 1189 (1964). See generally Weiss, The Law of Take Out Mergers: A Historical Perspective, 56 N.Y.U. L. Rev. 624 (1981).

[214] See notes 228-30, 290-93 and accompanying text infra.

[215] See Panel Report, supra note 43, at 39. One scholar has described these limitations as exhibiting a "pro-incumbent management bias." Prentice, supra note 50, at 410.

[216] See text accompanying notes 195-96 supra.

[217] For discussion of one such complexity, see text accompanying notes 290-98 infra.

[218] Under rule 34, an offeror must condition its acceptance and purchase of shares tendered under a mandatory bid upon the success of the bid in attracting enough tenders to give the offeror and persons acting in concert with it more than 50% of the target's voting shares after the

offers,[219] the Panel originally examined individual acquisitions on an ad hoc basis and imposed the mandatory bid obligation only when effective control had passed or would pass to the acquirer.[220] At this time, the percentage tests applied to acquisitions from directors or a limited number of sellers differed from those applied to market purchases from many shareholders.[221]

Rule 34 had a limited precursor in section 209(2) of the 1948 Companies Act.[222] Under section 209(2), when a purchaser acquires within four months ninety percent of the shares not already held by the purchaser, the remaining stockholders may compel the purchaser to buy their shares on the same terms as the previous acquisition.[223] Because rule 34 is triggered by a thirty percent rather than a ninety percent acquisition, it grants target stockholders a far broader buy-out right than that of section 209.

The rule 34 buy-out right has no equivalent in American tender offer regulation. Shareholders in American corporations have no general right to be bought out after a successful tender offer or substantial acquisition of stock by another, unless their shares were expressly redeemable at the shareholder's option or upon the occurrence of a specified event.[224] When shareholders do have the right to receive the

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offer. City Code, supra note 32, rule 34(3). Thus, if the offeror and persons acting in concert with it do not hold 50% of the voting shares before the rule 34 bid, and insufficient shares are tendered to give them the required margin, the bid must fail. In effect, rule 34 requires that the offer be conditioned on actual voting control passing to the offeror, who is presumed to have effective control once 30% is acquired. This requirement has been criticized as unfavorable to small shareholders, who may be prevented from selling at the price at which control passed unless the 50% condition is satisfied. Since the offeror is free to buy shares in the market during the offer period, it may be able to increase its block while still remaining short of 50%. See Weinberg & Blank, supra note 48, para. 972.

[219] See text accompanying note 197 supra.

[220] A. Johnston, supra note 34, at 91-92.

[221] Id.

[222] Companies Act, 1948, 11 & 12 Geo. 6, ch. 38, § 209(2) (amended 1976).

[223] Id. However, the courts have the authority to vary the compensation paid to minority stockholders who require the acquisition of their shares. Id.; see L. Gower, Modern Company Law, supra note 30, at 698. The Companies Act, 1948, 11 & 12 Geo. 6, ch. 38, § 209(1), generally entitles the purchaser in this situation to require the minority stockholders to sell their shares to it. Shareholders may ask a court to exempt them altogether from their obligation to sell, id., but the court cannot under this subsection vary the compensation owed them from that previously paid by the offeror, see L. Gower, Modern Company Law, supra note 30, at 697, 698 n.23.

[224] Professor Gilson has suggested that charter amendments requiring that redemption rights be available if the company is the object of a tender offer disfavored by its management might be an effective deterrent to unwanted bids. See Gilson, Shark Repellent Amendments, supra note 168, at 800-01. On the other hand, Professor Carney has maintained that such amendments may be efficient mechanisms for maximizing shareholder wealth. See Carney, supra note 168. His position and that of Professor Gilson are not wholly incompatible.

value of their shares, that right does not arise until the corporation itself proceeds with a transaction giving shareholders appraisal rights or the right to judicial review of the fairness of the transaction and the consideration offered.[225] If no such transaction follows a tender offer, the noncontrolling target stockholders cannot compel the corporation or the controlling stockholder to purchase their shares. American courts, therefore, are limited to reviewing the fairness of these post-offer transactions and enforcing the remedies available to dissenting target stockholders.[226] In many situations, rule 34 will prevent similar disputes from arising in Britain by enabling all shareholders to benefit from a premium price paid to a minority of shareholders who are able to transfer effective control.

One transaction currently permissible under the American system that raises questions about fairness is the so-called "two-step" or "front-end loaded" offer.[227] In this type of offer, the offeror varies the consideration offered to shareholders based on when they tender, typically offering cash at a high premium over market price to the first group to tender, and offering less attractive consideration to the remaining shareholders who do not tender or whose shares are not accepted as part of the first group.

These two-step transactions pose substantial problems. Under the Williams Act, an offeror must accept shares tendered in response to an oversubscribed partial bid on a pro-rata basis only during the first ten days that the offer is open.[228] The SEC, however, extended the minimum duration of an offer to twenty days[229] and subsequently adopted

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[225] Under many state corporation statutes, shareholders are entitled to appraisal rights only if the transaction is a merger, and even then statutory exceptions may apply. See, e.g., Del. Code Ann. tit. 8, § 262 (a)-(b) (Supp. 1982) ("merger or consolidation," with stated exceptions). The statute may also authorize a corporation to provide in its certificate of incorporation that shareholders have appraisal rights when other stated events occur. See id. § 262(c) (triggering events may include amendment to certificate of incorporation, merger or consolidation in which corporation is constituent, or sale of all or nearly all of corporate assets). Other statutes, and those cases accepting the principle of de facto mergers, require that appraisal rights be available in a broader range of transactions. See Revised Model Bus. Corp. Act § 13.02 (Exposure Draft 1983); W. Cary & M. Eisenberg, supra note 13, at 1456-57, 1492-97.

[226] See Gilson, Shark Repellent Amendments, supra note 168, at 788 n.52.

[227] For a discussion of possible inequities in such transactions, see, e.g., Bebchuk, supra note 117, at 1038-41; Brudney, supra note 189, at 1118-22; Brudney & Chirelstein, Fair Shares in Corporate Mergers and Takeovers, 88 Harv. L. Rev. 297, 304-06, 336-37 (1974).

[228] Williams Act § 14(d)(6), 15 U.S.C. § 78n(d)(6) (1982).

[229] See SEC rule 14e-1(a), 17 C.F.R. § 240.14e-1(a) (1983) (adopted in SEC Exchange Act Release No. 16,384, 44 Fed. Reg. 70,326, 70,348 (1979)). Offers by an issuer for its own securities, except those made in anticipation of or in response to another tender offer, are exempt from the rule. SEC rule 14e-1(a), 17 C.F.R. § 240.14e-1(a) (1983).

a rule requiring proration throughout the duration of an offer.[230] The SEC lengthened the mandatory proration period in part to avoid the pressures created when an offeror closes the first step of a two-step offer soon after the ten-day period expires, and then refuses to prorate its acceptance of shares tendered after the first ten days.[231] The offeror thereby not only offers higher payment to shareholders who tendered their shares quickly; if its partial offer is oversubscribed, it may purchase only shares tendered during the first ten days, or it may purchase all of those shares and a substantially lower proportion of subsequently tendered shares.[232] The multiple deadlines surrounding

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[230] SEC rule 14d-8, 17 C.F.R. § 240.14d-8 (1983). In adopting rule 14d-8, the SEC explained that the short statutory proration period did not give shareholders sufficient time to make an informed choice among the options open to them, and produced multiple ill-understood deadlines. SEC Exchange Act Release No. 19,336, 47 Fed. Reg. 57,679, 57,679-80 (1982); see also SEC Exchange Act Release No. 18,761, 47 Fed. Reg. 24,338, 24,339-41 & nn. 13, 17 (1982) (proposing rule). Two commissioners voted against adopting the rule. SEC Exchange Act Release No. 19,336, supra, at 57,680 (Shad, Chairman, dissenting); id. at 57,681 (Treadway, Comm'r, dissenting). One dissenting commissioner argued that, by lengthening the period over which offerors must prorate and thus must make available the consideration offered in the first part of a two-step bid, the rule would discourage hostile tender offers by giving target management more time to defend against the bid. Id. at 57,681 (Shad, Chairman, dissenting). Both dissenting commissioners also noted that the rule lengthens the mandatory proration period of ten days established in the Williams Act itself and may thus venture beyond the authorization of the statute. SEC Exchange Act Release No. 19,336, supra, at 57,680 (Shad, Chairman, dissenting); id. at 57,681 (Treadway, Comm'r, dissenting). Defenders of the rule perhaps could view the statutory period as only a minimum proration period, which the SEC has some discretion to extend as necessary for the protection of investors. However, § 14(d)(6) of the Williams Act, 15 U.S.C. § 78n(d)(6) (1982), which deals with proration, does not grant the SEC rulemaking authority. The SEC purported to act under the general antifraud rulemaking authority conferred by § 14(e) of the Williams Act, 15 U.S.C. § 78n(e) (1982), and the rulemaking authority conferred by § 23(a) of the Securities Exchange Act of 1934, 15 U.S.C. § 78w(a) (1982). SEC Exchange Act Release No. 19,336, supra, at 57,679 n.2. But since other sections of the Williams Act contain specific authorizations to adopt rules, see, e.g., Williams Act § 14(d)(1), (d)(4), (d)(5), (d)(8)(C), 15 U.S.C. § 78n(d)(1), (d)(4), (d)(5), (d)(8)(C) (1982), Congress may have intended to prevent the SEC from modifying the statutory provisions except where it expressly indicated otherwise. Moreover, Congress considered and rejected proposals to grant the SEC rulemaking authority under § 14(d)(6). See SEC Exchange Act Release No. 18,761, supra, at 24,339 & n.9; see also SEC Exchange Act Release No. 19,336, supra, at 57,681 (Treadway, Comm'r, dissenting) (summarizing arguments against validity of rule); Note, Tender Offer Timing Rules: Upsetting a Congressionally Selected Balance, 68 Cornell L. Rev. 914 (1983) (rule conflicts with language and policy choices of Williams Act); cf. San Francisco Real Estate Investors v. Real Estate Inv. Trust of Am., 692 F.2d 814, 817 (1st Cir. 1982) (10-day statutory proration period, "while not necessarily immutable, is certainly entitled to respect from courts").

Under the City Code, the duty to prorate extends through the entire duration of the offer. City Code, supra note 32, rule 27(4).

[231] See SEC Exchange Act Release No. 18,761, supra note 230, at 24,339 (proposing SEC rule 14d-8).

[232] See id. ("As a practical matter, security holders are compelled to make their investment decisions on these large and complex [two-step] transactions within the ten calendar day proration period . . . or risk losing both the opportunity to sell into the market at prices reflecting the

two-step transactions are often so complicated that shareholders do not understand the importance of the ten-day proration period to the likelihood that they will receive the higher first-step consideration for as many of their shares as possible.[233]

The new SEC rule requiring proration throughout the offer period diminishes the advantage of tendering during the first ten days of a two-step partial offer. It does not, however, prevent an offeror from paying a higher premium for shares accepted pro rata from shareholders who tendered during the first step, and it has no effect on front-end loaded offers for all of a target's shares. Certain fundamental problems with these offers thus persist. For example, shareholders may be coerced into tendering hastily by a desire to receive the more favorable first-step consideration. Individual or small noninstitutional shareholders are particularly likely to need more time than the first-step deadline may allow to evaluate the information disclosed with the offer and to reach an informed decision.[234] This pressure severely undermines the anti-stampede provisions of the Williams Act and the legislative concerns behind them. Moreover, any shareholder who does not tender risks being frozen out in a subsequent short-form merger and receiving only the consideration offered in the merger, subject to the shareholder's exercise of appraisal rights.[235] These arguments contributed to the SEC's decision to lengthen the proration period,[236] but they have not been successful in litigation challenging the legality of two-step transactions.[237]

For a number of reasons, two-step transactions are not feasible under the City Code. General principle 8 requires that all shareholders of the same class be treated similarly by an offeror.[238] This basic mandate of equality appears to prohibit an offeror from making a two-step bid and denying to some shareholders the more attractive consideration given to others. In addition, rule 34 requires that the offeror give nontendering shareholders the opportunity to sell for cash at the highest price paid by the offeror in the preceding twelve

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tender offer premium and the opportunity to participate in the [first-step] portion of the tender offer.").

[233] See id.; see also note 230 supra.

[234] See Masters, Lawyers Endorse New SEC Tender Offer Proposal, Legal Times of Wash., May 17, 1982, at 8.

[235] See generally 1 M. Lipton & E. Steinberger, supra note 8, §§ 9.1, 9.2.2, 9.3.2.2; see also authorities cited in notes 213, 225 supra.

[236] See SEC Exchange Act Release No. 18,761, supra note 230, at 24,339.

[237] See Radol v. Thomas, 556 F. Supp. 586, 589-90 (S.D. Ohio 1983) (summary judgment for defendants granted against plaintiffs' claim that two-tier merger was manipulative in violation of § 14(e) of Williams Act and § 10(b) of Securities Exchange Act); see also Radol v. Thomas, 534 F. Supp. 1302, 1311-13 (S.D. Ohio 1982) (preliminary injunction denied in same case).

