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ON THE PRECIPICE: A REEXAMINATION OF DIRECTORS' FIDUCIARY DUTIES IN THE CONTEXT OF HOSTILE ACQUISITIONS

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I. INTRODUCTION

To paraphrase Mark Twain, reexamining the fiduciary duties of a target company's board of directors in the context of a hostile takeover battle must be one of the easiest things to do,[1] since it is a topic that has been dissected, time and again, by lawyers,[2] jurists,[3]

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1. The quotation, "[g]iving up smoking is easy[;] I've done it hundreds of times," is generally attributed to Mark Twain. However, Mr. Twain's authorship of this statement has been called into question recently. *See* P. BOLLER & J. GEORGE, THEY NEVER SAID IT 123 (1989); *The Art of Quote Catching*, N.Y. Times, Sept. 14, 1980, § 6, at 110, col. 1 (Letter to the Editor from Esther Harriott) (attributing the statement to the Canadian humorist Stephen Leacock).

2. *See, e.g.*, 1 A. FLEISCHER, TENDER OFFERS: DEFENSES, RESPONSES, AND PLANNING (Supp. 1989); Block & Miller, *The Responsibilities and Obligations of Corporate Directors in Takeover Contests*, 11 SEC. REG. L.J. 44 (1983); Fleischer & Mundheim, *Corporate Acquisition by Tender Offer*, 115 U. PA. L. REV. 317 (1967); Lipton, *Takeover Bids in the Target's Boardroom*, 35 BUS. LAW. 101 (1979) [hereinafter *Takeover Bids*]); Lipton, *Takeover Bids in the Target's Boardroom: A Response to Professors Easterbrook and*

and academicians.[4] And yet, notwithstanding the attention this subject deservedly has received, numerous questions abound concerning the proper role of directors in this context. Many of these questions emanate from an inherent societal distrust of those who manage other people's property.[5] It cannot be gainsaid that, aside from Delaware corporate jurisprudence, and isolated pieces of federal legislation,[6] this country has failed to develop a meaningful contextual framework within which to resolve some of the thornier issues of fiduciary duty with which corporate directors (and, in turn, the Delaware courts) must grapple on virtually a daily basis.

Notwithstanding these frailties in our governing system, or perhaps because of them, tender offers[7] and new defensive

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Fischel, 55 N.Y.U. L. REV. 1231 (1980) [hereinafter *A Response*]; Lipton, *Corporate Governance in the Age of Finance Corporatism*, 136 U. PA. L. REV. 1 (1987) [hereinafter *Corporate Governance*]; McCord, *Limiting Defensive Tactics in Tender Offers: A Model Act for the Protection of Shareholder Decisionmaking*, 21 HARV. J. ON LEGIS. 489 (1984); Wander & LeCoque, *Boardroom Jitters: Corporate Control Transactions and Today's Business Judgment Rule*, 42 BUS. LAW. 29 (1986).

3. *See, e.g.*, *Even After* Time-Warner *Decision 'Just Say No' Isn't as Easy as it Sounds*, 22 SEC. REG. & L. REP. (BNA) 516 (Apr. 6, 1990) (discussing remarks of Andrew G.T. Moore, II, a justice on the Delaware Supreme Court; *'Just Say No' May be Viable Defense, But Not as Carte Blanche, Panelists Say*, 21 Sec. Reg. & L. Rep. (BNA) 1832 (Dec. 15, 1989). *See also* R. POSNER & K. SCOTT, ECONOMICS OF CORPORATE LAW AND SECURITIES REGULATION (1980); Easterbrook & Fischel, *The Proper Role of a Target's Management in Responding to a Tender Offer*, 94 HARV. L. REV. 1161 (1981).

4. *See, e.g.*, Demott, *Beyond Metaphor: An Analysis of Fiduciary Obligation*, 1988 DUKE L.J. 879 (1988); Oesterle, *Target Managers as Negotiating Agents for Target Shareholders in Tender Offers: A Reply to the Passivity Thesis*, 71 CORNELL L. REV. 53 (1985); Ribstein, *Takeover Defense and the Corporate Contract*, 78 GEO. L.J. 71 (1989); Siegel, *Tender Offer Defensive Tactics: A Proposal for Reform*, 36 HASTINGS L.J. 377 (1985); Yablon, *Poison Pills and Litigation Uncertainty*, 1989 DUKE L.J. 54 (1989).

5. *See* L. BRANDEIS, OTHER PEOPLE'S MONEY AND HOW THE BANKERS USE IT 3-13 (1914).

6. Federal law does regulate a target corporation's response to unsolicited acquisition efforts. *See, e.g.*, Williams Act Amendments to the Securities Exchange Act of 1934 (Exchange Act), 15 U.S.C. §§ 78m(d)-(e), 78n(d)-(f) (1982) (imposing disclosure requirements upon parties participating in the tender offer process); Hart-Scott-Rodino Antitrust Improvements Act § 7A, 15 U.S.C. § 18(a) (1982) (requiring premerger notification to the Federal Trade Commission and the Antitrust Division of the Department of Justice); Exon-Florio Amendment to the Defense Production Act of 1950, 50 U.S.C. app. § 2170 (1989) (authorizing the President to review the effects on national security of mergers, acquisitions, and takeovers by or with foreign entities that could result in foreign control of certain United States businesses). *See also infra* notes 175-201 and accompanying text (discussing the federal regulatory framework and its effect on the corporate control process).

7. During the last five years, the number of completed tender offers has

techniques[8] flourished during the 1980s.[9] Given the sophistication and

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increased dramatically. The number nearly doubled from 1983 to 1984. In 1983, there were 77 tender offers; while in 1984, there were 142. Austin & Mandula, *Tender Offer Update: 1985*, 20 MERGERS & ACQUISITIONS No. 1, at 67 (Spring 1985). The number fell slightly in 1985 to 121. Austin & Bernard, *Tender Offer Update: 1986*, 21 MERGERS & ACQUISITIONS No. 1, at 55 (July/Aug. 1986). The number soared in 1986 to 183, Austin, Nigem & Bernard, *Tender Offer Update: 1987*, 22 MERGERS & ACQUISITIONS No. 1, at 49 (July/Aug. 1987), but dropped in 1987 to 125. *Tender Offer Update: 1988*, 22 MERGERS & ACQUISITIONS No. 6, at 23 (May/June 1988). The figure rose again in 1988 to 198. *Tender Offer Update: 1989*, 23 MERGERS & ACQUISITIONS No. 6, at 25 (May/June 1989). While tender offers represent only a fraction of the merger and acquisition transactions in numerical terms during this five-year period, they were the primary vehicle for completing large deals among public corporations. For example, in 1988 the 10 largest completed tender offers involved aggregate prices of $45.7 billion, or one-fifth of the $226.6 billion in total purchase prices of mergers and acquisitions. *Id.*

8. The 1980s witnessed the development of innovative defensive tactics, such as shareholder rights plans (the so-called "poison pills") and their many variations, including pills that provide for "flip in," "flip over," "chewable," and "repurchase rights." *See, e.g.*, Martin & Struxness, *A Review of Current Developments in Shareholder Rights Plans*, 2 Mergers & Acquisitions L. Rep. 234 (1989); Helman & Junewicz, *A Fresh Look at Poison Pills*, 42 BUS. LAW. 771 (1987). A shareholder rights plan, or poison pill, generally involves the distribution of rights (often in the form of warrants) which have little or no value at the time of issuance, and which trade with the common stock to which those rights are attached. Upon the occurrence of one or more triggering events, however (for example, the acquisition of more than a certain percentage of the common stock by any person not approved by the target company's board of directors), the rights trade separately and, based upon a formula, permit all shareholders of the target company, *except the shareholder triggering the effectiveness of the rights*, to purchase additional shares of the target company at bargain prices. Because the triggering of the rights would have such a draconian effect, the net effect of such a plan is to cause most hostile acquirors to attempt to negotiate with the target's board of directors, and to protect against coercive takeover bids and so-called "street sweeps and creeping tender offers." *See* FLEISCHER, *supra* note 2, at 184.12-.19. Over 1,000 companies have adopted some variation of the poison pill. *See* INVESTOR RESPONSIBILITY RESEARCH CENTER INC., CORPORATE TAKEOVER DEFENSES 1989, at 1447-52 (1989).

Other innovative defensive tactics include "recapitalizations," "restructurings," "poison puts," "lock ups," "leg ups," "self tenders," "exchange offers," and "pac man" defenses. *See generally* FLEISCHER, *supra* note 2, at 388.47-.199 (extensively discussing the various techniques).

Increasing in popularity is the use of Employee Stock Ownership Plans (ESOPs) as a takeover defense. *See, e.g.*, Block & Hoff, *The Emerging Role of ESOPs in Corporate Control Contests*, N.Y.L.J., Feb. 16, 1989, at 5; Hilder & Smith, *ESOP Defenses are Likely to Increase*, Wall St. J., Apr. 6, 1989, at A2, col. 1. By establishing an ESOP, a target can place a substantial block of stock with its own employees who can generally be expected to side with management in contested takeover battles, especially where the hostile bidder is proposing dismemberment of the corporation or layoffs.

The increasing utilization of ESOPs in corporate control situations stems in

complexities of new tender offer defenses, the social and political consequences of corporate restructuring and corporate leveraging,[10] and the increased foreign interest in, and ownership of, American businesses,[11]

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part from the Delaware Court of Chancery's approval of the defensive use of an ESOP in Polaroid's successful defense against Shamrock Holdings. *See* Shamrock Holdings, Inc. v. Polaroid Corp., 559 A.2d 257, 271-74 (Del. Ch. 1989). In this case, Polaroid parked 14% of its stock in an ESOP, and Shamrock argued that since the ESOP stockholders were likely to side with management in refusing to tender, it would be impossible for a potential acquiror to satisfy the 85% exception to the three year bar on business combinations by interested stockholders under Delaware's takeover statute. *Id.* at 273. *See* DEL. CODE ANN. tit. 8, § 203(a)(2) (Supp. 1988). Under this exception, an interested stockholder (one who owns at least 15% of the corporation's stock) may engage in a business combination with the corporation if he obtains at least 85% of the corporation's voting stock in the same transaction which causes him to become an interested stockholder. *See id.* In refusing to find that the antitakeover aspect of the ESOP was unfair, the court found it significant that § 203(a)(2) only excludes from the 85% exception ESOPs without confidential tendering, and thereby provides a policy statement that ESOPs *with* confidential tendering, such as the one established by Polaroid, do not necessarily preclude a potential acquiror from satisfying the 85% requirement. *Shamrock Holdings*, 559 A.2d at 274.