[238] City Code, supra note 32, at 15.

months.[239] These provisions of the Code also prevent the offeror from providing a lesser consideration in a freeze-out merger within one year following a bid.[240] Thus, rule 34 eliminates the need for judicial scrutiny of the fairness of freezeouts and for judicial appraisal of dissenting stockholders' shares. Given the uneven American experience with such judicial determinations,[241] the straightforward appeal of rule 34 is undeniable. Furthermore, while the unavailability of the two-tier transaction may have inhibited some bids, it does not appear to have unduly burdened hostile offers in Britain generally.

The City Code's aggressive pursuit of shareholder equality has not been without cost. Like the Code's restrictions on partial bids,[242] the rule 34 obligation requires purchasers of significant numbers of shares to expand considerably the extent of their acquisitions. Some potential purchasers may be unable or unwilling to do so; even if they have the financing available for the additional investment in the target mandated by rule 34, they may prefer to diversify their investment opportunities and risks by investing elsewhere.[243] Rule 34, like the City Code's other restrictions on partial bids, may discourage some transactions that would benefit all parties.

The buy-out obligation imposed by rule 34 requires careful justification in light of the substantial costs the obligation can create. Historical commentary on the City Code has asserted that rule 34 was essential because of the inadequate remedies British law afforded to minority shareholders who believed that controlling shareholders were abusing their prerogatives.[244] Thus, a comparison of the British

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[239] Id. rule 34.

[240] See Lawrie, supra note 212, at 609-10, 620.

[241] For discussions of the uncertainty involved in American judicial appraisals, see, e.g., Schaefer, The Fallacy of Weighting Asset Value and Earnings Value in the Appraisal of Corporate Stock, 55 S. Cal. L. Rev. 1031 (1982); Weiss, supra note 213, at 671-90; see also Manning, The Shareholder's Appraisal Remedy: An Essay for Frank Coker, 72 Yale L.J. 223, 231-38 (1962); Note, Valuation of Dissenters' Stock Under Appraisal Statutes, 79 Harv. L. Rev. 1453 (1966).

Professor Carney has argued that shareholders' adoption of charter amendments that protect them against unfair treatment in the aftermath of a tender offer may be an efficient way to maximize shareholder wealth and to avoid the awkwardness of judicial determinations of fairness. See Carney, supra note 168, at 373-81. His argument does not address the question whether general rules like those in the City Code are preferable to the company-specific rules produced by charter amendments. In making this comparison, one should keep in mind that most proposals for such charter amendments are originated by management as an anti-takeover move. In turn, the availability of a general rule such as rule 34 of the City Code does not depend on the predilections of a particular company's management.

[242] City Code, supra note 32, rule 27; see text accompanying notes 80-84, 150-60 supra.

[243] The argument in the text parallels that in Javaras, Equal Opportunity in the Sale of Controlling Shares: A Reply to Professor Andrews, 32 U. Chi. L. Rev. 420, 426 (1964).

[244] See, e.g., Weinberg & Blank, supra note 48, para. 902.

minority shareholder's plight with that of his American counterpart is instructive.

There are two significant differences between the remedies available to the disgruntled stockholder in Britain and in the United States. First, stockholder derivative actions are relatively rare in Britain, in part because English courts follow the rule of *Foss v. Harbottle*.[245] With few exceptions, that rule prohibits derivative suits if the matter complained of could be remedied by a majority vote of the stockholders.[246] More importantly, derivative actions are also discouraged by English rules regarding attorneys' fees, which prohibit contingent fees and impose liability on the loser for the winner's attorneys' fees and other litigation costs.[247] Although recent changes have made derivative litigation a more serious possibility for the complaining stockholder,[248] the remaining difficulties still weaken the ability of minority shareholders to resist the will of the company's management and its controlling stockholders. Second, British company law confers no protection corresponding to the state-law rights of shareholders to receive the cash value of their shares if they dissent from merger transactions and perfect their statutory right to appraisal of their shares.[249] Shareholders in British companies have a statutory right to be bought out only when the company is liquidated and its business is sold in exchange for the shares of another company.[250] Although a dissenting shareholder may apply to a court to reject other schemes of reorganization, no type of reorganization other than liquidation confers appraisal rights. This limitation may further flexibility and avoid the awkwardness of judicial appraisal,[251] but it places the British minority shareholder in a less desirable position than that of her American counterpart.

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[245] 2 Hare 461, 67 Eng. Rep. 189 (Ch. 1843).

[246] Most notably, the individual may maintain a suit where those in control of the company are perpetrating a fraud on the minority. See id. at 492, 67 Eng. Rep. at 203. For other exceptions to the rule of *Foss v. Harbottle*, see L. Gower, Modern Company Law, supra note 30, at 644-45.

[247] See Gower, Some Contrasts, supra note 4, at 1385. The shareholder's position is strengthened somewhat, however, by the possibility of an investigation by the Department of Trade. See L. Gower, Modern Company Law, supra note 30, at 675-79. However, recent budget cutbacks have limited the frequency with which the Department can finance such investigations. See Honesty is the Cheapest Policy, The Economist, July 3, 1982, at 66.

[248] The expansion of the minority shareholder's ability to obtain judicial relief against actions unfairly prejudicial to the minority is detailed in L. Gower, Modern Company Law, supra note 30, at 644-70, and Hannigan, Statutory Protection for Minority Shareholders: Section 75 of the Companies Act 1980, 11 Anglo-Am. L. Rev. 20 (1982).

[249] See note 225 and accompanying text supra.

[250] Companies Act, 1948, 11 & 12 Geo. 6, ch. 38, § 287(3).

[251] See note 241 supra.

From this perspective, rule 34's stringent measures appear justified as much by the perceived inability of British law to prevent abusive treatment of minority shareholders as by egalitarianism alone. That the minority shareholder in an American corporation is not as vulnerable or remediless is surely a factor that must weigh heavily against the adoption of so costly a repurchase mandate as rule 34.

C. *The Selling Environment*

A regulatory scheme designed to protect shareholders must take account of quite disparate influences on the price of target shares on and off the stock exchanges. Bidding contests among tender offerors competing for the target are obviously such an influence; another is stock market trading by risk arbitrageurs in target shares. This section examines these two kinds of transactions and explores their significance for American and British tender offer regulation.

1. *Competitive Bidding*

a. The Basic Structure. Tender offer regulation can either encourage or discourage the development of competing bids for the target's shares. For example, a regulatory decision not to require that offers remain open for a minimum time would make competitive bidding less likely, since shareholders could be required to tender before an auction had time to develop.[252] Such a decision might be deliberately directed against auctions, but it might also be justified simply because the time required for an auction to develop may give the target management time to move aggressively against the bid. Thus the prevention of auctions might be only a consequence of attempts to prevent certain defensive maneuvers by target management.[253] Regulatory decisions that discourage auctions might also reflect the beliefs that corporate takeovers are desirable and that more takeovers will occur if bidders know that they are unlikely to meet competition.[254] However, this argument assumes that the benefit target shareholders would receive from more frequent offers under a regime that discourages competitive bidding is at least as great as the benefit to target shareholders of higher offer prices resulting from competitive bidding.[255] In particular, opponents of competitive bid-

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[252] See Bebchuk, supra note 117, at 1052.

[253] See id. at 1029.

[254] See Easterbrook & Fischel, supra note 3, at 1189-90.

[255] Professors Easterbrook and Fischel make this assumption. Id. at 1175. They observe that the benefits from competitive bidding in the form of higher prices to target shareholders are

ding assume that the costs of acquisitions made without auctions (including the cost of retransferring assets after a mistaken acquisition) will be lower than the costs accompanying auctions.[256] This assumption is very doubtful, but the debate over it and related questions has been well waged elsewhere[257] and will not be repeated here.

The various minimum duration requirements imposed by the Williams Act[258] and SEC rules in the United States[259] and the City Code in Britain[260] encourage auctions by giving potential bidders time to assess the target and launch their bids. SEC rules promulgated under the Williams Act[261] require that most offers be kept open for at least twenty days; the City Code imposes an initial open period of twenty-one days.[262] A likely danger of significantly longer periods is the possibility that given sufficient time, target management could frustrate the ability of the shareholders to tender to the highest bidder.[263]

Mandatory proration rights also favor competitive bidding, although they are probably not so important in this respect as minimum duration periods. Mandatory proration prohibits offerors who make partial bids from providing that, in the event of oversubscription, tenders will be accepted on a first-come, first-served basis. If a first-come, first-served condition were permitted, shareholders would have an incentive to tender early, which would give competitive bidders less time to become involved.[264]

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exactly offset by the bidder's payment and the consequent loss to the bidder's shareholders, and that as a result "[s]hareholders as a group gain nothing." Id. Of course, not all bidders are corporate entities with shareholders. In any event, this argument does not explain why target shareholders should be satisfied with lower prices for their shares when their company is sold merely because offeror companies and their shareholders gain from those prices. See Bebchuk, supra note 117, at 1049. Finally, competitive bidding appears to be the most efficient device for transferring assets to those new owners who put the highest value on their use. See id. at 1048-49.

[256] See Easterbrook & Fischel, Auctions and Sunk Costs in Tender Offers, 35 Stan. L. Rev. 1, 14 (1983).

[257] Compare Easterbrook & Fischel, supra note 3 (opposing competitive bidding) with Bebchuk, supra note 117 and Gilson, Defensive Tactics, supra note 3, at 868-75 (favoring competitive bidding).

[258] See note 8 supra.

[259] Id.

[260] See note 155 supra.

[261] See note 8 supra.

[262] See note 155 supra.

[263] Some state tender offer statutes require that offers remain open for as long as 60 days. See 1 M. Lipton & E. Steinberger, supra note 8, § 5.6.5; Bartell, supra note 20, at 527-29. Many states also impose a waiting period before the offer can proceed after notice has been given to the target and the state administrator. See Bartell, supra note 20, at 521-23. These delaying provisions increase the risk that target management may frustrate the ability of shareholders to accept a desirable bid.

[264] See notes 228-30 and accompanying text supra.

b. The Right to Withdraw Tenders. Frequently a tender offer will provoke a competing offer from another bidder, and shareholders who have tendered in response to the first offer may find the second more desirable. Both the British and American systems provide mechanisms, albeit different ones, that may enable shareholders to "detender" and then "retender" to the second bidder. Under the Williams Act and SEC rules, a shareholder may withdraw previously tendered shares, provided he does so within specified periods. Under rule 14d-7, the shareholder may withdraw tendered shares at any time within fifteen business days of the commencement of the offer.[265] In addition, if tendered shares have not been accepted for payment by the bidder under the terms of its offer and if another bidder makes a competing offer, rule 14d-7 allows the shareholder to withdraw the tendered shares within ten business days of the commencement of the second offer.[266] Thus, if the shareholder withdraws within the specified periods, he may sell his shares in the market, tender to another bidder, or continue to hold the shares. These absolute withdrawal rights substantially undercut strategic advantages the first offeror would otherwise have, for they permit shareholders who have accepted the initial offer to reject it later for a competitive bid.[267]

The City Code's treatment of withdrawal rights is substantially different, more complicated, and less clear than its American counterpart. Rather than granting shareholders a unilateral right to withdraw tendered shares within specified periods of time, the Code focuses on whether the offer has "become or been declared unconditional."[268] This event occurs when the offeror, under the terms of its offer and of the Code, becomes unconditionally obliged to purchase the tendered shares, i.e., when all conditions to its obligation to purchase set forth in the bid have been satisfied.[269] Two

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[265] SEC rule 14d-7, 17 C.F.R. § 240.14d-7 (1983). The SEC Advisory Committee on Tender Offers recommended that the minimum period during which shareholders may withdraw tenders be made the same as the minimum offering period, and that a competing bid not generally trigger additional withdrawal rights under the original offer. Advisory Committee Report, supra note 1, at 27-29. Under SEC rule 14d-7(a)(2), 17 C.F.R. § 240.14d-7(a)(2) (1983), a competing bid currently extends withdrawal rights under the original offer for 10 business days following commencement of the competing bid. By making a competitive bid for its own shares or by successfully prompting a bid from a white knight, the target may delay purchases by the original offeror under its bid. This result has evidently influenced the decisions of some targets to make such offers. See A. Sloan, Three Plus One Equals Billions 231 (1983). The Advisory Committee's rejection of rule 14d-7(a)(2) apparently resulted in part from its disapproval of such tactics. See Advisory Committee Report, supra note 1, at 28-29.

[266] SEC rule 14d-7, 17 C.F.R. § 240.14d-7 (1983).

[267] See E. Aranow & H. Einhorn, supra note 162, at 71, 134-35.

[268] City Code, supra note 32, rule 22(1).

[269] See P. Davies, supra note 46, at 23-25.

specific provisions of the Code affect the options of a shareholder who wishes to withdraw tendered shares and retender them in response to a later bid.

First, rule 22(1) provides that offers must be kept open for a minimum of twenty-one days.[270] If after another twenty-one days following the first closing date of the offer, the offer has not become or been declared an unconditional obligation of the offeror, the shareholder may withdraw any shares tendered.[271] Consequently, a minimum of forty-two days from the commencement of the offer must elapse before shareholders may withdraw tenders from that offeror.