9. *Cf.* Eisenberg, *After Decade of Effort, Legislators Still Can't Rule the Stock Market*, Legal Times, Nov. 28, 1988, at 14, col. 1 (discussing the largely unsuccessful legislative efforts to curb insider trading).

10. Such leveraging has the potential fundamentally to affect the fabric of American society. It can also affect this country's ability to compete in the international marketplace by causing American businesses to focus on short-term profits at the expense of long-term planning, or research and development. *See* Hayes & Abernathy, *Managing Our Way to Economic Decline*, 58 HARV. BUS. REV. 67, 68-70 (July-Aug. 1980) (attributing sluggish economic performance in part to the failure of American managers to keep their companies technologically competitive over the long run); Adams & Brock, *The Hidden Costs of Failed Mergers*, N.Y. Times, June, 21, 1987, § 3, at 3, col. 1 (stating that the devotion of funds and energies to mergers in the past two decades has diverted management from important tasks such as building new plants, investing in new production techniques, and producing new products). *See also* Spencer, *Capital-Gains Shift Could Curb LBO Break-Ups*, Wall St. J., Jan. 27, 1989, at A14 ("Takeovers are hurting the international competitiveness of American business. Hostile attacks on well-managed companies and the overloading of balance sheets with high-cost debt are weakening U.S. companies ...."). A concomitant potential reduction in our standard of living is omnipresent. *See* Reich, *The Economics of Illusion and the Illusion of Economics*, FOREIGN AFFAIRS 516, 527 (1988) (suggesting that in order for America to regain its stride in the world economy, among other things, aggregate consumption must be reduced).

11. Foreign investment in the United States—including both portfolio and direct—amounted to more than $1.5 trillion in 1987, up from $107 billion in 1970. *See* N. GLICKMAN & D. WOODWARD, THE NEW COMPETITORS: HOW FOREIGN INVESTORS ARE CHANGING THE U.S. ECONOMY 5 (1989). Foreign banks, for example, had approximately 22% of United States banking assets at the end of 1988, up from 15% in 1981. *See Oversight Hearings on European Community's 1992 Programs: Hearings Before the Subcomm. on Financial Institutions Supervision, Regulation and Insurance of the*

it is undoubtedly appropriate to reexamine yet again the fiduciary duties of directors confronted with unsolicited acquisition proposals.

For a number of reasons, such a reexamination does not denigrate Delaware's growing, and constantly evolving, body of corporate jurisprudence. First, the results of past cases is less significant than the predictability of future decisions for the businessmen and businesswomen who must conform their behavior to the dictates of the law. That, after all, is what our jurisprudential system is about—an ordered society that relies on predictable rules of law by which well-meaning citizens can adjudge and plan their own behavior.[12] If, and to the extent, the law does not apply evenly, or seems whimsical in its application, distrust for the rule of reason and the rule of law will be encouraged, and an environment of disrespect for our legal and judicial institutions will be fosted.

Second, the issue of fiduciary responsibilities cannot be resolved in a vacuum. Rather, this issue is, by definition, subject to constant reevaluation, reexamination, and rearticulation, as national and global environments change. Thus, to date, these responsibilities have properly derived their content from, and have been shaped by, a number of sources, including perceptions of conflicting loyalties,[13] the needs of competing participants,[14] and prevailing social mores.[15] Recently, however, new trends have surfaced which are also relevant to this analysis and reexamination, most notably the growing internationalization of markets[16] and the increased globalization of competition

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House Comm. on Banking, Finance and Urban Affairs, 101st Cong., 1st Sess. 93 (1989) (statement of Kathleen Cooper, Chief Economist, Security Pacific National Bank).

12. *See generally* Van Zandt, *Commonsense Reasoning, Social Change and the Law*, 81 NW. U.L. REV. 894, 936-38 (1987) (discussing the purposes and functions of legal rules).

13. *See* Marsh, *Are Directors Trustees?: Conflict of Interest and Corporate Morality*, 22 BUS. LAW. 35, 57-73 (1966) (discussing the myriad of conflicts faced by a target board in carrying out its fiduciary responsibilities). With the advent of state corporate statutes permitting, or sometimes directing, target managers to consider non-stockholder constituencies such as "the economy of the state and nation, [and] community and societal considerations," MINN. STAT. ANN. § 302A.251(5) (West Supp. 1990), the perception of conflicting loyalties undoubtedly will be exacerbated.

14. *See infra* notes 120-221 and accompanying text.

15. *See generally* Marsh, *supra* note 13 (discussing the various legal rules and the corresponding changes in directors' responsibilities during successive periods of history with respect to situations involving potential conflicts of interest).

16. *See, e.g.*, Moore, *Going Global*, Nat'l J., Sept. 20, 1986, at 2244 (discussing how United States enforcement officials, faced with the trend toward a global securities market, are seeking the cooperation of foreign governments in eliminating

in consumer goods and services,[17] as well as in the provision of goods and services to governments.[18]

In order to assess the future directions the law should take, therefore, it is necessary to recognize certain facets of the current system of standard setting, and the motivations and conflicts of each of the participants in the takeover process. After undertaking such a review, it is possible to evaluate the difficulties confronting those who must make decisions in a hostile battle for corporate control, and those who must evaluate and pass judgment on those decisions.

This article begins by suggesting that, in the context of hostile takeovers, it is critical to understand and acknowledge that constituencies other than shareholders of the target company have a vested interest in the outcome of a battle for corporate control. Thus, while ownership of stock affords shareholders a presumptive right freely to dispose of their property, other considerations or factors may mitigate against the sale of shares to a bidder who has launched an unsolicited acquisition effort.

Part III of this article discusses the shareholder population of today's public corporations, and the sometimes conflicting investment objectives among these disparate types of shareholders. Part IV considers the bidder's role in the hostile takeover setting, and notes that the bidder's characteristics and plans for the target company should play an important role in determining the proper response of a target's board of directors.

Next, this article considers the myriad of takeover standard setters, the persons who define appropriate standards of behavior for each of the participants in a hostile takeover. It is suggested that, while each standard setter has a legitimate and proper role to play in the hostile takeover context, there is no mechanism under our

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investigative obstacles in order to confront the new type of securities fraud that has emerged with this trend); Wayne, *The Realities of 'Friday the 13th,'* N.Y. Times, Oct. 22, 1989, § 3, at 1, col. 2 (discussing the ongoing debate regarding the impact of greater market internationalization); Gerth, *A Push for International Market Rules*, N.Y. Times, Nov. 23, 1987, at D3, col. 3 (discussing the efforts of world financial regulators to change national regulations that have become outdated as the market has become increasingly global).

17. *See, e.g.*, Wolman, *The First 100 Years: Securities, A Premium on Protection*, Fin. Times, Feb. 15, 1988, at 49 (noting the emergence of global competition over the past decade); Lorenz, *Marketing Myopia: An Insidious Disease*, Fin. Times, Apr. 1, 1985, at 8 (same).

18. *See infra* notes 217-21 and accompanying text (discussing Exon-Florio Amendment).

current system to evaluate the profound impact of hostile takeovers on our national interests. To remedy this situation, the creation of a bipartisan, national commission is proposed, to articulate a contextual framework for the takeover process. Such a framework could recognize the legitimate sphere of each of the standard setters in the process.

Finally, recognizing that, even with the articulation of such a national framework, the Delaware courts will continue to assume a leadership position in the ongoing development of standards upon which to judge the actions of target directors in responding to unsolicited bids, this article concludes by discussing the debate over the "just say no" defense and certain other critical issues currently being debated in the Delaware courts.

II. THE IMPORTANCE OF SHARE OWNERSHIP IN THE CONTEXT OF HOSTILE ACQUISITIONS

Since tender offers, by definition, involve an effort to acquire corporate stock,[19] the primary focus is appropriately on the target

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19. Any definition of the term "tender offer" is, however, a nonstatutory definition, since Congress intentionally declined to define the term "tender offer" when it passed the Williams Act, due to its concern that a "rigid definition [of the term] would be evaded." Hanson Trust, PLC v. SCM Corp., 774 F.2d 47, 56 (2d Cir. 1985) (citing *Takeover Bids: Hearings on H.R. 14475, S.510 Before the Subcomm. on Commerce and Financing of the House Comm. on Interstate and Foreign Commerce*, 90th Cong., 2d Sess. 18 (1968) (statement of Manuel Cohen, chairman, Securities and Exchange Commission [hereinafter SEC or Commission])). Consequently, Congress left it to the courts and the SEC to define the term. *Id.* The SEC initially refused to supply such a definition, "[i]n recognition of the dynamic nature of tender offers and the need for the Williams Act to be interpreted flexibly in a manner consistent with its purposes." Exchange Act Rel. No. 15,548, 16 SEC Docket 973, 980 (Feb. 5, 1979). Years later, the Commission grudgingly proposed a definition of the term, after the court in Brascan Ltd. v. Edper Equities Ltd., 477 F. Supp. 773, 791 (S.D.N.Y. 1979), criticized the Commission for failing to provide guidance for investors. Oesterle, *The Rise and Fall of Street Sweep Takeovers*, 1989 DUKE L.J. 202, 223 (citing Proposed Amendments to Tender Offer Rules, Exchange Act Rel. No. 34-16,385 (Nov. 29, 1979)). However, the proposed definition was later withdrawn in response to the harsh criticism it received on the grounds that the definition proposed was overly broad. *Id. See generally* Note, *The Developing Meaning of "Tender Offer" Under the Securities Exchange Act of 1934*, 34 HARV. L. REV. 1250 (1973) (discussing the development of the meaning of the term "tender offer").

The Commission has principally relied on an eight-factor "test" that it formulated without the benefit of any rule-making procedures, and which has been followed occasionally by the courts. *See, e.g.*, Wellman v. Dickinson, 475 F. Supp.783 (S.D.N.Y. 1979), *aff'd*, 682 F.2d 355 (2d Cir. 1982), *cert. denied*, 460 U.S. 1069

company's shareholders. Management does not own a corporation merely by virtue of its managerial responsibilities,[20] even though this is not always made apparent by the attitudes and reactions of some managers to hostile takeover initiatives. It is trite, but true, that the shareholders own the business, the directors are their fiduciaries, and management works for them.[21]

The right to dispose of or utilize one's property freely is fundamental to our capitalistic system. But, that "right" is not absolute; it is merely a presumption.[22] The use of property must also conform

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(1983). The test considers the following eight factors in determining whether the purchase of shares constitutes a "tender offer":

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

SEC Proposed Rules on Substantial Securities Acquisitions During and Following a Tender Offer, Exchange Act Rel. No. 34-24,976, 19 Sec. Reg. & L. Rep. (BNA) 1545, 1548 n.16 (Oct. 9, 1987) (citing *Wellman*, 475 F. Supp. at 823-24).

A number of courts have rejected the eight-factor test, with some preferring instead to look to the statutory purpose of the Williams Act in considering whether, in light of the totality of the circumstances, an offer to purchase shares is a solicitation that should be defined as a tender offer. *See, e.g.*, *Hanson Trust, PLC*, 774 F.2d at 56-57.

Another test was set forth in S-G Secs., Inc. v. Fuqua Inv. Co., 466 F. Supp. 1114 (D. Mass. 1978), which considers an acquisition proposal to be a tender offer where there is: (1) "a publicly announced intention by the purchaser to acquire a substantial block of the stock of the target company for purposes of acquiring control"; and (2) "a subsequent rapid acquisition by the purchaser of large blocks of stock through open market and privately negotiated purchases." *Id.* at 1126-27. Such a test has been referred to as the "public announcement/rapid acquisition test." *See* American Carriers, Inc. v. Baytree Investors, Inc., 685 F. Supp. 800, 809 (D. Kan. 1988).

20. The debate over the separation of ownership and control in a public corporation and its implications for shareholders' autonomy, first sparked by the seminal work of Berle and Means, see A. BERLE & G. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY (1932), is alive and well in today's legal literature. *See, e.g.*, *Corporations and Private Property: A Conference Sponsored by the Hoover Institution*, 26 J.L. & ECON. 235 (1983).

21. *See, e.g.*, Southdown, Inc. v. Moore McCormack Resources, Inc., 686 F. Supp. 595, 600 (S.D. Tex. 1988) ("The shareholders own the business; directors are their trustees; management works there.").

22. *See, e.g.*, L. TRIBE, AMERICAN CONSTITUTIONAL LAW 588-99 (2d ed. 1988)

to societal needs and objectives.[23] A good example of this is home ownership. The owner of a house must conform to building requirements,[24] environmental regulations,[25] zoning ordinances,[26] and, in some instances, historical preservation standards.[27] These limitations do not contravene or demean the right of property owners to utilize their property as they see fit, or to sell their homes when the mood strikes, but they do demonstrate that property ownership is only the beginning of our analysis, not the end.

This concept is harder to apply, but no less relevant, to corporations. For many of the issues that confront corporations, corporate owners—the shareholders—are the primary, and often the exclusive, constituency which our various state corporation laws seek to protect.[28] But, transactions in corporate control present a decidedly different context. Delaware law expressly recognizes this, for example, by allowing a target's board to preclude shareholders from ever voting on a merger proposal.[29] And, just as the courts have recognized

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(discussing the constitutionality of certain governmental restrictions on the use of private property without compensation where such restrictions do not amount to a taking under the fifth amendment). Some commentators appear to support that this is an absolute right constitutionally protected by the fifth and fourteenth amendments of the United States Constitution. *See, e.g.*, R. EPSTEIN, TAKINGS: PRIVATE PROPERTY AND THE POWER OF EMINENT DOMAIN 7-31 (1985).

23. *See, e.g.*, Baker, *Property and its Relation to Constitutionally Protected Liberty*, 134 U. PA. L. REV. 741, 758-60 (1986).

24. *See, e.g.*, C. FIELD & S. RIVKIN, THE BUILDING CODE BURDEN 33-56 (1975) (describing such requirements).

25. *See, e.g.*, Federal Water Pollution Control Act, 33 U.S.C. §§ 1251-1376 (1982 & Supp. 1989); Clean Air Act, 42 U.S.C. §§ 7401-7626 (1982 & Supp. 1989). *See also* D. MANDELKER, ENVIRONMENTAL AND LAND CONTROLS LEGISLATION (1976).

26. *See, e.g.*, 1 R. ANDERSON, AMERICAN LAW OF ZONING § 1.13 (3d ed. 1986).

27. *See, e.g.*, National Historic Preservation Act of 1966, 80 Stat. 95, 16 U.S.C. § 470 (1988). Moreover, over the past 60 years, all 50 states and over 500 municipalities have enacted laws that restrict a person's utilization of property determined to be an "historic landmark." *See* NATIONAL TRUST FOR HISTORIC PRESERVATION, A GUIDE TO STATE HISTORIC PRESERVATION PROGRAMS (1988). New York City's Landmarks Preservation and Historic Districts Law is typical of local laws that impose restrictions upon a property owner's operations concerning use of a landmark site. *See* N.Y.C. ADMIN. CODE tit. 25, ch. 3, § 25-301 (1988).

28. *See, e.g.*, DEL. CODE ANN. tit. 8, § 228 (1988) (*stockholder* right to action without need for formal meeting); DEL. CODE ANN. tit. 8, § 262 (1988) (appraisal rights attach to *stockholders* that dissent in a merger transaction); DEL. CODE ANN. tit. 8, § 220 (1988) (*stockholder* right to inspection of corporate books and records); N.Y. BUS. CORP. L. § 910 (McKinney 1987) (*stockholder* right to receive fair value of shares where stockholder dissents in a merger transaction).

29. *See, e.g.*, DEL. CODE ANN. tit. 8, § 251 (1988). Under § 251, the board

that directoral responsibilities and powers may be different in the hostile takeover context,[30] so too is it appropriate to consider whether shareholder rights should remain static in that environment.

In the context of a hostile tender offer, shareholders cannot be said to be the only group of persons interested in modern day corporations.[31] Society has many legitimate interests in the operation

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of directors must first approve a merger agreement before the agreement is submitted to shareholders for their approval. *Id.* § 251(b)(1). If the board does not approve a merger agreement, a shareholder vote cannot be compelled. *See, e.g.*, *In re* TW Servs. Inc. Shareholders Litig., [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,334, at 92,182 (Del. Ch. Mar. 2, 1989) (directorial decision not to pursue a merger proposal protected by the traditional business judgment rule).

30. *See, e.g.*, *In re* TW Servs. Inc. Shareholders Litig., [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,334, at 92,182 (Del. Ch. Mar. 2, 1989) (discussing disparity between the legal treatment of directoral decisions in takeover context and in non-takeover setting); Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 954-55 (Del. 1985) (directors' entitlement to the protections of the business judgment rule subject to enhanced judicial scrutiny in the takeover context).

31. The Delaware courts seem to recognize this proposition in change of control cases. For example, in Kors v. Carey, 39 Del. Ch. 47, 158 A.2d 136 (1960), the court permitted target directors to take action in order to preserve the company's established relationships with customers which would have been damaged if the insurgent had gained control. *Id.* at 52-53, 158 A.2d at 139-40. Similarly, in Cheff v. Mathes, 41 Del. Ch. 494, 199 A.2d 548 (Del. 1964), a dissident shareholder's likely change in sales policies, and the employee unrest that was anticipated to result from such a change, constituted a sufficient threat to the corporate enterprise to meet the directors' pre-*Unocal* burden of proving that a company share repurchase program was in the corporate interest. *Id.* at 507-08, 199 A.2d at 556.

After the delivery of this paper, the Delaware Supreme Court, in Mills Acquisition Co. v. MacMillan, Inc., 559 A.2d 1261 (Del. 1988), recognized that a target board, in framing a response to a hostile offer, may consider, among other things, "the impact of both the bid and the potential acquisition on ... constituencies [other than shareholders], provided that it bears some reasonable relationship to general shareholder interests." *Id.* at 1282 n.29. In an earlier decision, the court stated that constituencies such as "creditors, customers, employees, and perhaps even the community generally" may be considered in forming a response to a hostile acquisition proposal. *Unocal*, 493 A.2d at 955.

The court recently reaffirmed its view that a board has "a right, indeed a firm duty, to consider a host of factors in determining whether to entertain [a bidder's] offer." Citron v. Fairchild Camera & Instrument Corp., No. 270, 1988, slip op. at 44 (Del. Dec. 22, 1989) (*Citron 1989*).

Other courts have recognized that noninvestor constituencies are proper objects of management concern. *See, e.g.*, Norlin Corp. v. Rooney, Pace, Inc., 744 F.2d 255, 266 (2d Cir. 1984) (indicating that a board may consider interests of employees when considering a takeover bid); Amanda Acquisition Corp. v. Universal Foods Corp., 708 F. Supp. 984, 1009, 1015 (E.D. Wis.) (noting that a board may consider the interests of the corporate enterprise, its customers, suppliers, and employees in satifying its burdens under *Unocal*), *aff'd on other grounds*, 877 F.2d 496 (7th Cir.), *cert. denied*, 110 S. Ct. 367 (1989); GAF Corp. v. Union Carbide Corp., 624 F.

and ownership of corporations.[32] Corporations that provide unique services, employ significant numbers of citizens, and compete effectively domestically and internationally, are imbued with a public interest that is relevant to the takeover process. And yet, our current laws recognize this, if at all, in only a haphazard sort of way.[33]

For example, communications corporations are significant enterprises that cannot be replicated. There are, after all, just so many radio or television stations that can exist in any one community,[34] and those facilities serve public needs as well as the needs of their

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Supp. 1016, 1019-20 (S.D.N.Y. 1985) (stating that a target board may properly consider the interests of employees and management who serve the interests of investors in responding to a takeover bid); Enterra Corp. v. SGS Assoc., 600 F. Supp. 678, 687 (E.D. Pa. 1985) (stating that target management might properly consider the interests of suppliers, customers, and lenders when considering a takeover bid).

32. *See generally* E. MASON, THE CORPORATION IN MODERN SOCIETY (1959) (discussing the many important roles of the modern corporation in society); Dodd, *For Whom are Corporate Managers Trustees?*, 45 HARV. L. REV. 1145 (1932) (discussing the social responsibilities of the modern corporation and the existence of interests other than those of the stockholders in the operation of corporations).

One commentator has opined that

> [t]here are, of course, a great variety of concerns about the effects of takeover activity—actual and threatened—on persons and groups other than shareholders. One way to classify many of these misgivings is to separate a concern for the effects on persons whose lives are immediately affected by a particular corporation from concerns that are more national in scope. "Stakeholders" in specific corporations such as employees, suppliers, creditors, customers, and local enterprise-dependent communities fall within the former category. Diversion of credit to unproductive uses, narrow management focus on short run economic performance, inordinate use of debt, and waste of society's resources are oft-cited concerns about takeovers that fall within the latter category. Obviously, the distinction is somewhat artificial since many corporate activities affect both categories. Nonetheless, it serves as a reminder that while there are many persons and groups interested in the fate of individual corporations, there is also a larger societal concern about the cumulative effects of takeover activities.

Johnson, *Corporate Takeovers and Corporations: Who Are They For?*, 43 WASH. & LEE L. REV. 781, 783 n.11 (1986).