Second, rule 21 regulates any tender offer that, if fully accepted, would cause the bidder to own more than fifty percent of the voting shares. Such an offer may not become unconditional unless the offeror acquires or agrees to acquire sufficient shares so that the offeror will own more than fifty percent of the voting stock.[272] If an offeror fails to achieve control of more than half of the voting shares through its tender offer together with any other acquisitions of target shares, it is not under an unconditional obligation to purchase the tendered shares. The tendering shareholders may then withdraw their shares under the conditions of rule 22. The Panel imposed the fifty percent condition to discourage the transfer of effective control when the purchaser does not acquire more than fifty percent.[273]

Because the City Code permits offerors to purchase target shares on the market, however, the offeror is not restricted to acquisitions made through the bid in gaining control of over half of the voting shares.[274] Even if the tender offer price proves unattractive to target shareholders, the offeror has twenty-one days after the bid closes to count the number of shares tendered and then buy enough additional shares in the market to bring it over the fifty percent mark. Such a purchase fulfills the bid condition mandated by rule 21 and binds the

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[270] City Code, supra note 32, rule 22(1).

[271] Id. rule 22(1). Rule 22(2) prohibits offerors from declaring offers unconditional after 60 days have expired from the initial posting of the offer; to extend an offer beyond the 60-day maximum requires the Panel's consent, which normally is reserved for offers that have attracted competing bids. Id. rule 22(2). The 60-day provision is similar to § 14(d)(5) of the Williams Act, 15 U.S.C. § 78m(d)(5) (1982), which gives shareholders the right to withdraw tendered securities after 60 days from the date of the original tender offer. The right is unavailable if the stockholder has received payment for his shares or a notice that his tender has been accepted along with a commitment to pay. This provision was intended to prevent the offeror from tying up the shares indefinitely. See E. Aranow & H. Einhorn, supra note 162, at 134-35.

[272] City Code, supra note 32, rule 21(1).

[273] See A. Johnston, supra note 34, at 242.

[274] See text accompanying notes 95-100 supra.

shareholders who have tendered. The offeror's ability to maneuver through market purchases places considerable control over the satisfaction of the condition in its own hands.

Once the target shareholder has tendered his shares, he has markedly less ability to maneuver. If he agrees to sell to another bidder before it is clear that the original bid has failed—i.e., that not all conditions of the bid will be met—he is in breach of contract, since the shareholder cannot perform under his contracts with both bidders if all conditions of both bids are met.[275] Under the Code, shareholders may thus detender with impunity only if the offeror fails to acquire more than half of the voting shares, whether through the bid or market purchases, before the expiration of twenty-one days from the closing of the offer.[276]

Unlike the Williams Act, the City Code favors bidders who make the first offer; it protects their accumulation of tenders from shareholder withdrawals. Only after a condition of the bid has failed, such as the failure of a bidder seeking over fifty percent of voting strength to achieve that goal, may a shareholder withdraw his tender. The cost of that certainty for the initial bidder is substantial uncertainty and risk for tendering shareholders, who may lose the benefits of a higher, second bid without even being assured that their shares will ever be purchased by the initial bidder to whom they tendered.

2. *Arbitrage*

Risk arbitrage also affects the price paid to shareholders for their shares. For the purposes of tender offer regulation, "arbitrage" refers to the activity of market professionals who buy target company shares when a tender offer appears imminent or has been made in order to tender them to the offeror. This activity causes the market price of target shares to rise closer to the offer price. Target shareholders may then sell at a price in excess of the pre-offer price without risking the failure of the offer or waiting for its completion.[277] Furthermore, purchases by market arbitrageurs who anticipate a subsequent higher bid may cause the market price to rise above the bid price. In that

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[275] See P. Davies, supra note 46, at 23-24.

[276] See id. Of course, the statement in the text applies only to offers governed by rule 21. See text accompanying note 273 supra. A shareholder may also detender under rule 22 if the failure of some other condition prevents the offer from becoming unconditional. See text accompanying note 271 supra.

[277] See 1 M. Lipton & E. Steinberger, supra note 8, § 1.7.2, at 85 (Supp. 1979).

event, the prudent stockholder should either sell in the market or await the expected better offer.

Because the City Code hobbles arbitrage in at least two ways, however, it is not an important means of reducing target shareholders' risks in Britain. First, the mandatory fifty percent bid condition of rule 21 may make arbitrage activity unattractive. In setting the price they are willing to pay, arbitrageurs discount the offer price by, among other factors, the risk that the offer will not be consummated and the risk of proration in a partial bid.[278] If the offeror conditions its commitment to purchase any shares on receiving a minimum number of tendered shares, the risk that the offer will fail increases, particularly if the minimum is a high one.[279] The mandatory fifty percent condition of rule 21 significantly increases the likelihood that the offer will fail and that arbitrageurs will be deprived of the premium prices generated by a tender offer.[280] Second, rule 34 may operate directly against arbitrageurs. An arbitrageur who acquires thirty percent or more of the target's securities is itself subject to the rule's requirement that a person acquiring thirty percent ownership or more offer to buy out the remaining stockholders.[281] Such a requirement would obviously discourage arbitrageurs from accumulating a holding large enough to trigger the mandatory bid obligation.[282]

These burdens on arbitrage inhibit a potentially important market-supplied form of protection for British target shareholders. They tend to deprive shareholders of the opportunity to sell in a market

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[278] See id. at 85-86. If the offer is for fewer than all of the target's shares, the arbitrageur also discounts the price it is willing to pay by the risk that the offer will be oversubscribed and only a pro-rata portion of the shares tendered will be accepted. See id.

[279] See id. § 1.7.3, at 86.

[280] The City Code does not inhibit arbitrage connected with partial bids for less than 30% of the target's shares in this way, since the Code does not impose any minimum on such bids. See text accompanying notes 80-82 supra.

[281] See text accompanying notes 76-78 supra.

[282] The Panel has stated that, except under two special circumstances, it will not normally waive the bid requirement for a 30% purchaser when another shareholder already owns 30% of the company's securities. The exceptions arise if a single shareholder who holds 50% or more and thus has legal control of the target states that he would not accept the purchaser's rule 34 bid, or the purchaser can obtain similar statements from holders of 50% or more of the voting rights. See City Code, supra note 32, practice note no. 15, § 16 ("Balancing Block"). Factors other than the City Code rules evidently contribute to the absence of arbitrage activities in Britain. One authority has speculated that the reason there is "very little arbitraging" in Britain may be "one of custom or tradition or unwillingness to devote resources to what can be a speculative activity." Letter from Peter Lee, Deputy Director-General of the Panel on Take-overs and Mergers, to Author (Sept. 18, 1981) (on file at New York University Law Review).

stimulated by arbitrage, and thereby to receive a price closer to the offer price while avoiding the risk of the offer's failure.[283]

The practice of large-scale risk arbitrage in the United States has been criticized.[284] Arbitrageurs may acquire such large blocks of stock that they, rather than the target's original shareholders, determine whether a particular offer will succeed or fail. It has been argued that the offer's success then turns on the predilections of the arbitrageurs rather than on its inherent merits, and that this phenomenon may induce offers "artificially" simply by creating the prospect of a sale to arbitrageurs at an elevated price.[285] The consequence would presumably be that offers are made that should not be, or would not be, in the absence of extensive risk arbitrage.

Studies of *post*-takeover consequences have evaluated the merits of an offer by assessing the offeror's success in assimilating and employing profitably the acquired corporation. Although the data for both countries indicate that a significant number of mergers are not profitable, the proportion of unprofitable to profitable mergers has been much greater in Britain.[286] A 1980 British study concluded that, based on earlier studies, as many as eight out of nine mergers had been unprofitable.[287] The author suggested several reasons that acquisitions continued to occur despite their frequent unprofitability, and examination of those reasons is illuminating for the American experience as well.[288] Many acquirers appear to exaggerate the economies of scale that will follow a particular merger and to disregard many of the complexities involved in realizing these economies. They underestimate the personnel problems, especially managerial ones, that will arise after the merger. Moreover, successful offerors often fail to give adequate attention to these problems after the acquisition occurs. Frequently, takeovers are made for the "wrong reason," as an easy way for the acquiring firm to grow in size. Compounding these problems is the difficulty of determining the proper price to pay. The

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[283] Some upward movement in the target's price may nonetheless occur if the bidder purchases target shares in the market. But because bidders may not make market purchases at all, or may make them in far smaller numbers than would arbitrageurs, the ability of bidders to make market purchases is clearly not a substitute for arbitrage. For a discussion of regulatory issues raised by tender offer arbitrage in the U.S., see generally Henry, Activities of Arbitrageurs in Tender Offers, 119 U. Pa. L. Rev. 466 (1971); Comment, Should Tender Offer Arbitrage Be Regulated?, 1978 Duke L.J. 1000.

[284] See, e.g., Comment, supra note 283, at 1028.

[285] See, e.g., id.

[286] Davies, Takeovers: it seems everyone's a loser, 58 Mgmt. Acct. 22 (Sept. 1980).

[287] Id. at 23.

[288] See id.

acquiring firm's management may become personally committed to achieving the acquisition, even at a price that cannot be justified by the potential profitability of the target.[289] In short, the operational problems of digesting the target firm are frequently aggravated by the payment of too high a price for the target, so that post-merger profitability is difficult to achieve. The persistence of the ill-advised acquisition in the arbitrage-free British environment may suggest that risk arbitrage alone does not explain why such transactions do or do not occur.

As the American experience suggests, arbitrage can frustrate regulatory efforts to promote shareholder equality if it is not given special attention. Because of their sophistication in market operations and special investment goals, arbitrageurs have strong reasons for attempting to maneuver around the rules and can often do so. For example, arbitrageurs quickly discovered how to evade the proration requirements of the Williams Act through short tendering, that is, tendering more shares than they actually owned in order to sell a greater portion of their shares under proration.[290]

When the SEC responded by prohibiting short tendering,[291] arbitrageurs soon devised the practice of hedged tendering, which involves

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[289] Id. Many studies, based on both British and American data, have examined the factors surrounding an offeror's selection of a particular target. E.g., D. Austin & J. Fishman, Corporations in Conflict—The Tender Offer 43-57 (1970); G. Meeks, Disappointing Marriage: A Study of the Gains from Merger (1977); A. Singh, Take-Overs 45-122 (1971). Some studies have tested the predictive force of models for describing likely targets of takeover bids. One study examined the thesis, suggested by the writings of Robin Marris, that takeover bids will be encouraged by target managements who do not maintain acceptable "valuation ratios," i.e., acceptable ratios between the market value of equity capital to the book value of the equity assets. See G. Newbould, Management and Merger Activity 97-107 (1970) (citing R. Marris, The Economic Theory of 'Managerial' Capitalism (1st ed. corrected 1967)). In this model, the relevant variables are the proportion of earnings retained in the firm, the expected rate of return on firm assets, and the discount rate applied to the firm's shares by investors. G. Newbould, supra, at 98. This theory implies that likely targets should display an absence of high valuation ratios and a preponderance of low valuation ratios. See id. at 97-100. However, an examination of actual target companies demonstrated that neither of these characteristics held for the sample studied. Target firms could not readily be identified by their valuation ratios; indeed, in about half the cases the target management was more "successful" (in the valuation ratio sense) than the bidder's management. See id. at 100-05. Other studies have evaluated the "survival strategies" that firms might pursue in order to avoid being taken over based on the thesis, related to the Marris thesis, that these firms would be well-advised to increase profitability. Again, however, the evidence demonstrated that the pressure upon managers to avoid takeover through improved profitability is weak and that, in fact, the best survival strategy is to increase size rather than profitability. See G. Meeks, supra, at 66-67.

[290] See Friedman, Tender Offer Issues for 1982, 14 Rev. Sec. Reg. 833, 836-37 (1981).

[291] Short tendering is currently prohibited by SEC rule 10b-4, 17 C.F.R. § 240.10b-4 (1983); see also SEC Exchange Act Release No. 8321, 33 Fed. Reg. 8269 (1968) (adopting rule 10b-4).

buying shares in the market, tendering them all, and then reselling in the market tendered shares that the bidder will be unable to accept because of the proration rule. This practice, although more expensive than short tendering, achieves substantially the same result.[292] The SEC has proposed prohibiting hedged tendering as well,[293] although it simultaneously proposed in the alternative abandoning altogether its efforts to regulate such methods of frustrating the proration requirement.[294]

The SEC's experience in attempting to restrain certain arbitrage activity illustrates the difficulties of regulating tender offers on the assumption that all shareholders, whether they are individuals, institutional investors, or arbitrageurs, should be treated alike. The Williams Act contemplates a constituency of "a large number of passive and anonymous shareholders,"[295] but in reality, the dominant players in many takeover contests are a small number of arbitrageurs and institutional shareowners, each owning a large block of shares. The Act's misconception of the role played by small shareholders makes it difficult for the SEC to regulate arbitrageurs in ways that recognize their special characteristics. That difficulty, in turn, helps arbitrageurs undermine the general regulatory agenda of the SEC. The British market, with its regulatory and social pressures discouraging arbitrage, does not face these problems, but it sacrifices the insurance benefits arbitrage affords small shareholders.[296]

British and American regulatory authorities have reached different conclusions about the relative values to target shareholders of equality and risk arbitrage. The SEC's recent proposal to control hedged tendering, however, may suggest that the SEC is rethinking its assumptions. The SEC release accompanying that proposal noted that market professionals are more likely to be able to engage in short or hedged tendering than are individual shareholders, who generally cannot short tender because they cannot borrow stock during offers and who lack the financing for other sophisticated market strategies

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[292] See SEC Exchange Act Release No. 18,050, 46 Fed. Reg. 43,459, 43,460 (1981) (commenting on "anomalous" fact that hedged tendering can "accomplish precisely the same result" as prohibited short tendering).