33. The recent adoption of state takeover statutes aimed at permitting or directing target boards to consider non-shareholder constituencies exemplifies this recognition. The Minnesota Antitakeover Statute is typical of the so-called "stakeholder" statutes. It permits directors of Minnesota corporations to evaluate how a takeover could affect employees, customers, suppliers, creditors, and even the communities in which the corporation is located or has significant operations. *See* MINN. STAT. ANN. § 302A.251 (West Supp. 1990). *See also infra* note 42.

34. *See generally* L. POWE, AMERICAN BROADCASTING AND THE FIRST AMENDMENT 203-04 (1987) (noting that private market forces, as well as the federal licensing scheme, limit the number of radio and television stations in any one community).

owners.[35] They are not, simply stated, entities that can be operated or disposed of freely because, in at least some instances, their importance to society outweighs, or at least equals, the rights of those who own these entities.[36] The same is true, in somewhat different ways, for public utilities,[37] defense contractors,[38] depository institutions,[39] transportation companies,[40] and insurance companies.[41] Un-

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35. *See, e.g.*, 47 U.S.C. §§ 151, 303, 307, 308, 310, & 316 (1989) (indicating that the interests, necessities, and convenience of the public are some of the policy concerns underlying federal regulations pertaining to the communications industry).

36. *Id.* This point was forcefully recognized by the court in Herald Co. v. Seawell, 472 F.2d 1081 (10th Cir. 1972), a case which involved another subset of the communications media—a newspaper. There, the plaintiff, a minority shareholder, brought a derivative action on behalf of the Denver Post, Inc., a newspaper publishing company, against the company's officers and directors, alleging that the management had breached its fiduciary duty in connection with the purchase of stock for the company's employee stock trust plan. *Id.* at 1083-90. The plaintiff, a wholly owned subsidiary of Samuel I. Newhouse, alleged that the purchase of stock amounted to an entrenchment device. *Id.* at 1091.

In holding for the Denver Post, on the ground that its actions in fending off a perceived hostile threat were reasonable, the court determined that media concerns were responsible not only to shareholders but also to their employees and the public. *Id.* The court stated: "In this case we have a corporation engaged chiefly in the publication of a large metropolitan newspaper, whose obligation and duty is something more than the making of corporate profits." *Id.* The court went on to state that "a newspaper such as the Denver Post ... has an obligation to the public, that is, the thousands of people who buy the paper, read it, and rely upon its contents. Such a newspaper is endowed with an important public interest." *Id.* at 1094-95. The court termed the Denver Post a "quasi-public institution" and, as such, was entitled to consider a broad range of constituencies. *Id.* at 1095.

37. *Cf.* Wolff Packing Co. v. Court of Indus. Relations of the State of Kan., 262 U.S. 522, 535 (1923) (public utilities are businesses "clothed with a public interest" justifying public regulation); People v. Phelps, 67 Ill. App. 3d 976, 978, 385 N.E.2d 738, 741 (Ill. App. Ct. 1978) (characterizing public utility as a "private enterprise clothed with the public interest," thus subject to extensive state and federal regulation).

38. *Cf.* Exon-Florio Amendment to the Defense Production Act of 1950, 50 U.S.C. app. § 2170 (1989) (requiring Presidential approval of acquisitions of United States businesses that implicate national security concerns).

39. *See, e.g.*, McCoy, *The Future of U.S. Banking: A Modest Legislative Agenda to Encourage Competitiveness*, 49 OHIO ST. L.J. 1189, 1190 (1989) (noting the legislative attitude that banks, including depository institutions, are "quasi-public utilities whose social welfare obligations are of primary importance").

40. *See, e.g.*, New York Cent. R.R. v. Transport Workers Union of Am., 49 L.R.R.M. (BNA) 2897, 2899 (S.D.N.Y. 1962) (noting the importance of the New York Central Railroad Company to the northeast section of the United States).

41. *See generally* V. ZELIZER, MORALS & MARKETS: THE DEVELOPMENT OF LIFE INSURANCE IN THE UNITED STATES (1979) (discussing the development of life insurance in the United States and its significance in society); Mundheim, *A Comment on the Social Responsibilities of Life Insurance Companies as Investors*, 61 VA. L. REV. 1247 (1975) (discussing the social responsibilities of life insurance companies).

fettered ownership powers in shareholders of at least these types of corporations would misstate the vital significance of these enterprises to society at large.

It is not radically different to say that constituencies other than shareholders have relevant and vital stakes in the utilization and disposition of virtually *all* corporations.[42] Is it inappropriate for corporations to consider the impact their operation and sale could have on the labor force?[43] On consumers?[44] On suppliers?[45] Is it irrelevant to consider that shareholder-owners do not have the right to permit

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42. Certainly the trend on the state level is to permit, and sometimes direct, management to consider the impact of acquisition proposals on consumers, suppliers, creditors, employees, and, in some cases, the national and local economy. *See, e.g.*, ME. REV. STAT. ANN. tit. 13-A, § 716 (1989); OHIO REV. CODE ANN. § 1701.59 (Anderson 1988); PA. STAT. ANN. tit. 42, § 8363 (Purdons 1988). Approximately 23 states have adopted laws allowing or requiring directors to consider non-monetary factors when faced with a hostile takeover bid, and many of these laws permit directors to consider constituencies other than shareholders in making decisions in the change of control context. *De Facto Federal Anti-Bidder Stance Exists Through State Laws, IRRC Says*, 21 Sec. Reg. & L. Rep. (BNA) 1501 (Oct. 6, 1989). Such statutes have been the subject of criticism by those members of the corporate bar. *See, e.g.*, Block & Hoff, *Indiana: A 4th-Generation Statute or a Prohibition?*, N.Y.L.J., Mar. 23, 1989, at 5, 6 (asserting that Indiana's recently enacted statute, which expands directorial discretion to include board consideration of non-stockholder constituencies in all contexts, and rejects the higher degree of scrutiny imposed on directors' decisions in the takeover context under the *Unocal* standard, could undermine standards of fiduciary obligations). *See generally* Hanks, *Analysis of State Takeover Statutes*, *reprinted in* AMERICAN BAR ASS'N, DYNAMICS OF CORPORATE CONTROL IV: EVOLVING LEGAL STANDARDS APPLIED TO THE FRONTIERS OF CORPORATE STRATEGY (1989) (discussing the various state takeover statutes).

43. As one commentator has noted:

> If the corporation is conceived ... as an operating institution combining all factors of production to conduct an on-going business, then the employees ... are as much members of that enterprise as the shareholders who provide the capital. Indeed, the employees may have made a much greater investment in the enterprise by their years of service, may have much less ability to withdraw, and may have a greater stake in the future of the enterprise than many of the stockholders.

Summers, *Codetermination in the United States: A Projection of Problems and Potentials*, 4 J. COMP. CORP. L. REV. 155, 170 (1982).

44. *See, e.g.*, Dutt, *A Freeze on the Frenzy: Businesses Grapple With Debt from Long Buyout Binge*, Newsday, Oct. 22, 1987, at 4, col. 1 (noting that, as a result of the RJR-Nabisco buyout, the price of the company's products have risen 9.2%).

45. *See, e.g.*, *Amanda Acquisition Corp.*, 708 F. Supp. at 1009, 1015 (approving a target board's determination that a hostile bid posed a threat to, among other things, the corporation's suppliers), *aff'd on other grounds*, 877 F.2d 496 (7th Cir.), *cert. denied*, 110 S. Ct. 367 (1989); PA. STAT. ANN. tit. 42, § 8363 (Purdons 1988) (permitting target companies to consider, in responding to acquisition proposals, non-shareholder constituencies, including the target's suppliers).

their corporations to pollute the environment or otherwise operate a corporation to the detriment of other members of society?[46] Does it matter to us if all our automobile companies are owned by foreign enterprises?[47] If our defense contractors are owned by financial buyers rather than strategic corporate operators?[48]

These are, of course, rhetorical questions. They are intended to demonstrate that *any* corporation can have a societal impact—if only by its contributions to the local communities in which the corporation operates,[49] whether or not the company is specially reg-

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46. The conflict between existing and prospective shareholders was pointed out most dramatically in a speech by the late Ray Garrett, Jr., during his tenure as chairman of the Securities and Exchange Commission, analyzing the obligation of corporations to disclose illegal or improper behavior:

> It seems to me that I would want to know that [a company had made bribes to obtain or retain corporate business] if I were considering investing in the company. . . . It is also true that present, as against prospective, investors in the company might have a different attitude. They might reasonably say, "Perhaps I would have appreciated this bit of intelligence before I bought any stock, but now that I have it, don't tell me, since you can't tell me without telling all the world and blowing the whole deal."

Address by R. Garrett, Jr., *Homily on the Glories of Right Conduct and the Wages of Sin*, at 24, at American Society of Corporate Secretaries, Inc., White Sulphur Springs, W. Virginia (June 27, 1975) (on file with the *Delaware Journal of Corporate Law*).

47. *See, e.g.*, Adams & Brock, *The "New Learning" and the Euthanasia of Antitrust*, 74 CALIF. L. REV. 1516 (1986) (discussing United States restrictions on foreign imports, generally, and automobiles specifically); Crandall, *Import Quotas and the Automobile Industry: The Costs of Protectionism*, in THE BROOKINGS REV. 8-16 (Summer 1984).

48. In Wall Street parlance, "strategic buyers" are established companies that bid for other companies to expand into new markets or add new products. Hilder, *Dealmakers Mourn Raiding as a Lost Art*, Wall St. J., Sept. 27, 1989, § 3, at 1, col. 2. A financial buyer, on the other hand, is a person or entity that bids for companies as a financial investment. Financial buyers often do not expect to participate in the day-to-day management of the business. *See* Braunschweiger v. American Home Shield Corp., [Current Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,779, at 94,187, 94,189 n.4 (Del. Ch. Oct. 26, 1989) (defining the terms "strategic buyer" and "financial buyer"). *See also* Bartlett, *The New Takeovers*, N.Y. Times, Dec. 17, 1989, § 3, at 1, col. 2 (discussing the current status of financial buyers in the market for corporate control).

49. The enormous lengths to which some communities are prepared to go to preserve these contributions was demonstrated a decade and a half ago, when the small town of Urbana, New York (with a population of 1,650) became the first, and perhaps the only, town to adopt its own antitakeover ordinance, to protect the Taylor Wine Company from the onslaught of a hostile takeover (and from the concomitant negative impact on the economy of the community of Urbana). *See* Ehrbar, *Corporate Takeovers Are Here to Stay*, Fortune, May 8, 1978, at 91, 92. Taylor Wine Company ultimately was acquired by Coca-Cola, Inc., in a friendly merger. *Id. See Coca-Cola: A Spurt in Wine that is Altering the Industry*, Bus. Wk., Oct. 15, 1979, at 126. *See also* Sheets, *People Pay the Highest Price in a Takeover*, U.S. News

ulated or the subject of specific legislation. In sum, stock ownership implies a *presumption* of the right to sell or the right to operate, but not an unfettered right to do so. There may be equal, or even more important, considerations present.

III. DISTINGUISHING BETWEEN TYPES OF SHAREHOLDERS

The types of shareholders who own today's public companies are also relevant to our analysis. To paraphrase, but contradict, Gerturde Stein, a shareholder is *not* always a shareholder.[50] This is a concept the courts have recognized. Thus, the common law,[51] as well as state statutory corporate law,[52] recognizes that majority shareholders do not have unfettered rights in running a corporation and, conversely, that minority shareholders cannot tyrannize the will of

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& World Rep., July 22, 1985, at 51 (discussing Gulf Oil's contribution to Pittsburgh organizations of over $2 million in 1983, and the psychological as well as economic impact on the Pittsburgh community resulting from Gulf Oil's departure after a takeover by Chevron).

50. Stein, *Sacred Emily*, in GEOGRAPH AND PLAYS 178, 187 (1922) ("[r]ose is a rose is a rose is a rose").

51. *See, e.g.*, Southern Pac. Co. v. Bogert, 250 U.S. 483, 487-88 (1919) ("The majority has the right to control; but when it does so, it occupies a fiduciary relation toward the minority ...."); Weinberger v. UOP, Inc., 457 A.2d 701, 703 (Del. 1983) (majority shareholders bear the burden of showing the fairness of the transaction in a cash-out merger of minority shareholders by majority shareholders, where such has not been approved by an informed vote of a majority of the minority shareholders); Jones v. H.F. Ahmanson & Co., 460 P.2d 464, 476 (Cal. 1969) ("controlling shareholders may not use their power to control the corporation for the purpose of promoting a marketing scheme that benefits themselves alone to the detriment of the minority").

52. Many state corporation statutes expressly grant affirmative rights to minority shareholders to obtain relief from certain acts of the majority. The creation of appraisal rights for shareholders who dissent from fundamental corporate changes is one example of this phenomenon. *See generally* Buxbaum, *The Dissenter's Appraisal Remedy*, 23 U.C.L.A. L. REV. 1229 (1976) (discussing appraisal rights).

Another example can be found in some corporate codes—preemptive rights granted to shareholders when a company issues additional stock. Preemption provisions generally grant each shareholder the right to participate in a *pro rata* fashion in sales by a corporation of its own shares, in new issues of shares, and in repurchases and redemptions by the corporation of its own shares. Such rights attempt to protect minority shareholders against majority shareholder attempts to dilute the minority's *pro rata* claims to corporate prosperity. Although some states expressly provide for such rights, see, e.g., PA. CONS. STAT. ANN. § 1611B (Purdons 1987), most states, including Delaware, allow the articles of incorporation to provide for or alter those rights. *See, e.g.*, DEL. CODE ANN. tit. 8, § 102(b)(3) (1988); N.Y. BUS. CORP. LAW § 622(e) (McKinney 1988).

a majority of shareholders.[53] Similarly, the United States Supreme Court has recognized that a shareholder-acquiror is not entitled to the same rights, protections, and even deference as are other shareholders of a target company.[54]

Simply put, not all shareholders are alike, nor are they necessarily entitled to be treated the same. But, how far can this principle be extended? Should it matter to directors, for example, if the target's shareholders are no longer principally comprised of long-standing individual investors, but rather of arbitrageurs, who recently acquired their stock, and who are interested only in capitalizing on a quick premium for their newly-acquired stock?[55] One can readily draw

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53. The enactment of appraisal statutes sought to alleviate the problems associated with the early common law rule that required the unanimous consent of shareholders to carry out major corporate transactions, such as mergers or consolidations, or a sale of all or substantially all of a corporation's assets. *See, e.g.*, Dreiseszun v. FLM Indus., Inc., 577 S.W.2d 902, 907 (Mo. Ct. App. 1979). The common law rule permitted a minority of shareholders effectively to block the actions of the majority. Appraisal statutes seek to protect the minority shareholders while at the same time allow the majority (or sometimes two-thirds) of shareholders to implement policies and decisions to their liking. *See, e.g.*, Woodward v. Quigley, 257 Iowa 1077, 1086, 133 N.W.2d 38, 43 (1965).

54. *See* Piper v. Chris-Craft Indus., Inc., 430 U.S. 1 (1977). In *Piper*, the unsuccessful tender offeror in a contest for control brought a private action for damages under the Exchange Act against the target and its "white knight" (a competing bidder to whom target management was kindly disposed), alleging that the target and its friend had violated § 14(e) of the Exchange Act, 15 U.S.C. § 78n(e) (1982), the Williams Act's general antifraud provision, in connection with the tender offer contest. *Piper*, 430 U.S. at 39-40.

In holding that an unsuccessful tender offeror had no standing to maintain an implied private damage action under § 14(e), the Court noted that the bidder's status as a disgruntled acquiror took precedence over its status as a target shareholder. Since the bidder did not stand in the shoes of the Williams Act's intended beneficiaries (the target's shareholders), the Court held the bidder was not entitled to receive the protections afforded to target shareholders under the Act. *Id.* at 39. *See* Pitt, *Standing to Sue Under the Williams Act After* Chris-Craft: *A Leaky Ship on Troubled Waters*, 34 BUS. LAW. 117 (1978) (extensively discussing *Piper*).

The Delaware Supreme Court's decision in Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985), similarly held, on state fiduciary grounds, that a target company may deal selectively with a corporate raider who is also a target shareholder, and deny the raider the economic benefits of the target's proposed self-tender. *Id.* at 958. The vitality of *Unocal* has, however, been eviscerated as a result of the SEC's adoption of the "All-Holders Rule," 17 C.F.R. § 240.13e-4(f)(8)(1) (1989), which mandates that issuer self-tender offers be open to *all* holders of the class of securities sought.

Finally, the effectiveness of poison pills also is predicated on the notion that a corporation can discriminate against categories of shareholders. *See supra* note 8.

55. For a discussion of the role of arbitrageurs in the takeover arena, see

distinctions between long-term shareholders and short-term profit-takers, such as arbitrageurs, and their stockholding objectives.[56] But, do these distinctions justify a board of directors in elevating certain corporate constituencies (say, long-term investors) over arbitrageur-shareholders? Delaware jurisprudence does not yet squarely address this premise, but the Delaware Supreme Court has acknowledged, in general terms, that distinctions among types of shareholders are neither inappropriate nor irrelevant.[57]

This attempted distinction is a potential two-edged sword. One could argue that a board of directors may have higher obligations to its shareholders if they purchased their shares solely to capitalize on a hostile acquisition effort.[58] Directors might have more latitude

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Brown, *Corporate Secrecy, the Federal Securities Laws, and the Disclosure of Ongoing Negotiations*, 36 CATH. U.L. REV. 93, 148-53 (1986) (noting reasons that arbitrageurs do not engage in long-term investment); Henry, *Activities of Arbitrageurs in Tender Offers*, 119 U. PA. L. REV. 466, 469 (1971) (noting that arbitrageurs assume the risk that the takeover will not take place); Rubin, *Arbitrage*, 32 BUS. LAW. 1315 (1977); Welles, *Inside the Arbitrage Game*, 15 INSTITUTIONAL INVESTOR No. 8, at 41 (Aug. 1981); Comment, *Should Tender Offer Arbitrage be Regulated?*, 1978 DUKE L.J. 1000 (1978); *The Place of Arbitrageurs in Mergers and Acquisitions*, 21 MERGERS & ACQUISITIONS No. 1, at 24 (July/Aug. 1986).

56. Long-term investors, for these purposes, are investors whose investment in the target company is of a long-standing nature, and whose outlook is to achieve long-term growth and appreciation. *See, e.g.*, Arbel & Kaff, *Make the Market Safer for the Little Guy*, Newsday, Nov. 13, 1989, at 53 ("individual investors ... put their money into securities for long term gains, often as part of their lifetime savings plan"). Arbitrageurs, by contrast, attempt to deploy their capital quickly and for a short period, maximizing the profit-potential of each investment, as measured not only by the return, but by the speed with which that return is realized. *See, e.g.*, H. MANNE, INSIDER TRADING AND THE STOCK MARKET 94-96 (1968). *See also* Gavin & Neilson, *Individual v. Institutional Investors: Who Will Govern?*, N.Y.L.J., May 28, 1985, at 19, col. 1 (discussing how the ownership objectives of financial institutions, in contrast to those of individual investors, are short-term and often at odds with the corporation's operating plans).

57. See *Unocal*, 493 A.2d at 955-56, where the court, in articulating a standard upon which to judge target management's response to a hostile bid, opined in *dicta* that "a board may reasonably consider the basic stockholder interests at stake, including those of short term speculators, whose actions may have fueled the coercive aspect of the offer at the expense of the long term investor." *Id. See also* Ivanhoe Partners v. Newmont Mining Corp., 535 A.2d 1334, 1341-42 (Del. 1987) (restating the *dicta* in *Unocal*). *But see* Oesterle, *The Negotiation Model of Tender Offer Defenses and the Delaware Supreme Court*, 72 CORNELL L. REV. 117, 143-44 (1986) (criticizing the *Unocal dicta* because, according to the author, it is contrary to the efficient market theory, which ignores any distinction between long-term and short-term interests).

58. *Cf.* Gilson, *A Flight for the Right to "Just Say No" to Hostile Tender Offers*, Legal Times, June 26, 1989, at 19 (arguing that arbitrageurs stand as less risk-

if they (and those who subsequently judge them) cannot say with certitude just what are the desires of the target company's various shareholder-constituencies.

The issue is more complex, however, and should be viewed somewhat differently. Arbitrageurs are in business to take the risk that an announced takeover may fail.[59] That is why, in the days before insider trading became a cottage industry,[60] arbitrageurs used to be referred to as "risk arbitrageurs."[61] These shareholders would seem much more akin to those who buy into a litigation. The courts have not usually treated those persons kindly.[62] There seems to be no reason that target company directors should have greater obligations in essentially comparable circumstances.

Should institutional investors be treated as legally indistinguishable from individual investors? Institutions often are merely vehicles for individuals to invest in the stock market—such as pension plans and mutual funds.[63] One could conclude, therefore, that such institutional investors are entitled to be treated the same as individual

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adverse surrogates for long-term investors who have already demonstrated, by selling their shares to the arbitrageurs, that they perceive the size of the premium to exceed the company's long-term value).

59. *See* sources cited *supra* note 55 (discussing in detail the role of arbitrageurs in the hostile takeover process).