[293] See id. at 43,464 (proposed amendments to rule 10b-4 (to be codified at 17 C.F.R. § 240.10b-4) (proposed Aug. 21, 1981)); see also id. at 43,461-63 (summary and explanation of proposed amendments). The SEC Advisory Committee on Tender Offers recommended that hedged tendering be prohibited. Advisory Committee Report, supra note 1, at 48. The Committee viewed multiple tendering, which occurs when a shareholder tenders the same shares to more than one offeror, as "simply a variant of short tendering," and recommended outlawing this practice as well. Id.

[294] See SEC Exchange Act Release No. 18,050, supra note 292, at 43,463.

[295] Friedman, supra note 290, at 837.

[296] See text accompanying notes 279-83 supra.

employed by arbitrageurs.[297] Prohibiting these practices, the argument runs, would equalize shareholders' exposure to the risk of proration. But the release also recognized that regulation of short tendering and hedged tendering lowers the price available to target shareholders who desire to sell in the market. To the extent that arbitrageurs can minimize the threat posed by proration, the market price will be closer to the offer price, since arbitrageurs will demand less of a margin to compensate for the risk of proration.[298] If the SEC acts to protect shareholders by preventing arbitrageurs from evading the risks of proration, it paradoxically denies small shareholders who wish to sell their shares valuable protection against the risk that the tender offer will fail. The question this dilemma raises is whether, or in what form, the SEC should tolerate or even encourage special devices employed by risk arbitrageurs because of the opportunities arbitrageurs create for other shareholders. Congress, too, may address that question if it reconsiders the structure of federal securities regulation. In short, those designing American tender offer regulation must confront the fact that the market cannot benefit from arbitrage activity without suffering its disadvantages. As a practical matter, only investors with substantial capital can engage in the profitable but highly speculative practice of risk arbitrage, and stock in arbitrage companies is generally not publicly traded.[299] Thus, tolerating risk arbitrage is inconsistent with a regulatory commitment to equality of opportunity for investors, as risk arbitrage is an investment opportunity that is not widely available. Current American regulation attempts to resolve this tension by permitting arbitrageurs to operate and thus to provide an important insurance benefit for small investors, while regulating arbitrage tactics that appear especially abusive, overreaching, or likely to undermine general investor confidence. Arbitrageurs should not be permitted a systematic advantage in evading rules applicable to other investors.

IV

Defensive Maneuvers by Target Management

The British and American systems of tender offer regulation differ sharply in their treatment of efforts by target management to

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[297] See SEC Exchange Act Release No. 18,050, supra note 292, at 43,459.

[298] See id.

[299] See id.; see also R. Phalon, The Takeover Barons of Wall Street—Inside the Billion-Dollar Merger Game 140-42 (1981). Professional arbitrageurs also enjoy superior access to nonpublic information about offers before they are formally announced. Id. at 143-51. Phalon reported high demand for an offering of limited partnership interests, requiring a minimum investment of $250,000, in a fund investing exclusively in arbitrage deals. Id. at 141.

discourage or defeat unwanted tender offers. The City Code requires shareholder approval for drastic defensive tactics once an offer has been announced or appears imminent.[300] The American regulatory system treats most defensive responses to tender offers considerably more leniently. The American view assumes that because the factors relevant to assessing an offer do not differ significantly from those attending other major corporate decisions made by management, management should determine the target's response to a tender offer. The British view regards the response to a tender offer as a shareholder prerogative, much like the shareholder's decision whether to sell her stock.

These different opinions about corporate decisionmaking may derive from the evolution of corporate law in each country. In Britain, the structure of the modern business corporation grew from the unincorporated partnership, an arrangement based on mutual agreement between the owners concerning the conduct of their affairs.[301] As a result, English company law owes much to the principles of partnership and contract law, and its provisions generally determine a corporation's structure only in the absence of agreement among the shareholders and managers to the contrary. By contrast, American law has traditionally regarded the corporation as an entity distinct from its owners, requiring state authorization for its existence. American corporation laws therefore define the corporation's rights and internal allocation of power.[302]

In Britain, then, the internal structure of a corporation is essentially a contractual matter; in the United States, it is defined by statute. Many internal matters that are prescribed by American corporation statutes, e.g., the method of selecting directors and the respective powers of directors and stockholders, are left to contractual agreement in Britain.[303]

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[300] See text accompanying notes 90-91 supra.

[301] See Gower, Some Contrasts, supra note 4, at 1369, 1371-72. Some enterprises were organized as statutory companies incorporated under acts of Parliament, typically to carry out major ventures such as canal and railroad construction. Statutory companies enjoyed limited liability and had separate corporate personalities with the capacity to sue and be sued. See P. Atiyah, The Rise and Fall of Freedom of Contract 562 (1979).

[302] See Gower, Some Contrasts, supra note 4, at 1377.

[303] Many American corporation statutes now permit parties to vary the statutory terms by agreement, especially in the case of closely held corporations. See generally Manne, Our Two Corporation Systems: Law and Economics, 53 Va. L. Rev. 259 (1967). Nonetheless, statutes still control most aspects of internal corporate governance in the United States. See, e.g., M. Eisenberg, The Structure of the Corporation: A Legal Analysis 1-3 (1976).

Because American corporation statutes give management defined rights, powers, and responsibilities, the management of an American corporation has an institutional force that exceeds that of its British counterpart. This scheme has tended to support the frequently encountered claims of management that its efforts to remain in control express the interests of the corporation as a separate entity.[304] Furthermore, it is also relevant that the extensive professionalization of management that occurred in the United States before World War I did not take place in Britain until after World War II.[305] A hierarchical structure of business management in large integrated firms developed and was accepted earlier in the United States than in Britain. The emergence of that management structure, staffed by professional managers with specialized skills and formal training whose competence was expected to cover decisionmaking in very different firms, also helps to explain why the American legal system defers more than the British system to management decisions that a tender offer should be resisted.[306] This Part of the Article describes more fully the British

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[304] For a history of the developments in American corporation law culminating in "managerialism," see Werner, Corporation Law in Search of Its Future, 81 Colum. L. Rev. 1611 (1981).

A great many consequences flow from the choice of whether to identify the corporation with management or with the shareholders. For example, in Scherk v. Alberto-Culver Co., 417 U.S. 506 (1974), the question presented was the enforceability of an arbitration clause in a contract. The plaintiff claimed that several of the defendant's contractual representations violated the antifraud prohibition of the Securities Exchange Act of 1934. The Court held that its reluctance to enforce arbitration clauses in securities cases, expressed in Wilko v. Swan, 346 U.S. 427 (1953), did not extend to cases involving international corporate transactions like that at issue in *Alberto-Culver*. 417 U.S. at 519-20. The Court reasoned that because the substantive law applicable to such transactions and the appropriate forum for resolving disputes arising from them were uncertain, strong policy considerations supported enforcing the agreement among the parties on the matter. Id. at 515-19. The dissent argued that the fraud would injure not the corporation but rather its stockholders, and that consequently the consent of Alberto-Culver's management to arbitration should not reduce the protection the securities laws afforded to the stockholders. Id. at 526 (Douglas, J., dissenting). It noted the international and negotiated characteristics of the transaction, but struck the balance in favor of vindicating federal protection of the corporation's ultimate owners, its stockholders. Id. at 533 (Douglas, J., dissenting). One might view the theory of the dissent as the obverse of traditional instances of piercing the corporate veil.

[305] See A. Chandler, The Visible Hand: The Managerial Revolution in American Business 498-500 (1977). Chandler hypothesized that professional management developed earlier in the United States for a number of reasons. He observed that domestic markets in this country tended to be larger and more homogenous than those in Europe, and that this difference hastened the growth of mass production and marketing techniques. Id. at 498-99. In addition, the Sherman Act's prohibition of cartels meant that small family firms could not federate, as they did in Europe; they were instead prompted "to consolidate their operations into a single, centrally operated enterprise administered by salaried managers." Id. at 499.

[306] Id. at 8-9. As a result of their formal education in management, managers "had an approach to their work that was closer to that of lawyers, doctors, and ministers than that of the

and American treatment of defenses undertaken by target managements.

A. *The Limits of the Business Judgment Approach*

The American cases give management substantial leeway to decide whether to recommend or oppose shareholder acceptance of an offer and, if the choice is opposition, to employ a variety of defensive strategies. Although the legal authority of management to adopt defensive tactics is not unlimited, its choices usually survive challenges in litigation by shareholders.

Panter v. Marshall Field & Co.[307] resembles many other unsuccessful shareholder suits challenging defensive responses. Carter Hawley Hale (CHH), a retail chain, proposed a merger with Marshall Field & Co., also a retail chain. Field's antitrust counsel advised the directors that the proposed merger would violate the antitrust laws in light of present competition between Field and CHH stores. CHH then announced that unless Field began merger negotiations, it would make a public exchange offer worth $36 per share, or $14 per share more than the current market price.[308] The directors then filed an antitrust suit. After receiving an investment banker's advice, the board also concluded that the price offered was inadequate.[309]

CHH subsequently announced that it intended to make an exchange offer at $42 for Field stock. Field's board decided that consummation of the offer would violate the antitrust laws and did not discuss its merits. The board also announced plans to acquire another group of stores and to establish a Field store in a shopping mall where CHH already operated an outlet.[310] CHH then withdrew its offer on the ground that Field's expansion program cast doubt on the company's earnings potential; soon thereafter the market price of Field stock dropped to $19.[311]

The shareholder plaintiff in *Panter* asserted several challenges to the activities of Field's directors, among them a claim that the direc-

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owners and managers of small traditional business enterprises." Id. at 9. In Britain, skepticism of the notion that management was a profession comparable to the older professions endured into the mid-twentieth century. Some members of the social elite viewed business managers as "the antithesis of the old knightly ideals." A. Sampson, The Anatomy of Britain 453 (1962).

[307] 646 F.2d 271 (7th Cir.), cert. denied, 454 U.S. 1092 (1981).

[308] Id. at 279.

[309] Id. at 279-80.

[310] Id. at 280-81.

[311] Id. at 281.

tors breached their fiduciary duties to the corporation.[312] The court held that the business judgment rule, which is described more fully below,[313] afforded a presumption of good faith to the actions of the directors and that the plaintiff had not demonstrated that the directors had acted from improper motives.[314]

Other suits that have challenged defensive transactions as breaches of fiduciary duty have similarly foundered on the business judgment rule, unless the plaintiff has shown that the defendants acted in bad faith or engaged in forbidden self-dealing, fraud, gross overreaching, or abuse of discretion.[315] If the plaintiff meets its burden of making this showing, it has rebutted the business judgment presumption of good faith.[316] The burden of proof then shifts to the defendants, who must establish that the challenged transaction was fair and reasonable for the corporation.[317]

The rule is probably rooted in the idea that managers will run businesses better if granted broad discretion and left substantially immune from *post hoc* examination of their decisions by judges not involved in the business.[318] The *Panter* court applied the rule to decisions of directors affecting corporate ownership and control in the same way the rule is routinely applied to ordinary decisions about

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[312] Id. at 293. The plaintiff also alleged violations of the prohibition on manipulation and deception in connection with tender offers contained in § 14(e) of the Williams Act, 15 U.S.C. § 78n(e) (1982), and of the general antifraud provisions contained in § 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b) (1982). 646 F.2d at 285. The court of appeals upheld the district court's grant of a directed verdict for the defendants on both claims. The court held that the defendants could not have violated § 14(e) unless a tender offer was actually made; the allegation that a tender offer was withdrawn or frustrated as a result of impermissible conduct did not suffice. Id. at 285-86; see also Lewis v. McGraw, 619 F.2d 192, 195 (2d Cir.), cert. denied, 449 U.S. 915 (1980). The *Panter* court also disposed of § 10(b) claims with a directed verdict, finding that the plaintiff had failed to prove that the defendants had misstated or failed to disclose any matters of material fact during their campaign against CHH's takeover attempt. 646 F.2d at 289-93.

[313] See text accompanying notes 315-22 infra.

[314] 646 F.2d at 293-95.

[315] See, e.g., Treadway Cos. v. Care Corp., 638 F.2d 357, 382 (2d Cir. 1980); Johnson v. Trueblood, 629 F.2d 287, 293 (3d Cir. 1980), cert. denied, 450 U.S. 999 (1981); Arsht, supra note 29, at 134.

[316] *Panter*'s formulation of the plaintiff's initial burden, see 646 F.2d at 293-94, makes it very difficult for the plaintiff to meet that burden, but the *Panter* framework is consistent with that of many other cases. See cases cited in note 315 supra. Of course, the verbal formula by which the business judgment rule is expressed will be far less important than the degree of scrutiny a court actually applies to the facts under examination. The *Panter* court was unusually deferential; for a much more searching review of a challenged defensive transaction, see Condec Corp. v. Lunkenheimer Co., 43 Del. Ch. 353, 362-66, 230 A.2d 769, 775-77 (1967) (placement of initial burden of proof unclear). See also note 319 infra.

[317] See Treadway Cos. v. Care Corp., 638 F.2d 357, 382 (2d Cir. 1980).

[318] See Easterbrook & Fischel, supra note 3, at 1196.

business operations.[319] *Panter* would probably also permit a board to acquire other companies in order to strengthen management's position in antitrust litigation against unwanted offerors.[320] Such tactics reflect not so much ordinary business judgment as strategy to retain control over the corporation. That the effect of defensive maneuvers, if they are successful, will be to strengthen the directors' control of the corporation, or that the directors may lose their positions if the takeover succeeds, does not, under *Panter*, weaken the presumption that the directors acted to further the corporate interest.[321] If directors obtain even moderately sophisticated legal and financial advice, they will be able to resist tender offers vigorously without creating evidence that might defeat the presumption of the business judgment rule. Only uncounseled directors would authorize defensive transactions so recklessly as to demonstrate that their decisions stemmed from impermissible motives.[322]

This judicial deference has enabled inventive techniques to discourage or defeat unwanted tender offers to flourish. Indeed, a thriving market for expert advice on how to discourage and resist tender offers apparently exists.[323] Some strategies are designed to discourage any offeror from making a bid. One British scholar, Gerald Newbould, has described business activity during takeover efforts: "The managerial activity at the time of a merger can be likened to that of a cornered animal; and the management unit, like the cleverest animals, may act on the predisposition that it is better not to be cornered

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[319] See *Panter*, 646 F.2d at 294-95 (citing cases). But cf. Klaus v. Hi-Shear Corp., 528 F.2d 225, 228, 233-34 (9th Cir. 1975) (under California law, management's donation of treasury shares to employee stock ownership trust controlled by management during takeover battle is judged by "balancing of the good to the corporation against the disproportionate advantage to the majority shareholders and incumbent management"). In cases involving transactions that present exceptionally strong potential conflicts of interests for directors, courts sometimes appear to place an initial burden of demonstrating good faith on the directors. See, e.g., Cheff v. Mathes, 199 A.2d 548, 554-55 (Del. 1964) (both chief executive officer and attorney of corporation had "personal and pecuniary" interests in retaining employment and therefore must prove that their votes as directors to approve corporate purchase of shares from shareholder threatening to seek control were made in good faith).

[320] See *Panter*, 646 F.2d at 296.

[321] See id. at 294; accord Crouse-Hinds Co. v. Internorth, Inc., 634 F.2d 690, 702 (2d Cir. 1980); Johnson v. Trueblood, 629 F.2d 287, 292-93 (3d Cir. 1980), cert. denied, 450 U.S. 999 (1981).

[322] See Cohn, supra note 3, at 495-96.

[323] One investment banker offering such advice has publicly described his firm's superior success rate in enabling its clients to fend off takeover attacks. In his view, general knowledge that a company has engaged such assistance itself helps to deter unwanted bids, like a window sticker on a house declaring that it has a burglar alarm. See Carrington, Kidder Teaches Clients How to Fend Off Takeover Bids, Wall St. J., Nov. 25, 1980, at 29, col. 4.

in the first place."[324] To deter unwanted offers, corporations are frequently advised to operate so as to keep the stock market price of shares relatively high.[325] Directors may also discourage tender offers by seeking shareholder approval of amendments to the corporation's charter that make it more difficult for a raider to gain control without management's assent.[326] One such provision would stagger the terms of the directors, so that a new majority shareholder could not replace a majority of the board members at the next annual meeting. Another would require a supermajority shareholder vote to approve a merger or sale of the corporation's assets, and thus would make any combination of the target's business with that of the offeror more arduous. Some charter amendments have specified high buy-out prices for minority stockholders if a merger occurs after a tender offer, while others have attempted to place additional restrictions on stock transfer.[327]

Once deterrent strategies have failed and a tender offer appears imminent, a number of defensive options are available, some more drastic than others in their impact on the target. Urging stockholders to reject the offer on the ground that the price is inadequate is a common tactic.[328] Almost as common is litigation against the offeror alleging violations of federal and state tender offer regulations or, as in *Panter*, the antitrust laws.[329] Other alternatives involve finding a more desirable purchaser, a "white knight," even though this tactic ultimately sacrifices the target's independence. Some white knights can be persuaded simply to outbid the unwanted offeror and thereby acquire control.[330] Others receive special inducements from target management, such as blocks of authorized but unissued shares, to assist their efforts to gain control of the target.[331] The target may also

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[324] G. Newbould, supra note 289, at 96.

[325] Id.

[326] See generally Black & Smith, Antitakeover Charter Provisions: Defending Self-Help for Takeover Targets, 36 Wash. & Lee L. Rev. 699 (1979); Friedenberg, Jaws III: The Impropriety of Shark-Repellent Amendments as a Takeover Defense, 7 Del. J. Corp. L. 32 (1982); Gilson, Shark Repellent Amendments, supra note 168.

[327] See, e.g., Cole, Foremost's Bid to Stop Posner, N.Y. Times, July 10, 1980, at D8, col. 3; Zonana, Foremost-McKesson's Antitakeover Move May Trigger Suit by Sharon Steel Corp., Wall St. J., July 24, 1980, at 25, col. 2.

[328] See Cohn, supra note 3, at 488-89.

[329] Id. at 487-88; see *Panter*, 646 F.2d at 279-80. The appeal of litigation as a defensive tactic appears to have waned. Few targets believe that it will succeed. See A. Sloan, supra note 265, at 150-51.

[330] See Lynch & Steinberg, The Legitimacy of Defensive Tactics in Tender Offers, 64 Cornell L. Rev. 901, 932 (1979).

[331] See, e.g., Blustein, More Companies Use 'the Lockup' to Ward Off Unfriendly Takeovers, Wall St. J., Jan. 28, 1981, at 31, col. 4.

seek to discourage the offeror by making itself less attractive through divestitures or acquisitions,[332] like those in *Panter*,[333] or perhaps even through threatening to liquidate if the offeror does not desist.[334] The possible attraction of the target's liquid assets may also be reduced if it repurchases a quantity of its own shares.[335] Indeed, some targets may be able to prevent a takeover by repurchasing enough of their own shares to go private, thereby eliminating public stockholders who may be tempted by a tender offer.[336]

Forces other than target management may help to discourage the offer. For example, employees of the target may organize and threaten to leave if the offer succeeds.[337] A related tactic is the "golden parachute" arrangement, in which a target board enters into employment contracts with certain managers, promising them generous compensation if the company is taken over.[338] Finally, and perhaps most drastically, the target may itself make a tender offer for the offeror.[339] Judicial acceptance of such tactics often permits management to inhibit or prevent unwanted changes in corporate control. Not surprisingly, commentators have doubted that the business judgment rule adequately protects shareholder interests in tender offer battles.[340] Some have argued that so permissive a test properly applies only to situations in which the interests of the corporation and all of its stockholders do not conflict with the interests of management,[341] and that to apply the test in cases involving such conflicts undermines managerial accountability to corporations and their stockholders.[342]

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[332] See, e.g., Cole, St. Joe Sale of CanDel Under Fire, N.Y. Times, Mar. 31, 1981, at D1, col. 2.

[333] See 646 F.2d at 280-81.

[334] See, e.g., Wayne, Self-Interest and Takeovers, N.Y. Times, Apr. 3, 1981, at D1, col. 3.

[335] See, e.g., St. Joe to Buy 15.5% of Shares at $60 Each to Thwart Seagram's Offer of $45 Apiece, Wall St. J., Mar. 25, 1981, at 2, col. 3. In Britain, a target's ability to defend through stock repurchases is sharply limited. See notes 171 supra and 372 infra.

[336] See, e.g., Sansweet, Fox Film Studies Going Private in Move Seen as Strategy to Resist Takeover Bids, Wall St. J., Nov. 26, 1980, at 4, col. 2.

[337] See Whiteside, Onward and Upward with the Arts: The Blockbuster Complex-III, New Yorker, Oct. 13, 1980, at 52, 57-58 (opposition of authors and editors to takeovers of publishing houses).

[338] See Mufson, Conoco Protects Nine of Its Top Officers with Takeover Compensation Agreements, Wall St. J., July 9, 1981, at 4, col. 2.

[339] See Metz, Kennecott Corp. Plans to Acquire Curtiss-Wright, Wall St. J., Nov. 24, 1980, at 3, col. 1. For discussion of the legal problems created by such transactions, see DeMott, Pac-Man Tender Offers, 1983 Duke L.J. 116.

[340] See Brudney, Fiduciary Ideology in Transactions Affecting Corporate Control, 65 Mich. L. Rev. 259, 272-74 (1966); Cohn, supra note 3, at 492-96; Gelfond & Sebastian, supra note 3, at 415.

[341] See Brudney, supra note 340, at 272-74.

[342] Id. at 275-76. Much the same argument is made by the dissent in *Panter*. See 646 F.2d at 299 (Cudahy, J., dissenting).

The relevant inquiry, however, is not merely whether the interests of managers and those of shareholders can diverge during a tender offer resisted by management; it is rather whether this divergence should compel any change in the applicable legal rules. For example, managers plainly have an interest in their continued employment by the corporation, an interest that may well be threatened by a successful takeover. Furthermore, target managers who have devoted substantial effort and ingenuity to developing the firm's business may be loath to lose control of their creation. Clearly, a hostile takeover attempt creates tension between these managerial interests and the investment interests of the stockholders. Some observers appear confident that the professionalization of management will permit these conflicts to be adequately resolved by the managers themselves.[343] Others believe that this tension can be sufficiently resolved by insuring that outside directors determine the target's conduct during a tender offer.[344] Other commentators, however, believe that these conflicts are irreconcilable through procedural or formal devices, and consequently argue that target management should at least be forbidden to engage in the more extreme maneuvers.[345]

Not all commentators view management's potential conflicts of interest as disqualifying it from responding to tender offers on the corporation's behalf. The most forceful spokesman for managerial prerogative, Martin Lipton, has pointed out that the function of directors in responding to a tender offer is comparable to their func-

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[343] Cf. Klein, The Modern Business Organization: Bargaining Under Constraints, 91 Yale L.J. 1521, 1542-43 (1982) (emphasizing legitimacy of managers' interest in corporate control in light of the intensity of their commitment to the firm).

[344] See Gelfond & Sebastian, supra note 3, at 467-70. The authors argue that if the target's response has been determined by its outside directors with the assistance of independent financial advisors, the courts should use only the lenient business judgment standard in reviewing decisions to take defensive actions. Former SEC Chairman Harold M. Williams has also urged greater involvement by outside directors in decisions concerning tender offers. See Metz, Role of Target In a Hostile Bid, N.Y. Times, Feb. 7, 1980, at D6, col. 3. Chairman Williams suggested that the investigation of an offer be delegated to a committee of independent directors, who would recommend a response to the full board.

[345] See Brudney, supra note 340, at 274-77; Cohn, supra note 3, at 490-98; Easterbrook & Fischel, supra note 3, at 1175; Gilson, Defensive Tactics, supra note 3, at 878-79. One commentator has described the crucial choice as one between management's loyalties to present stockholders, many of whom may prefer short-term benefits for themselves, and its loyalties to the corporate entity itself, which could encompass a preference for long-term benefits of future stockholders. Knauss, Corporate Governance—A Moving Target, 79 Mich. L. Rev. 478, 497-98 (1981). But this view assumes that responding to a tender offer is properly management's prerogative. It suggests only that management should consider its view of the interests of shareholders more carefully, and not that shareholders should be permitted to assert their interests for themselves.

tion in responding to a proposal for a merger.[346] The directors use their own judgment to determine whether the merger transaction and its terms are desirable for the corporation; if the directors find the proposed merger to be inadvisable, it is not submitted to the shareholders. In short, the directors' refusal to approve the transaction is dispositive, and according to Lipton, it should also be dispositive in responding to tender offers.[347] Only the target's directors, Lipton argues, are in a position to evaluate fully the consequences of a takeover, consequences that are the subject of careful and expert negotiation when they arise in a proposal for an agreed merger.[348] The managerial prerogative extends to responding to a tender offer because, in Lipton's view, "[a] takeover bid is no different than any other fundamental business decision," decisions which the corporation's managers make as a matter of business judgment.[349] Shareholders who disagree with management's decisions concerning these matters are limited to the recall remedy: they may vote to change the directors.[350] This view implicitly recognizes that many of management's decisions involve potential conflicts of interest and suggests that decisions about tender offers cannot reasonably be distinguished from other similar decisions. Management may, in its discretion, make many decisions that entrench its position within the company or that disappoint stockholders; Lipton has implied that defending against a tender offer is not substantially different. In this view, although the legal rules can protect against fraud and particularly blatant forms of self-dealing by management, they cannot do much more without denying the company the benefits of management's expertise in making major corporate decisions.

In *Mobil Corp. v. Marathon Oil Co.*,[351] the Sixth Circuit restrained management's use of defensive tactics by relying on section 14(e) of the Williams Act rather than on the business judgment rule. After Mobil announced a cash tender offer for Marathon stock, Marathon's management negotiated with the United States Steel Corp., a white knight, to arrange the terms of a tender offer by U.S. Steel for Marathon stock and a subsequent merger of the two compan-

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[346] See Lipton, supra note 1, at 116-20.

[347] Id. at 116.

[348] Id. at 118-20.

[349] Id. at 120.

[350] Id.