60. *See generally* Pitt & Shapiro, *Securities Regulation by Enforcement: A Look Ahead at the Next Decade*, 9 YALE J. REG. 149 (1990) (discussing the increase in insider trading in the early 1980s and the subsequent increase in securities law enforcement).

61. *See, e.g.*, Dennis, *Risk Arbitrageurs and the Market for Corporate Control*, 37 HASTINGS L.J. 409 (1985); Coffee, *Regulating the Market for Corporate Control: A Critical Assessment of the Tender Offer's Role in Corporate Governance*, 84 COLUM. L. REV. 1145 (1984) (referring to arbitrageurs as "risk arbitrageurs").

62. *See, e.g.*, Cohen v. Beneficial Indus. Loan Corp., 337 U.S. 541, 556 (1949) (stating that the requirement that a plaintiff bringing a derivative action be a shareholder at the time of the disputed transaction, in Rule 23 of the Federal Rules of Civil Procedure, indicates that a federal court will not permit a "purchased grievance" to be litigated). *Cf.* Bateson v. Magna Oil Corp., 414 F.2d 128, 131 (5th Cir. 1969) (stating that estoppel principles will operate to deny standing to a plaintiff who buys stock with knowledge of the wrongs of which he complains).

63. *See* Winter, "*On Protecting the Ordinary Investor*," 63 WASH. L. REV. 881, 887 (1988) (noting that institutions, such as pension or mutual funds, serve as conduits by which small investors participate in the capital market); Comment, *Whistle Blowing as a Rule 10b-5 Violation:* Dirks v. SEC; 36 U. MIAMI L. REV. 987 (1982) (stating that large institutional investors "indirectly represent the pooled interests of millions of small investors holding stock in mutual funds, pension, plans, or insurance companies"). *See generally* D. MCGILL, FUNDAMENTALS OF PRIVATE PENSIONS (3d ed. 1975) (explaining individual investors' utilization of mutual funds); *Mutual Funds as Investors of Large Pools of Money*, 115 U. PA. L. REV. 669 (1972) (same).

investors. But, a pension plan that is a significant owner of a company's stock[64] may represent the investments of employees whose interests, and values, are vastly different from those of non-employee shareholders.[65]

Yet other institutional managers depend on fees that reflect, directly or indirectly, their performance as money managers.[66] Consequently, they may be more inclined to pursue short-term profit-taking strategies,[67] rather than long-term corporate development.[68] Should we require directors automatically to assume that the decision-making processes of such portfolio managers necessarily reflect the values of those whose money they represent? Or, is it permissible to draw a different inference, at least in some cases, that the money manager's decisions are selfishly motivated?[69] And, in all of this

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64. *See, e.g.*, P. DRUCKER, THE UNSEEN REVOLUTION: HOW PENSION FUND SOCIALISM CAME TO AMERICA (1976) (detailing the percentage of ownership by employee pension funds); MONEY MARKET DIRECTORIES, INC., THE MONEY MARKET: DIRECTORY OF PENSION FUNDS AND THEIR INVESTMENT MANAGERS 1986 XIV-XXIII (1986) (providing statistics on holdings of pension funds).

65. Masters, *Employee Plans Central in Takeovers*, Legal Times, Oct. 11, 1982, at 1 (noting that employee-shareholders are interested in preserving their jobs and their companies, in addition to making a profit); *What a Corporation Owes Its Shareholders*, N.Y. Times, Oct. 27, 1982, at A26, col. 4 (Letter from Phillip Brewer) (distinguishing shareholders who can easily disassociate themselves from a corporation, from employees and communities, whose "well-being is often intimately and irrevocably tied to a corporation's behavior"). *Cf. Martin Marietta Sues in Bendix Fight*, PR Newswire, Sept. 16, 1982 (reporting the filing of an action involving the tendering of shares held in an ESOP by an ESOP trustee to a hostile tender offer, even though such was prohibited by the terms of the plan; illustrating the potential competing interests of employee stockholders and non-employee stockholders). Employee-shareholders tend to think of themselves as employees first, and shareholders second. *See, e.g.*, Simmons, Ward & Watson, *An ESOP Can Be an Effective Anti-Takeover Device*, Nat'l L.J., June 30, 1986, at 25, 27 (noting that ESOP participants are likely to act in accordance with management's recommendations, where the ESOP allows participants to exercise tender rights, because of the threat to job security posed by many hostile takeovers).

66. *See, e.g.*, *Corporate Governance*, *supra* note 2, at 7.

67. *See, e.g.*, Drucker, *A Crisis of Capitalism*, Wall St. J., Sept. 30, 1986, at 32, col. 3 ("[An investment-fund] manager has little choice but to focus on the very shortest term; his own job depends on showing immediate gains, with his performance in most cases judged quarter by quarter.").

68. *See, e.g.*, *Corporate Governance*, *supra* note 2, at 7, 8; Carrington & Hertzberg, *Jumpy Markets: Stock Prices Become More Volatile as Role of Institutions Grows*, Wall St. J., Nov. 30, 1982, at 1, col. 6; Conine, *Boosting America's Competitiveness: Investment Pressures for Short-Term Gains Must Be Changed*, L.A. Times, Jan. 12, 1987, § 2, at 5, col. 3.

69. The churning of accounts by brokers exemplifies such selfish motivations. Churning refers to a securities broker/dealer repeatedly buying and selling stock

analysis, it should be borne in mind, of course, that institutional managers who pursue short-term profit objectives provide much-needed liquidity for our capital markets.[70]

The point is that different shareholders *do* have different investment objectives, and it may be meaningless for lawyers and judges to talk of directors' fiduciary duties to shareholders, without identifying whether there are different consequences arising from the disparate types of shareholders comprising the ownership of most public corporations.[71] A board of directors should be justified—

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on behalf of a customer in an effort to generate commissions. Beck, *Turning Churning into Big Bucks*, Am. Law., July-Aug. 1989, at 166. Allegations of churning have been made in several recent actions brought against securities brokers. *See, e.g.*, Adams v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 888 F.2d 696, 697 (10th Cir. 1989); DeRance, Inc. v. PaineWebber Inc., 872 F.2d 1312, 1325 n.8 (7th Cir. 1989).

70. *See, e.g.*, *Institutional Investor Study Report*, H.R. Doc. 92-64, 92d Cong., 1st Sess., pt. 4, ch. 10 (1971). *See also* Wallace, *Talking Deals: RJR 'Junk' Test Passed by Drexel*, N.Y. Times, May 18, 1989, § D2, col. 1.

71. Broadly speaking, a director owes a fiduciary duty of care and loyalty to the shareholders and to the company he serves. *See, e.g.*, *MacMillan*, 559 A.2d at 1280; Guth v. Loft, 23 Del. Ch. 255, 262, 5 A.2d 503, 510 (Del. 1939). Under the rubric of the duty of care, a director must discharge his duties in good faith, with the care of a prudent person in a like position under similar circumstances, and in a manner he reasonably believes to be in the best interests of the corporation. *E.g.*, Model Business Corp. Act § 8.30 (1989). Thus, he must act in an "informed" manner, availing himself of all relevant information prior to exercising business judgment. *See, e.g.*, Smith v. Van Gorkom, 488 A.2d 858, 872 (Del. 1985). While the standard of liability for a breach of the duty of care has been the subject of much debate, see, e.g., 1 R. BALOTTI & J. FINKELSTEIN, THE DELAWARE LAW OF CORPORATIONS AND BUSINESS ORGANIZATIONS § 4.7 (1988), Delaware has adopted a standard of "gross negligence." *See, e.g.*, Aronson v. Lewis, 473 A.2d 805, 812 & n.6 (Del. 1984). *See also Citron 1989*, No. 270, 1988, slip op. at 39 (reaffirming gross negligence as the standard of liability for a breach of the duty of care).

The duty of loyalty requires that directors exhibit an undivided and unselfish loyalty to the corporation. *See, e.g.*, *Guth*, 23 Del. Ch. at 262, 5 A.2d at 510. Such a rule of undivided loyalty demands that there be no conflict between that duty and a director's self-interest. *See* Weinberger v. UOP, Inc., 457 A.2d 701 (Del. 1983).

Directors' duties of care and loyalty also have been the subject of extensive commentary. For some of the more thoughtful articles, see, e.g., Arsht, *The Business Judgment Rule Revisited*, 8 HOFSTRA L. REV. 93 (1979); Kaplan, *Fiduciary Responsibility in the Management of the Corporation*, 31 BUS. LAW. 1477 (1984); Manning, *Reflections and Practical Tips on Life in the Boardroom After* Van Gorkom, 41 BUS. LAW. 1 (1985); Radin, *The Director's Duty of Care Three Years After* Smith v. Van Gorkom, 39 HASTINGS L.J. 707 (1988); Ruder, *Duty of Loyalty: A Law Professor's Status Report*, 40 BUS. LAW. 1383 (1985); Veasey & Seitz, *The Business Judgment Rule in the Revised Model Act, the* Trans Union *Case, and the ALI Project—A Strange Porridge*, 63 TEX. L. REV. 1483 (1985).

perhaps compelled, in appropriate circumstances—in considering the extent to which those differences dictate different responses to a hostile takeover.[72]

Of course, it could be argued that, in the face of a hostile tender offer, we need not guess what the shareholders' predilections are. One way to determine what different shareholders desire is to let them vote on the question.[73] From the bidder's perspective, a shareholder vote may be preferable to the implementation of defensive tactics by the target company's board of directors.[74] But, bidders by definition believe that the shareholders get to "vote" in the only way that counts—with their pocketbooks—when they decide (assuming, of course, that they are permitted to decide) whether to tender their shares.[75] In a different context, the courts have suggested that such an attitude about what is important to shareholders—one that could be characterized as economic determinism—misperceives the multi-faceted personalities and values shareholders possess.[76]

From the directors' perspective, the question is more complicated. The shareholders may not know everything there is to know, and the directors may think it is not in the shareholders' or the

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72. *See, e.g.*, *Unocal*, 493 A.2d at 956 (bidder's reputation as a "greenmailer" in part justified target's exclusionary self tender).

73. This is the proposal offered by Professor Bebchuk. *See* Bebchuk, *The Pressure to Tender: An Analysis and a Proposed Remedy*, 12 DEL. J. CORP. L. 911 (1987). Professor Bebchuk advocates an arrangement in which tendering shareholders would be able to indicate their approval or disapproval by checking an appropriate box on the tender offer form that accompanies all tendered shares. *Id.* at 931. The success of the bid would depend upon whether the bidder attracted approving tenders from a majority of the target's shareholders, irrespective of the number of tendered shares. *Id.* at 932. If the bidder failed to attract the requisite majority of approving tenders, the bidder would be prohibited from acquiring a controlling interest, and the target would remain independent. *Id.* Professor Bebchuk suggests that such a rule be adopted either by charter amendment or through legislation. *Id.* at 935-37.