[351] 669 F.2d 366 (6th Cir. 1981). For a spirited defense of the *Mobil* court's interpretation of the Williams Act, see Weiss, Defensive Responses to Tender Offers and the Williams Act's Prohibition Against Manipulation, 35 Vand. L. Rev. 1087 (1982).

ies.[352] As part of these proposed transactions, Marathon agreed that U.S. Steel's tender offer and merger agreement would have two conditions: U.S. Steel would receive an option to buy ten million authorized but unissued Marathon shares (equal to about seventeen percent of Marathon's outstanding shares), and an option to buy Marathon's interest in a valuable oil field, exercisable only if U.S. Steel's tender offer failed and a third party gained control of Marathon.[353] Both of these options enhanced the white knight's position against the original offeror: the stock option by increasing the number of shares the white knight controlled, and the asset option by promising the white knight a consolation prize if it failed to gain control and by taking Marathon's prize asset out of the reach of other bidders.[354] The court of appeals held that these options, termed "lockups" by takeover practitioners, were manipulative within the meaning of section 14(e) of the Williams Act[355] and thus illegal.[356] In the court's view, the options were manipulative because they "not only artificially affected, but for all practical purposes completely blocked, normal healthy market activity,"[357] and thus frustrated the ordinary forces of supply and demand by "creating an artificial price ceiling in the tender offer market for Marathon common shares."[358]

The *Mobil* approach is problematic for several reasons. Other defensive maneuvers also affect potential offerors' willingness to make hostile bids. The *Mobil* court's reasoning may therefore reach defensive tactics that, by discouraging hostile bids, effectively cap the target's market price. On the other hand, it is possible to read the opinion as reaching only the extreme situation of a defensive maneuver that effectively determines the outcome of a contest for control in response to a hostile bid.[359] But the only other court of appeals to

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[352] 669 F.2d at 367.

[353] Id.

[354] See id. at 375-76.

[355] Williams Act § 14(e), 15 U.S.C. § 78n(e) (1982).

[356] 669 F.2d at 377.

[357] Id. at 374. Although *Mobil* interpreted manipulation quite broadly, it relied on statements culled from two Supreme Court opinions in which the Court *restricted* private rights of action under the general antifraud provision of the Securities Exchange Act of 1934. See id. at 374 (discussing Santa Fe Indus. v. Green, 430 U.S. 462, 476 (1977) and Ernst & Ernst v. Hochfelder, 425 U.S. 185, 199 (1976)).

[358] Id. at 375.

[359] For example, in many friendly acquisitions not preceded by a hostile bid, the acquiring company receives an option on the target's stock or assets to protect it from being outbid by a subsequent hostile bidder. Such options do have some impact on the market price of the target's securities, but perhaps less dramatically so than when the options have been preceded by a hostile bid. Likewise, the value of the assets or block of stock covered by the options may be significant, since it affects the options' impact on the costs and prospects of the hostile bidder.

consider the issue has rejected even this narrow interpretation of *Mobil*; the Second Circuit has held that misrepresentation is an essential element of a section 14(e) claim[360] and has explicitly rejected *Mobil*'s suggestions to the contrary.[361]

B. The British Position

British treatment of management defenses to tender offers proceeds from the notion that responding to an offer is an incident of share ownership, rather than of management; shareholders must consent by a majority vote to any defensive tactics that preclude their opportunity to tender. Thus, British regulation rejects the managerialist view of the target's response, and instead regards the response as an aspect of the property right of shareholders to sell their shares.[362] There is a certain rough justice in the fact that defensive transactions are more difficult to execute in Britain for, as we have seen, hostile offers are also generally more difficult to execute in Britain.[363]

The British rule apparently originated in part as a response to two particularly controversial takeover battles. In 1958, the management of British Aluminium bitterly opposed a bid for control of the company made by Reynolds Metals, an American company, and Tube Investments, Inc., a British engineering group. British Aluminium's management attempted to enlist Alcoa as a white knight by issuing Alcoa a block of shares equal in size to one-third of British Aluminium's then-outstanding shares, without obtaining the approval of British Aluminium's existing stockholders. Although the Reynolds-Tube Investments bid eventually succeeded, the proposed defensive issuance of shares provoked hostile opposition from merchant banks and secur-

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Furthermore, conditional options on assets, exercisable only if a party other than the white knight achieves control, may appear more devious or "artificial" than an outright sale of assets, although they are likely to have the same effect on bidding. See Nathan, Novel Legal Questions Explored, Nat'l L.J., Mar. 29, 1982, at 25, 30-31.

[360] Data Probe Acquisition Corp. v. Datatab, Inc., [Current] Fed. Sec. L. Rep. (CCH) ¶ 99,569, at 97,241 (2d Cir. Nov. 22, 1983), petition for cert. filed, 52 U.S.L.W. 3512 (U.S. Dec. 21, 1983) (No. 83-1023).

[361] See id. (citing Buffalo Forge Co. v. Ogden Corp., 717 F.2d 757, 760 (2d Cir.), cert. denied, 104 S. Ct. 550 (1983); cf. Swanson v. Wabash, Inc., No. 83-C-0459, n.11 & accompanying text (N.D. Ill. Dec. 16, 1983) (available on LEXIS, Genfed library, Dist file) (criticizing *Mobil* and holding that misrepresentation is essential element of § 14(e) manipulation claim); Martin Marietta Corp. v. Bendix Corp., 549 F. Supp. 623, 630 (D. Md. 1983) (characterizing *Mobil* as "an exceptionally strained interpretation" of the Supreme Court's definition of manipulation); Hundahl v. United Benefit Life Ins. Co., 465 F. Supp. 1349, 1368-70 (N.D. Tex. 1979) (interpreting § 14(e) narrowly).

[362] See text accompanying notes 300-03 supra.

[363] See text accompanying notes 147-71, 215 supra.

ities professionals.[364] In response, the Governor of the Bank of England created a working party that issued a statement of principles and practices to be followed in future takeover contests. This statement was intended to respond to criticisms of conduct in the British Aluminium contest, but its regulations were too weak to solve the perceived problems.[365]

The immediate impetus to establish the Take-over Panel came from the 1967 takeover bid for Metal Industries made by Aberdare Holdings. Aberdare first acquired fifty-three percent of Metal Industries' stock through a tender offer and stock market purchases, and then made an offer for the remaining forty-seven percent of the equity. Metal Industries' management responded by issuing, without stockholder consent, a large block of stock to an unsuccessful bidder, Thorn Electrical Industries. This transaction reduced Aberdare's ownership from fifty-three percent to thirty-two percent of Metal Industries.[366] The stockholders of Metal Industries had authorized a large increase in the company's authorized shares seven years earlier on management's representation that they would not be issued without shareholder consent if issuance would materially affect control of the company or the nature of its business.[367] The working party was again convened, this time by the Stock Exchange, and it agreed to establish the Panel.[368]

Since it was originally issued in 1969, the City Code has prohibited management from undertaking specified defensive maneuvers without shareholder consent. General principle 4 provides that once a tender offer has been made or appears to be imminent, the target board should take no action without shareholder approval that "could effectively result in any *bona fide* offer being frustrated or in the shareholders of the offeree company being denied an opportunity to decide on its merits."[369] Rule 38, which was promulgated under general principle 4, requires shareholder approval for many of the defensive techniques popular in the United States, such as sales or acquisi-

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[364] See A. Johnston, supra note 34, at 14-16; E. Stamp & C. Marley, supra note 34, at 6-8.

[365] E. Stamp & C. Marley, supra note 34, at 8-9.

[366] Id. at 16-17.

[367] Id. at 16. Moreover, Metal Industries' action in issuing the shares was contrary to the general undertaking given by companies listed on the Stock Exchange. Metal Industries, however, had not signed this undertaking because companies were required to do so only when they sought a quotation for new shares, and the requirement was not in effect when Metal Industries had last needed a quotation. See Goch, Mergers and Takeovers—A Review of the Past Twenty-Five Years, 1974 Certified Acct. 91, 93-94.

[368] A. Johnston, supra note 34, at 37-39.

[369] City Code, supra note 32, general principle 4.

tions of assets, issuance of authorized but unissued shares, grants of options with regard to unissued shares, and other "contracts otherwise than in the ordinary course of business."[370] Because the Panel has taken the position that general principles govern the interpretation of rules and control in situations not specifically covered by rules,[371] transactions not explicitly mentioned by rule 38 nonetheless risk the Panel's disapproval if they appear likely to frustrate an offer and are conducted without the consent of the shareholders.[372]

Despite the stringent measures of the City Code, the Panel does permit management to employ some defensive tactics. Since general principle 4 and rule 38 apply only when an offer has been or is about to be made, defensive measures taken before that time do not trigger the Code's requirement of shareholder consent.[373] Once an offer is made, rule 10 requires the target board to circulate to the shareholders its views on the offer which, of course, need not be favorable.[374] Target management may also propose an alternative transaction to the shareholders.[375] The City Code requires shareholder consent if a white knight's participation is to be "sweetened" by issuing new shares or by granting an option on authorized but unissued shares, but the Panel would not prevent target management from negotiating with prospective white knights.[376] Nor does the Code forbid target directors and their allies to purchase target shares in the market as a means of reducing the number of uncommitted shares available to the offeror.[377] Target management may also lobby the Secretary of State for

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[370] Id. rule 38. Some commentators have stated that the Code prohibits these transactions altogether. See Advisory Committee Report, supra note 1, at 100 (separate statement of Frank H. Easterbrook & Gregg A. Jarrell); Gilson, Defensive Tactics, supra note 3, at 878 & n.212. But prohibiting certain transactions outright and requiring that they be approved by shareholders are plainly different rules.

[371] See A. Johnston, supra note 34, at 196.

[372] For example, the Panel might well disapprove a target's efforts to repurchase its own shares as a defensive maneuver against a takeover. Before 1981, English companies lacked power to repurchase their own common shares. See L. Gower, Modern Company Law, supra note 30, at 225. They were, however, permitted to issue redeemable preference shares. See Companies Act, 1948, 11 & 12 Geo. 6, ch. 38, § 58(1), repealed by Companies Act, 1981, ch. 62, § 119(5) & sched. 4, superseded by Companies Act, 1981, ch. 62, § 45. The Companies Act, 1981, removed this broad prohibition for companies authorized by their articles of association to purchase their own shares. See Companies Act, 1981, ch. 62, § 46. However, share repurchases must be authorized by a special shareholder resolution, which passes only if approved by a three-quarters vote. See id. §§ 47(5), 48(3), 49(3).

[373] See Weinberg & Blank, supra note 48, para. 2402.

[374] City Code, supra note 32, rule 10(1).

[375] See Weinberg & Blank, supra note 48, paras. 2454-2455.

[376] A. Johnston, supra note 34, at 199.

[377] Id. However, the corporation's ability to repurchase its shares as a defensive tactic is limited. See note 372 supra.

Prices and Consumer Protection or the Director General of Fair Trading in the hope of convincing them that the bid may violate antitrust laws and therefore should be referred to the Monopolies and Mergers Commission.[378]

Even apart from the City Code, the popular American tactic of defending against an offer by bringing extensive litigation against the offeror is impractical in Britain. Although the British antitrust laws apply to mergers that would have anticompetitive consequences, they cannot be enforced by private parties and thus cannot be used directly by the target to obstruct hostile takeover attempts.[379] Other regulations governing tender offers do not generally create private rights of action and so cannot be enforced by the target.[380] Finally, even if the target may plausibly allege that the bid is illegal, British law severely limits the availability of injunctive relief against consummation of the bid.[381] Indeed, at least one commentator has advised British targets

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[378] See Weinberg & Blank, supra note 48, para. 2482; see also id. para. 1515 ("effect of intervention by the Secretary of State").

[379] For a general comparison of American and British attitudes toward antitrust policy and enforcement, see A. Neale & D. Goyder, The Antitrust Laws of the U.S.A. 478-93 (3d ed. 1978). British merger regulation is described in Wasserstein, British Merger Policy from an American Perspective, 82 Yale L.J. 656 (1973).

[380] See P. Davies, supra note 46, at 43.

[381] The Panel itself does not have access to injunctive relief. Id. at 43. The Court of Appeal severely limited the availability of such relief to private parties in Dunford & Elliott Ltd. v. Johnson & Firth Brown Ltd., [1977] 1 Lloyd's L.R. 505 (C.A. 1976). The plaintiff, Dunford & Elliott, was the target of a takeover by one of its competitors in the steel trade, Johnson & Firth Brown. As a result of severe financial difficulties, Dunford & Elliott decided to seek new capital by issuing shares, which it would offer only to its present shareholders. Because the company's financial problems had made its stock unattractive for most individual investors, Dunford & Elliott negotiated with its institutional shareholders to underwrite the issue by purchasing the shares themselves. Id. at 506-07 (opinion of Lord Denning, M.R.). As prospective underwriters, they received a confidential report prepared by the investment banker which, in turn, one of them passed onto Johnson & Firth Brown, apparently as another potential underwriter. When Johnson & Firth Brown subsequently decided to make a takeover offer for Dunford & Elliott, Dunford & Elliott sought an injunction against the bid, claiming that Johnson & Firth Brown had improperly employed confidential information. Id. at 507-08 (opinion of Lord Denning, M.R.).

In the leading opinion in the Court of Appeal, Lord Denning, M.R., explained that although the information in the report was confidential, the court should not enforce the understanding of confidentiality because Dunford & Elliott disseminated the information so widely and some Dunford & Elliott directors apparently traded in the company's shares based on the information. Lord Denning, M.R., also noted that Johnson & Firth Brown had never explicitly promised not to use the information. Id. at 509-10. Lord Denning, M.R., observed that "the very moving for an injunction would seem to be a breach of general principle 4 of the Code: seeing that it is an action designed to frustrate the making of the bid." Id. at 510. In a separate opinion, Lord Justice Lawton noted that the relief requested, an injunction prohibiting an imminent offer, could not restore confidentiality to the information disclosed and would severely burden the bidder and target shareholders. Id. at 515. Lord Justice Lawton's opinion thus suggests that a court may refuse equitable relief if it cannot restore the situation that existed

seeking to avoid hostile takeovers to acquire an American operation in the same line of business as the likely offeror. In addition to its new operation, the target thereby acquires the right to contest future takeovers in United States courts as violations of the American antitrust and securities laws.[382] This defensive practice, however, does not appear to be widespread.

The English case law governs tender offers generally, including those not subject to the City Code, but it is largely consistent with the Code's treatment of defensive transactions. In the leading case, *Hogg v. Cramphorn Ltd.*,[383] the target board received an unsolicited bid for all of the company's common and preferred stock.[384] The board responded by establishing a trust for the benefit of the company's employees, to which the board issued a large block of authorized but unissued preferred shares. Each of these shares was assigned ten votes, although all other target shares carried a single vote per share.[385] When combined with the voting power of shares already held by the directors and their supporters, the votes conferred on the trust assured the directors that over half of the votes were in friendly hands.[386]

The court held that this defensive transaction was improper, but not because management had failed to exercise its business judgment in good faith. The court found that although the directors had acted in response to the takeover threat, they were not "actuated by any unworthy motives of personal advantage, but acted as they did in an honest belief that they were doing what was for the good of the company."[387] According to the court, the directors believed that re-

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before the harm occurred. Such a principle would frequently doom a target's suit for an injunction, even in the face of clearly objectionable conduct by the offeror.

The Panel considered whether target management should be required to obtain shareholder consent, or to consult with the Panel, before instituting litigation against an offeror. Some commentators argued that the Panel could distinguish between bona fide claims and litigation brought simply to harrass the offeror, and could prohibit the latter as inconsistent with general principle 4. See A. Johnston, supra note 34, at 200. Others argued that any attempt by the Panel to restrain target managers in the exercise of their legal rights would be improper, id., and that the distinction between justifiable and vexatious litigation would be difficult for the Panel to draw, Interview with Peter R. Frazer, Deputy Director-General of the Panel on Take-overs and Mergers, in London (Feb. 25, 1981).

[382] See Dyer, British Securities Transactions and External Law: Some Guide Posts, in The Regulation of the British Securities Industry 156, 169 (B. Rider ed. 1979).

[383] [1967] 1 Ch. 254 (1963).

[384] Id. at 257-58 (court reporter's summary of facts).

[385] Id. (court reporter's summary of facts).

[386] Id. (court reporter's summary of facts).

[387] Id. at 265.

taining the incumbent management would be more advantageous to shareholders, staff, and customers than the changes that would occur if the takeover succeeded, and they accordingly took steps to discourage the offeror from proceeding.[388]

The court began its analysis with the proposition that a majority of the corporation's shareholders may pursue any course within the company's powers, as long as they do not unfairly oppress minority shareholders. In the court's view, the directors had interfered with the "constitutional rights" of a potential shareholder majority by preventing the bidder's offer from reaching the shareholders for consideration.[389]

The court's characterization of the shareholders' right to assess the merits of an offer as a "constitutional" matter suggests that the right results from the contractual relationships established by the corporation's charter and bylaws within the statutory framework. If the court did rely on such a view, the shareholders might agree, as a matter of private contract, to place the prerogative to respond to takeovers elsewhere within the corporation. *Hogg v. Cramphorn Ltd.*, for example, would have upheld the employee trust scheme had the corporation's shareholders ratified it by majority vote, with the shares issued to the trust not voting, on the reasoning that the arrangement would not have been improper had the shareholders approved it in advance.[390] A later case, *Bamford v. Bamford*,[391] followed this suggestion in *Hogg*. *Bamford* held that approval by a simple majority of shareholders properly ratified a defensive share issuance approved

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[388] Id. at 265-66.

[389] Id. at 268.

[390] Id. at 269-70. At a subsequent shareholders meeting, the transactions were ratified, except that the shares issued to the trust were allowed only one vote per share. Id. at 272 n.*. The *Hogg v. Cramphorn Ltd.* court had interpreted the target corporation's articles of association to prohibit issuance of shares with more than one vote each, but it held that because the trust might choose to retain the shares without their special voting power, the shareholder plaintiff could not on this ground obtain cancellation of the shares. See id. at 264.

A resolution of the shareholders to ratify arguably improper action by the directors must be passed bona fide in the company's interests. Moreover, it may be ineffective to shield the directors from a suit brought by an individual shareholder if the directors did not act honestly in what they believed to be the company's best interests. See L. Gower, Modern Company Law, supra note 30, at 620. English authorities and cases frequently use the phrase "bona fide for the benefit of the company as a whole" or similar phrases. In Greenhalgh v. Arderne Cinemas, Ld., [1951] 1 Ch. 286 (C.A. 1950), the court stated that the quoted phrase does not ordinarily refer to the interests of "the company as a commercial entity distinct from the corporators." Id. at 291. It refers instead to the interests of the corporators—the stockholders—as a general body. See id.; see also Clemens v. Clemens Bros, [1976] 2 All E.R. 268, 281 (Ch.) (quoting *Greenhalgh*).

[391] [1970] 1 Ch. 212 (C.A.).

by the directors, despite the fact that a three-quarters majority was required to amend the corporation's articles.[392]

The English courts thus not only allow a majority of shareholders to accept or reject a tender offer but also allow a majority to authorize defensive maneuvers by the directors or to ratify such maneuvers after the fact, even if the directors have acted beyond their authority. This result seems anomalous in light of other principles of British company law. If the shareholders' prerogative to assess the merits of the offer is truly a constitutional right because it bears on the essential terms of the shareholders' contract, the source of the corporation's existence, then one would expect that the voting process to alienate that right, and perhaps even to exercise it, would track the process for modifying the shareholders' contract through amending the articles of incorporation. However, under the Companies Act, 1948,[393] amending the articles requires a special resolution and a three-quarters majority vote.[394]

The uniform refusal of British courts to permit management efforts to thwart takeover bids may have been tempered by certain dicta in *Howard Smith Ltd. v. Ampol Petroleum, Ltd.*, a Privy Council decision.[395] Since the case decided an Australian appeal, it is

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[392] See id. at 240-41 (opinion of Harman, L.J.) (citing Hogg v. Cramphorn Ltd., [1967] 1 Ch. 254, 269 (1963)); [1970] 1 Ch. at 242-43 (opinion of Russell, L.J.).

[393] Companies Act, 1948, 11 & 12 Geo. 6, ch. 38 (as amended).

[394] Id. §§ 10, 141. This amendment requirement is subject to conditions in the company's memorandum. Id. § 10. The memorandum must specify the name of the company, the country in which its registered office is located, and its objects, id. § 2; it is the basic constitution of an English registered company, see id. § 1. The memorandum itself may be amended by special shareholder resolution, but only for reasons set forth in the Act, and judicial or administrative approval of certain amendments may be required. See id. §§ 5, 18, 23.

One opinion in *Bamford* asserts that a special shareholder resolution is unnecessary because the ordinary resolution ratifying the directors' action would not alter or contradict any provision of the articles. [1970] 1 Ch. at 241-42 (opinion of Russell, L.J.). This argument seems unrealistic if the directors' action is improper because it is inconsistent with the allocation of power to shareholders in the articles. One American critic of defensive transactions has argued that only a unanimous shareholder vote should be sufficient to authorize or ratify these tactics, since they constitute breaches of the fiduciary duty owed shareholders by directors. On a more practical level, permitting the majority to authorize defensive issuances of stock allows it to dilute the minority's interest in order to perpetuate the incumbents' control. See Brudney, supra note 340, at 275-78. That English courts permit ratification by a simple majority of shareholders suggests that the courts view the shareholders' right as one to be asserted and exercised collectively, rather than as the private right of each individual shareholder. The relevant analogy, in short, is not to the shareholder's individual right to decide whether to sell his stock on the market, but rather to the shareholders' collective right to approve or veto a merger transaction proposed by the directors. This treatment is consistent with the English practice of permitting shareholders in general meeting to release directors from their duties, as long as fraud on the company would not thereby be perpetrated. See L. Gower, Modern Company Law, supra note 30, at 619-20.

[395] 1974 A.C. 821 (P.C.) (N.S.W.).

of only persuasive authority in English courts.[396] In *Howard Smith Ltd.*, the directors of a corporation confronted by an unwanted takeover bid issued a large block of shares to a preferred suitor.[397] The Privy Council held that the issue was improper because its only purpose was to create voting power, thereby interfering with the right of the shareholders to pass on the merits of the competing offer.[398] Although *Howard Smith Ltd.* condemned the directors' conduct on the facts of the case, the Privy Council seized the chance to expand upon *Hogg v. Cramphorn Ltd.* in describing the proper purposes for which directors may issue shares. The Privy Council stated that directors could properly issue shares for the purpose of assuring the company's financial stability, even if an incidental effect of this step was to discourage or defeat a takeover bid.[399] The propriety of the directors' action turns on its purpose. If that purpose is to block a tender offer, the action is improper even if the directors acted from genuine concern for the corporation rather than for their personal advantage.[400] No subsequent British case makes clear whether *Howard Smith Ltd.* significantly relaxed the limits *Hogg* imposed on the directors' power to take unilateral action that might have the effect of defeating a takeover. Any takeover covered by the City Code would be governed by the specific limitations of rule 38[401] and general principle 4.[402] In litigation challenging the legality of management tactics resisting a takeover governed by the Code, the courts would probably defer to the Panel's interpretation of Code requirements, or would at least view its interpretation as a persuasive statement of accepted business practice.[403]

The ultimate question is why comparable tactics in the United States have not yet sparked regulatory action. Although a definitive answer is impossible, some tentative explanations are plausible. It is much easier for a relatively informal, nongovernmental entity like the Panel to correct perceived abuses by target managements than it is for Congress or the SEC to achieve comparable reforms in the United States. The legality of target management's behavior in the United

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[396] See R. Cross, Precedent in English Law 20-22 (3rd ed. 1977).
[397] See 1974 A.C. at 829-31.
[398] See id. at 837-38.
[399] See id. at 835-36.
[400] See id. at 837.
[401] City Code, supra note 32, rule 38.
[402] Id. general principle 4.
[403] See note 58 and accompanying text supra.

States is defined largely by state corporation statutes and common law fiduciary principles to which change comes, if at all, slowly and unevenly.[404] Moreover, to prevent greater government regulation of the financial industry, the Panel may have become "more regulatory than the regulators"[405] and thus willing to require sporting conduct from target management as well as offerors. Finally, the general presumption that management acts competently and in good faith may be stronger in the United States; American managers are more likely to be perceived as professionals with special technical competence whose decisions merit deference, even though their decisions affect investment interests of shareholders.[406] The relative lack of deference in Britain to managers' rejection of tender offers is also encouraged by the greater predominance of institutional shareholdings in Britain,[407] coupled with the view that institutional investors are generally more competent to assess the merits of defensive transactions than are most individual shareholders.

C. Shareholder Voting

The British and American systems have reached different conclusions about whether the prerogative of responding to a tender offer belongs to shareholders as owners of the enterprise, or to managers as the decisionmakers for its operations. Nonetheless, both systems do require a shareholder vote in connection with some defensive maneuvers. In Britain, shareholder involvement is timely and direct; both the case law and the City Code require that management obtain shareholder approval before undertaking defensive transactions that would frustrate an offer.

In the United States, management need not obtain direct shareholder authorization to engage in defensive maneuvers generally. However, shareholders do play a role in the approval of certain defensive maneuvers; for instance, management cannot unilaterally amend the target's certificate of incorporation in an attempt to dis-

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[404] See text accompanying notes 301-22 supra.

[405] Prentice, supra note 50, at 410.

[406] See text accompanying notes 305-06 supra.

[407] By the end of 1980, major institutional investors owned 35.4% of all shares listed on the New York Stock Exchange. New York Stock Exchange, 1983 Fact Book 52 (1983). This percentage has remained almost unchanged since 1975. Id. In contrast, in 1975 institutions owned 46.8% of the shares listed on the London Stock Exchange. M. Blume, The Financial Markets, in Britain's Economic Performance 276 (1980); see also Roundtable: Tender Offers, in Mergers & Acquisitions, Fall 1983, at 26, 32 (referring to relatively high institutional ownership of securities in Britain).

courage hostile takeovers. Like all amendments to a corporation's charter, these measures require an affirmative vote of a majority of the corporation's shareholders as specified by the relevant state corporation statute.[408] Shareholders in several American corporations have approved such amendments in recent years.[409]

However, making all hostile takeovers more difficult by amending the corporate charter may be inconsistent with the best interests of the shareholders.[410] If the amendment successfully discourages takeover bids, it may deny shareholders the premium price available from an offeror, and may also decrease the incentives to efficient management that such a prospect creates.[411] These amendments seek a general advance sanction for anti-takeover provisions and are therefore unlike defensive transactions British shareholders may authorize in resistance to a particular bid. Some shareholders may vote to approve charter amendments because they do not understand their consequences for potential offers. Shareholder approval may also stem from "rational apathy."[412] If shareholders read and analyzed carefully the proxy

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[408] These amendments have not been popular as a defensive technique in Britain. The buy-out obligation created by some American amendments would obviously be redundant in light of the Code's rule 34. Amendments that authorize a block of unissued shares and grant management the discretion to issue the shares are not feasible due to the Stock Exchange's unwillingness to list shares authorized with no limit on their use. Interview with Peter R. Frazer, Deputy Director-General of the Take-over Panel, in London (Feb. 25, 1981). The defensive maneuver executed by British Aluminium, described in text accompanying notes 364-65 supra, would no longer be feasible. Defensive amendments that operate by requiring supermajorities to approve business combinations have apparently never been tried in Britain. Interview with J.M. Horner, Quotations Department, The Stock Exchange, in London (Mar. 9, 1981).