74. While a discussion of the wide array of defense tactics utilized by target companies is beyond the scope of the article, some of the more commonly used tactics include "golden parachutes," "crown jewel" lock-up options, "poison pills," "shark repellants," "white knights," and "Pac-man" defenses. *See generally* FLEISCHER, *supra* note 2, at 388.47-.199 (providing a thorough and lucid explanation of the use of defensive tactics in hostile takeovers).

75. *See* Easterbrook & Fischel, *supra* note 3, at 1198 & n.106 (asserting that the decision of whether to accept or reject a tender offer is the shareholders' and efforts of the target's management to resist tender offers should be proscribed).

76. *See, e.g.*, Mills v. Electric Auto-Lite Co., 396 U.S. 375, 383 & n.5 (1970) (signifying that fairness of a merger proposal alone is not determinative of the shareholders' vote because many other factors are involved in the shareholders' decision whether to accept or reject a merger proposal).

company's long-term interests to tell the shareholders and the public what they do not already know, at least at the present time.[77] Moreover, if there are other valid considerations present, or the nature of the company's shareholder population warrants, the mere fact that a majority of existing shareholders might support the hostile bid may be outweighed by other considerations.[78]

Finally, consideration must be given to whether a meaningful vote can be exercised at all. In some circumstances, paternalistic as it may seem,[79] a shareholder plebiscite is not desirable, because a bid effectively is coercive, deceptive, or otherwise contrary to the

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77. Since there is no affirmative disclosure obligation per se under federal law, the directors can decide to maintain the secrecy of material, nonpublic information under the federal securities laws, if the public company involved can meet the following five tests:

1. The company is not subject to some specific, "line item" disclosure requirement under the SEC's regulations;
2. The company has not previously made some statement about the subject of the material information that has become inaccurate or misleading due to the passage of time and subsequent developments;
3. The company is not engaged in buying or selling its own securities;
4. The company has a good faith business reason for withholding disclosure at the particular time; and
5. There are no rumors or other statements circulating publicly about the subject matter in question that emanate from, or properly may be traceable to, the company.

See Brown, *supra* note 55, at 96-116 (outlining the tests for disclosure under federal securities laws). It should be noted, however, of course, that under the rules of the various stock exchanges and the National Association of Securities Dealers, Inc., a company's listing agreement may technically require affirmative disclosures under circumstances in which federal law does not impose such an obligation.

78. In the recent battle for corporate control between Time Inc., Warner Communications, Inc., and Paramount Communications, Inc., Chancellor Allen found that the Time Board was under no legal obligation to consider the desires of its shareholders, or even a majority thereof, to tender their shares to Paramount in light of the Time Board's good-faith judgment to merge with Warner. Paramount Communications, Inc. v. Time, Inc., [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,514, at 93,264, 93,284 (Del. Ch. July 14, 1989), *aff'd*, Nos. 284, 1989, 279, 1989, & 283, 1989 (Del. Feb. 26, 1990). The chancellor opined that

> the financial vitality of the corporation and the value of the company's shares is in the hands of the directors and managers of the firm. The corporation law does not operate on the theory that directors, in exercising their powers to manage the firm, are obligated to follow the wishes of a majority of shares. In fact, directors, not shareholders, are charged with the duty to manage the firm.

Id.

79. *But cf.* Basic, Inc. v. Levinson, 108 S. Ct. 978, 984 (1988) ("[D]isclosure, and not paternalistic withholding of accurate information, is the policy chosen and expressed by Congress.").

interests of shareholders.[80] These attributes may not be readily apparent to the shareholders, and even if made apparent, shareholders caught in a real-life version of the "Prisoners' Dilemma" may simply not be able to resist a truly coercive bid.[81]

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80. A bid may be deemed "coercive" because it takes the form of a two-tier, front-end loaded offer, and thus stampedes shareholders into tendering. *See, e.g.*, Greene & Junewicz, *A Reappraisal of Current Regulation of Mergers and Acquisitions*, 132 U. PA. L. REV. 647, 692 (1984).

An offer might be deceptive if the bidder announces a tender offer or simply circulates rumors of a potential takeover after arbitrageurs accumulate the target company's shares. In those circumstances, the bidder might then "sweep the street" by purchasing large blocks of the target's shares from the arbitrageurs without complying with the Williams Act's tender offer rules. Such tactics have, contrary to the desire of the SEC, been upheld by the courts. *See, e.g.*, Hanson Trust, PLC v. SCM Corp., 774 F.2d 47 (2d Cir. 1985) (upholding a hostile bidder's private purchases from arbitrageurs made shortly after it terminated its tender offer, after finding such purchases were not subject to the Williams Act's tender offer rules). *Cf.* Ivanhoe Partners v. Newmont Mining Corp., 535 A.2d 1334, 1343-44 (Del. 1987) (upholding a street sweep by the target's largest shareholder during the pendency of a hostile tender offer, rejecting the allegation that the street sweep was inequitably coercive).

81. The term "Prisoners' Dilemma" describes a game created by two psychologists to study strategic interactions. *See* A. RAPOPORT & A. CHAMMAH, PRISONER'S DILEMMA (1965). It was described most recently by one court as follows:

> Two prisoners, unable to confer with one another, must decide whether to take the prosecutor's offer: confess, inculpate the other, and serve a year in jail, or keep silent and serve five years. If the prisoners could make a (binding) bargain with each other, they would keep silent and both would go free. But they can't communicate, and each fears that the other will talk. So both confess. Studying Prisoners' Dilemma has led to many insights about strategic interactions. See THOMAS C. SCHELLING, THE STRATEGY OF CONFLICT 53-80, 119-61 (1960; 1980 rev.); ROBERT AXELROD, THE EVOLUTION OF COOPERATION (1984).

Page v. United States, 884 F.2d 300, 301 (7th Cir. 1989) (Easterbrook, J.). *See also* Brudney & Chirelstein, *Fair Shares in Corporate Mergers and Takeovers*, 88 HARV. L. REV. 297, 337 (1974) (discussing the potential coerciveness of a tender offer notwithstanding disclosure of bidder's plan to conduct a second-step merger at a lower price).

For present purposes, the real life game of Prisoners' Dilemma arises most often in the context of a coercive takeover bid, "'[t]he paradigm [of which] is the two-tiered [front-end loaded] bid in which the first tier pays cash and the second tier consists of junk bonds (heavily subordinated debt securities).'" A. Copeland Enterprises, Inc. v. Guste, 706 F. Supp. 1283, 1286 n.3 (W.D. Tex. 1989) (quoting Note, *False Halo: The Business Judgment Rule in Corporate Control Contests*, 66 TEX. L. REV. 843, 857 n.77 (1988)). The Prisoners' Dilemma posed by such a bid was recently described as follows:

> individual dispersed shareholders are forced to tender their shares . . . regardless of whether they think the offer being proposed gives them full

IV. THE BIDDER'S IDENTITY, INTENTIONS, AND ANTICIPATED IMPACT

Not every would-be corporate acquiror is evil, nor is every unsolicited bid inadequate. By the same token, however, it is safe to say that hostile acquirors are interested *only* in accomplishing their acquisition objective as cheaply and as quickly as they can, with a minimum of time for rational thought, defensive maneuvering, or competition to develop.[82] This is not surprising; nor is it inherently improper. But, it does suggest that target directors have an important

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> and fair value. They act out of fear that other shareholders, with whom they cannot communicate or collaborate, will tender and thus enable the bidder to relegate the non-tendering shareholder to the distinctly less attractive position of minority shareholder in a company controlled by a majority interest.

Minstar Acquiring Corp. v. AMF Inc., 621 F. Supp. 1252, 1255 (S.D.N.Y. 1985). *See also* Oesterle, *supra* note 4, at 62 & n.35 (discussing the "Prisoners' Dilemma" in the context of a two-tiered tender offer).

Both courts and commentators have been critical of this two-step acquisition technique. *See, e.g.*, *Unocal*, 493 A.2d at 956 ("It is now well recognized that [two-tier] offers are a classic coercive measure designed to stampede shareholders into tendering at the first tier, even if the price is inadequate, out of fear of what they will receive at the back end of the transaction."); Horwitz v. Southwest Forest Indus., Inc., 604 F. Supp. 1130, 1133 (D. Nev. 1985) (tacitly approving defendant-corporation's assertion that "a front-end loaded, two-tier tender ... is coercive and unfair to the shareholders"); Brudney, *Equal Treatment of Shareholders in Corporate Distributions and Reorganizations*, 71 CALIF. L. REV. 1073, 1118-22 (1983); Greene & Junewicz, *supra* note 80, at 676-84; Finkelstein, *Antitakeover Protection Against Two-Tier and Partial Tender Offers: The Validity of Fair Price, Mandatory Bid, and Flip-Over Provisions Under Delaware Law*, 11 SEC. REG. L.J. 291, 293 (1984) (citations omitted) (noting the recognition by courts and commentators that two-tier offers unduly pressure shareholders to tender in the first step to avoid the freeze-out in the second step).

Ironically, as the availability of junk bond financing increased, the number of offensive two-tiered tender offers declined, while the number of defensive two-tiered bids by target managements increased. *See* Grundfest, *Two-Tier Bids Are Now a Defensive Technique*, Nat'l L.J., Nov. 9, 1987, at 26.

82. *See, e.g.*, Shipman, *The Case for Reasonable State Regulation of Corporate Takeovers: Some Observations Concerning the Ohio Experience*, 57 U. CIN. L. REV. 507, 508, 537 (1988) (noting how hostile offerors wish to stampede shareholders into selling shares quickly and at cheapest possible price); O'Connell, *Defenses Help Boost Return to Shareholders*, N.Y.L.J., Sept. 28, 1988, at 33 (noting how acquirors attempt to gain control as inexpensively as possible). *Cf.* Henry, *supra* note 55, at 469 (noting how cash tender offers are not subject to the time-consuming registration requirements applicable to exchange offers, and are therefore viewed as less risky than exchange offers by arbitrageurs because there is less time for the target to implement defensive plans and for the occurrence of takeover-hindering events); Note, *False Halo: The Business Judgment Rule in Corporate Control Contests*, 66 TEX. L. REV. 843, 857 n.77 (1988).

role to play, even if their company is to be sold. That role includes preventing the acquisition of the target company's shares without the payment of a meaningful control premium, in a considered environment, in a way that is fair to all target shareholders, and that permits the greatest opportunity for competing bids to emerge.[83]

In this context, the identity of the bidder; the adequacy, terms, feasibility, and fairness of its offer; its motivation; its *modus operandi*; its available resources; its prior history; and its plans for the future of the target company are most pertinent.[84] Unless the courts are prepared to say—and thus far they have not been—that every unsolicited acquisition offer at a premium above the prevailing market price for a company's securities must be accepted, or even pursued,[85]

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83. The role of target's management in responding to a hostile offer has been the subject of intense debate. Commentators have taken positions ranging from the passivity thesis, see Easterbrook & Fischel, *supra* note 3, to the position that a target board may take any measures it deems appropriate once it concludes that an acquisition is not in the best interests of the shareholders or the company. *See Takeover Bids*, *supra* note 2. Others advocate rules that would permit target management the opportunity to seek competing bids once a hostile bid is commenced. *See, e.g.*, Bebchuk, *The Case for Facilitating Competing Tender Offers*, 95 HARV. L. REV. 1028, 1030 (1982); Gilson, *Seeking Competitive Bids Versus Pure Passivity in Tender Offers*, 35 STAN. L. REV. 51 (1982). And still others would authorize defensive tactics where the target's management demonstrates that such action is in the best interests of the shareholders and the company. *See* Oesterle, *supra* note 4, at 76-82.