[409] See notes 326-27 and accompanying text supra. The SEC Advisory Committee on Tender Offers recommended prohibiting charter or by-law provisions that "erect high barriers to change[s] of control." Advisory Committee Report, supra note 1, at 36. Until these recommendations are adopted, the committee proposed that companies be permitted to adopt provisions requiring supermajority approval for "change of control" transactions only by vote of the same supermajority of shareholders as is specified in the provisions. Id. at 36-37. Under the committee's proposal, these provisions would lapse unless reratified every three years by the specified supermajority. See id. Certain other charter amendments or transactions that might affect the likelihood of a change in corporate control would be subject to advisory shareholder votes of approval or disapproval at each annual meeting. See id. at 38-39.

[410] See, e.g., Gilson, Shark Repellent Amendments, supra note 168, at 823.

[411] Because such amendments may disadvantage shareholders, their adoption may cause the value of shares to decline. See Gilson, Shark Repellent Amendments, supra note 168, at 823. That decline might even have the paradoxical effect of making the corporation more vulnerable to a takeover attempt. See Advisory Committee Report, supra note 1, at 87 (separate statement of Frank A. Easterbrook & Gregg A. Jarrell). Professors Easterbrook and Jarrell have argued that, in the long run, only charter provisions "beneficial to investors would survive in a competitve market." Id. But this view rests on dubious premises about investor decisionmaking, cf. text accompanying notes 412-14 infra, and in any case does not explain why shareholders should be treated unfairly while waiting for unfairness to become less common.

[412] Clark, Vote Buying and Corporate Law, 29 Case W. Res. L. Rev. 776, 779 (1979); see also Gilson, Shark Repellent Amendments, supra note 168, at 824-27.

statement accompanying a proposed charter amendment, they might realize that a negative vote would be in their best interests. But most proxy materials concern technical matters not injurious to shareholders, and shareholders are thus unlikely to make the effort necessary to identify an objectionable proposal.[413] One exceptional group that frequently votes against such proposed amendments consists of institutional investors,[414] who have staff analysts to assess the impact of the charter amendment on their employers' interests. However, institutional investors generally do not resort to proxy fights to persuade other shareholders to disapprove the amendment. Apparently they believe the cost of a proxy battle is not justified by the speculative benefit of defeating these amendments, many of which may be of only marginal effectiveness in deterring and defeating hostile offers.[415]

The natural inertia that encourages adoption of general charter amendments disappears when stockholders vote to approve or disapprove a specific defensive transaction, as in Britain. Under rule 38 of the City Code, shareholders must authorize any defensive transaction during the course of an offer or even before an offer is made, if the target's board "has reason to believe that a *bona fide* offer might be imminent."[416] Since the vote concerns a concrete transaction rather than a general charter amendment, the consequences of approval are readily ascertainable. Shareholders can perceive the direct financial impact of the transaction, as in a merger or liquidation proposal, and shareholders are thus more likely to analyze the proposal carefully. The publicity and media scrutiny that accompany hostile bids provide valuable information and strengthen the shareholders' ability to weigh the merits of the transactions. In short, shareholders are competent to pass on specific defensive transactions because they can understand the need for information about the consequences of the decision and can easily obtain that information.[417] The shareholders are thus likely

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[413] Clark, supra note 412, at 781.

[414] See Gilson, Shark Repellent Amendments, supra note 168, at 826.

[415] See id. at 826-27.

[416] City Code, supra note 32, rule 38.

[417] State regulation of corporate governance generally distinguishes between the competence of corporate managers and that of stockholders. State law usually presupposes that the primary competence of managers lies in making ordinary business decisions. One commentator has defined these decisions to be those that "require specialized business skills, are not individually of great economic significance, affect a relatively short timespan, occur in profusion, and must be made very quickly." Eisenberg, The Legal Roles of Shareholders and Management in Modern Corporate Decisionmaking, 57 Calif. L. Rev. 1, 11 (1969). The primary competence of shareholders, on the other hand, is thought to be in making decisions that involve investment skills—decisions that occur infrequently and have great economic significance. Id. at 13. Thus, state

to make informed decisions, in contrast to the haphazard way in which they pass on "pig in a poke" defensive charter amendments.

Admittedly, both the British and American systems give management undeniable advantages in the use of the proxy machinery to influence shareholder voting.[418] But in both systems, management and offeror must fully disclose all factors pertinent to the transaction in their proxy materials, and financial analysts and a sophisticated financial press examine these disclosures and report on their significant aspects. The British system, which gives shareholders greater decision-making authority, provides an important additional source of information to shareholders: rule 4 of the City Code requires target management to obtain "competent independent advice on any offer" and to communicate that advice to shareholders.[419] The credibility of this advice is important in assuring that shareholders understand the consequences of rule 38 transactions they are asked to approve. The small size and social cohesion of the community of financial advisers in Britain gives the advisors a strong interest in protecting their own reputations for integrity and in inducing their clients to behave properly.[420] Thus, the disclosure and competent independent advice re-

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corporation statutes, although they vary in their details, give shareholders the right to vote on "fundamental" corporate decisions, including the merger or liquidation of the business. Indeed, Eisenberg suggests that shareholder votes should be required for a broader array of decisions than current state laws mandate. Id. at 32-33. The decision to authorize a defensive transaction involves similarly "fundamental" issues within the primary competence of the shareholders.

[418] See Weinberg & Blank, supra note 48, para. 2455.

Martin Lipton has implied that shareholders will always vote to reject proposals that will impede tender offers. See Lipton, supra note 1, at 116. Lipton states that requiring the board to submit any takeover bid to shareholders "would be the equivalent of mandating sale whenever an unsolicited takeover bid is made." Id. But even if this doubtful assertion is true, it does not follow that shareholders would always reject a specific management-sponsored alternative to the hostile bid. See Cohn, supra note 3, at 524 ("[B]oth the English and proposed models provide for shareholder consideration of the merits of the issuance of shares, not a shareholder vote on acceptance or rejection of the tender offer." (footnote omitted)).

[419] City Code, supra note 32, rule 4. The effect of rule 4 on management's advantages in the proxy system was not considered in Gilson, Defensive Tactics, supra note 3, at 879 n.214, which rejected shareholder approval as an alternative to outright prohibition of certain defensive transactions. As the text illustrates, not all regulatory schemes that require shareholder approval of these transactions are afflicted by the disabilities of the present American system of proxy solicitation and shareholder meetings.

[420] The self-interested probity of this community is illustrated by the fact that outright "advice shopping" for desirable rule 4 opinions apparently does not occur. At least there are no known instances in which a target management, dissatisfied with the independent advice on the merits of a bid received from one adviser, sought an opinion from another adviser. Interview with Peter R. Frazer, Deputy Director-General of the Panel on Take-overs and Mergers, in London (Feb. 25, 1981). Such collective probity stems from social characteristics well beyond the purview of rules governing securities transactions. Cf. Self-Control in the City, supra note 55, at 18

quirements, along with the specific choice often presented to shareholders between the bid and management's "alternate proposition" (as the British occasionally describe defensive transactions), offset management's advantages in the use of the proxy machinery and make the shareholder vote a workable check on management's defensive proposals. These requirements may also have a prophylactic effect in deterring management from proposing defensive transactions that will be unattractive to target shareholders.[421]

The British experience with shareholder approval of defensive transactions has much to recommend it. Shareholders are competent to decide whether to approve or reject specific alternative propositions designed by management. Because there are many more potential targets with large numbers of stockholders in the United States than in Britain, obtaining shareholder approval of defensive transactions through the proxy process would be more complicated logistically, since more shareholders have the opportunity to vote in behemoth corporations. Because the American community of financial advisers is far larger and less self-policing than that in Britain, it may also be difficult to design an American equivalent to the British requirement that management obtain "competent independent advice" on any offer and communicate that advice to the shareholders. Nonetheless, the provisions of the City Code requiring shareholder approval of defensive maneuvers and mandating independent review of offers merit close scrutiny by American regulators. A much more extreme reform of the American system advocated by some commentators—outright prohibition of some kinds of defensive transactions—assumes that shareholders as a group would be better off if no defensive transactions were permitted than if target shareholders were allowed to choose between hostile offers and alternate management proposals. Of course, one can always hypothesize that, at the margin, tender offers are inhibited when there is an increase in the costs of making a hostile offer or in the risk that it will not succeed. But this speculation hardly establishes that beneficial transactions will actually be discouraged in any substantial way; hostile tender offers may often be attractive enough to their makers that they are largely unaffected by the increases in cost and risk associated with a shareholder approval rule.

("London has retained more non-statutory regulation of its financial markets than any other great financial centre . . . because, in the past, the British sense of fair play has, by and large, made clubbishness work.").

[421] See Lowenstein, Pruning Deadwood in Hostile Takeovers: A Proposal for Legislation, 83 Colum. L. Rev. 249, 331 & n.327 (1983).

And the persistence of hostile offers in the current American scheme, which allows management to employ many radical defensive tactics on its own, does not suggest that making defensive tactics more difficult through a shareholder approval rule would nonetheless leave hostile bidders overburdened. The British experience indicates that permitting management to employ defensive transactions subject to the requirement that it obtain shareholder approval may well strike the proper compromise between the varied interests of target management, target shareholders, and bidders.

Conclusion

This Article has not attempted to establish a general theory of tender offer regulation. Indeed, it suggests that only an undogmatic view of these issues can foster an adequate understanding of highly complex transactions executed by highly sophisticated players. The simplistic assumptions developed in an earlier day to explain investor behavior fail to account for precisely those complexities that effective modern regulation must address. For this reason, insights about actual conduct gleaned from comparative studies are more helpful than abstract and hypothetical models in assessing regulatory alternatives. Because British transactions resemble those transactions executed in the United States in their key economic characteristics, the market consequences of British regulation are likely to be particularly helpful in considering proposals for reform of the American system.

Apart from its implications for particular types of American tender offer regulation, comparative analysis is useful in understanding the effect of takeover rules on market activity. In both Britain and the United States, tender offer rules function against a market background that includes such complex events as competitive bidding for shares in target companies and risk arbitrage. Clearly, regulators should carefully assess the likely impact of rules on these market activities. Although the British experience demonstrates that takeovers can occur under a scheme that systematically and successfully discourages risk arbitrage, eliminating arbitrage in the United States would deprive shareholders of important protections. Similarly, some American commentators have argued that rules which effectively lengthen the period before the consummation of a takeover—minimum duration requirements and prorated purchase requirements—may discourage some offers by giving competing bidders more time to enter the fray. Once again, however, regulation under the City Code suggests that the disincentives to hostile offers created by lengthening the offer process are not insurmountable. And unlike arbitrage activity, a trun-

cated offer period may be difficult to justify on grounds of policy, apart from a questionable reliance on the need to avoid discouraging tender offers.

Neither British nor American tender offer regulation distinguishes among kinds of shareholders. This position is puzzling, since shareholders in both countries differ widely in relative size and sophistication, as well as in investment goals and in the length of time they typically retain any particular investment. The indifference of the two regulatory systems to shareholder diversity is especially striking given their shared goal of protecting shareholders from the demonstrated hazards of wholly unregulated takeover transactions. Shareholders obviously differ widely in their need for various kinds of protection. A realistic regulatory system should take account of the differences between individuals owning retirement nest eggs composed of small holdings in a few companies, and arbitrageurs whose holdings may become large enough to determine the outcome of a takeover bid. Too simple a view of neutrality among shareholders may underlie the SEC's recurring difficulty in formulating effective rules to require proration in partial tender offers. The difficulty is in designing rules that cannot be readily undermined by arbitrageurs through devices like short and hedged tendering, and that do not result in offers with structures so complex that they are unintelligible to individual stockholders.

This comparative analysis of regulation also demonstrates major differences between the American and British conceptions of shareholder equality. The British and American systems have defined the equality they seek to achieve quite differently, and have reached different assessments of the extent to which it is feasible or desirable to treat shareholders of a target company equally. Thus, although the buy-out obligation imposed by rule 34 of the City Code effectively grants shareholders who tender and those who do not the same opportunity to share in the offer premium, many American observers would probably view rule 34 as a drastic imposition on offerors that can only raise the cost of acquiring control. Conversely, British observers might consider American proration requirements to be oddly lopsided, especially when coupled with the American system's indifference to the post-offer lot of shareholders who did not tender. These differences illustrate the range of possible definitions of shareholder equality and demonstrate that regulatory systems vary in their willingness to impose the costs of achieving that equality on their constituency.

The systems have also developed radically different conceptions of the proper roles of target company shareholders and managers in

responding to a hostile tender offer. Although making an offer is more costly in Britain, the merits of the offer, once it is made, will be assessed by the target's shareholders along with any alternative submitted by management. In the United States, making a hostile offer is less costly, but evaluating the offer's merits is chiefly a management prerogative. The British approach embodies a profound skepticism of deference to management decisions about the ultimate best interests of a corporation and its shareholders.