84. The Delaware Supreme Court recently opined that

> [Delaware] law could not be clearer that in assessing the bidder's bid and the bidder's responsibility, the board's unquestioned duty included the obligation to consider "the adequacy and terms of the offer; its fairness and feasibility; the proposed or actual financing for the offer, and the consequences of that financing . . . the risk of nonconsumation [sic] . . . the bidder's identity, prior background and other business venture experiences; and the bidder's business plans for the corporation and their effects on stockholder interests."

Citron 1989, No. 270, 1988, slip op. at 45 (citing *MacMillan*, 559 A.2d at 1282 n.29). *See also Ivanhoe*, 535 A.2d at 1341-42; *Unocal*, 493 A.2d at 955-56. The Delaware Supreme Court has also held certain defensive tactics are appropriate in light of the bidder's previous history. For example, the Delaware Supreme Court upheld a board's selective self-tender in light of the bidder's "national reputation as a 'greenmailer'." *Unocal*, 493 A.2d at 956. Similarly, in another case the Delaware Supreme Court noted that the same bidder's "typical *modus operandi*" in attempting to break-up companies, and thereafter extracting greenmail, was a proper basis for concluding that the tender offer was not in the shareholders' or the target company's best interests. *Ivanhoe*, 535 A.2d at 1342.

85. *See Ivanhoe*, 535 A.2d at 1345; Pogostin v. Rice, 480 A.2d 619, 627 (Del. 1984). In *Pogostin*, the Delaware Supreme Court rejected the proposition that a board has a duty to accept a tender offer made at a premium, or to negotiate with

target company directors must be able to evaluate the bids they receive, and the source from whom they receive such bids.

The implementation of this concept is often problematic. For many directors, the fact that any bidder is willing to pursue a hostile bid is itself evidence of that bidder's unworthiness. That type of thinking, while understandable, simply cannot be countenanced.[86] By the same token, the mere receipt of an offer should *not*, by itself, require a target company's directors to put their company "in play."[87] To be sure, any serious, *bona fide* bid deserves serious, *bona fide* consideration by the target's board.[88] But, just as a premium bid

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the bidder:

> Establishing such a principle would rob corporate boards of all discretion, forcing them to choose between accepting any tender offer or merger proposal above market, or facing the likelihood of personal liability if they reject it. To put directors to such a Hobson's choice would be the antithesis of the principles upon which a proper exercise of business judgment is demanded of them.

Id.

See also Amanda Acquisition Corp. v. Universal Foods Corp., 708 F. Supp. 984 (E.D. Wis.) (no duty on part of target to negotiate with bidder), *aff'd on other grounds*, 877 F.2d 496 (7th Cir.), *cert. denied*, 110 S. Ct. 367 (1989); Buckhorn, Inc. v. Ropak Corp., 656 F. Supp. 209, 229 (S.D. Ohio) (target directors did not breach fiduciary duties by refusing to negotiate with bidder), *aff'd*, 815 F.2d 76 (6th Cir. 1987); Desert Partners, L.P. v. USG Corp., 686 F. Supp. 1289, 1300 (N.D. Ill. 1988) (no duty to negotiate with bidder over terms of the offer); Panter v. Marshall Field & Co., 646 F.2d 271, 295-97 (7th Cir.) (directors' policy of resisting merger offers was not a breach of fiduciary duty to shareholders), *cert. denied*, 454 U.S. 1092 (1981).

86. Our economic and legal systems eschew such broad-based presumptions. It cannot be gainsaid that the acquisition of many companies may enhance appropriate societal goals. A presumption that any unsolicited acquisition offer is contrary to the public interest, or even simply contrary to the interests of the particular company receiving the unsolicited bid, would deprive the company, its various constituencies and society at large from the opportunity to achieve appropriate and desirable goals.

87. *See generally A Response*, *supra* note 2, at 1233 (target board must be vested with discretion to dictate company's response to an unsolicited bid). A company is deemed "in play" when the perception of investors is that the company is ripe for a takeover, and that someone imminently will make (or, perhaps, already has made) a bid. *See* Seagoing Uniform Corp. v. Texaco, Inc., [Current Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,791, at 94,254 (S.D.N.Y. 1989). Usually, companies "in play" undergo a substantial alteration of their shareholder base; long-standing shareholders begin selling into the market, and their shares are usually taken up by arbitrageurs and other professionals looking for short-term appreciation in the value of the target company's stock. *See* Ribstein, *supra* note 4, at 84.

88. It seems beyond dispute that a board of directors must give good faith consideration to serious, formal offers despite the unsolicited nature of such offers, consistent with the board's fiduciary duties to its shareholders. *See, e.g.*, *Desert*

need not automatically be accepted, neither should the theoretical underpinning of such a bid—that this is the right time to sell the company, or the right person to whom the company should be sold—automatically be required to be accepted.[89]

It is, therefore, appropriate for boards to consider who the bidder is. Accordingly, directors should be permitted to ask: Does the bidder have experience in managing operations of the type owned by the target?;[90] Whether or not the bidder has such prior experience, does the bidder have some sort of business plan that makes sense?[91] However, directors should not be permitted to answer these questions in a manner that automatically would preclude first-time or financial buyers from the bidding process entirely.[92] But, financial buyers *are* different from strategic buyers,[93] and boards should be allowed to assess those differences as part of their overall analysis.[94] Many financial acquirors seek to dismember a corporation and sell off at least certain of its pieces, on the theory that the sum of the target's parts may be greater than the company's worth as a whole.[95] Selling

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Partners, 686 F. Supp. at 1294 (citation omitted) ("These [fiduciary] responsibilities require directors to take an active role in responding to a pending takeover bid."); Enterra Corp. v. SGS Assocs., 600 F. Supp. 678 (E.D. Pa. (1985).

89. The Delaware Supreme Court recently made clear that "[d]irectors are not obligated to abandon a deliberately conceived corporate plan for short-term shareholder profit unless there is clearly no basis to sustain the corporate strategy." *Paramount Communications, Inc.*, Nos. 284, 1989, 279, 1989, & 283, 1989, slip op. at 50 (Del. Feb. 26, 1990). *See also Takeover Bids*, *supra* note 2, at 115-18 (suggesting that a hostile bidder's mere request for approval or nonopposition by target directors should not mandate that such request be acceded without further study or examination of the effects of a takeover on the shareholders, the corporation, and its constituences).

90. *See MacMillan*, 559 A.2d at 1282 n.29 (bidder's prior business experience).

91. *See Citron 1989*, No. 270, 1988, slip op. at 45; Cardiff Acquisitions, Inc. v. Hatch, 751 F.2d 906, 922-23 (8th Cir. 1984) (interpreting Minnesota law).

92. Both first-time and financial buyers have done well, not only for themselves, but for the target companies involved and their shareholders. *See, e.g.*, Fabrikant, *When Leverage Works*, N.Y. Times, Dec. 24, 1989, § 3, at 1, col. 2 (discussing the favorable outlook for Viacom Inc. over one year after its leveraged buyout by Sumner Redstone, a noted entrepreneur); Little & Klinsky, *"Real Money" Buyouts: How Leveraged Buyouts Can Really Work*, 2 J. OF APPLIED CORP. FIN. 71, 73-75 (Spring 1989) (discussing Forstmann, Little & Co.'s successful buyouts of Sybron Corporation and Dr. Pepper Company).

93. *See supra* note 48 (explaining the distinction between financial and a strategic buyers).

94. *See Unocal*, 493 A.2d at 955-56.

95. In today's parlance, this type of acquisition is referred to as a "bust-up" or "break-up" takeover. *See generally* Lipton, *Greenmail, Bust-Up Takeovers—A Discussion Memorandum*, N.Y.L.J., Sept. 7, 1984, at 1, col. 3 (discussing the mechanics

off pieces of the company may be a long overdue improvement in the operation of the target.[96] But, it may also adversely affect significant corporate constituencies.[97]

Similarly, the bidder's plans, and its ability to effectuate them, are quite relevant to the decisions a board must make. A tender offer for *The New York Times* by an international terrorist group seeking to find an influential voice for its political agenda might be made at a substantial premium over market, but still be undesirable and worthy of rejection. Should we deny corporate directors the opportunity to reject such a bid, merely because they could not say that the bid was inadequate or unfair?[98] Of course, terrorist groups may allow us to make rather simple moral judgments. But, if this example is placed in a contextual framework, we presumably cannot have an absolute rule that all adequate, fair, and premium bids must be embraced, with the exception solely of bids to "terrorists?" Instead, we need to recognize that *who* the bidder is, and *what* the bidder plans to do, are relevant criteria for boards of directors to assess and apply in deciding how to respond to a hostile acquisition offer.[99]

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and purposes of such an acquisition technique); Coffee, *Shareholders Versus Managers: The Strain in the Corporate Web*, 85 MICH. L. REV. 1, 3-4 (1986) (discussing the increasing utilization of the bust-up takeover technique); Coffee, *The Uncertain Case for Takeover Reform: An Essay on Stockholders, Stakeholders, and Bust-Ups*, 1988 WIS. L. REV. 435, 444-47 (1988) (same).

96. *See, e.g.*, Easterbrook & Fischel, *supra* note 3, at 1200-01 (placing heavy reliance on this premise in arguing for managerial passivity in the face of hostile offers).

97. *See, e.g.*, Note, *The Lawyer as Impresario: Form vs. Substance in the Target's Boardroom*, 39 HASTINGS L.J. 759, 773 (1988) ("The 'bust-up' takeover ... tends to adversely affect employees and others financially interested in the continued successful operation of the target Company.").

98. *See* Herald Co. v. Seawell, 472 F.2d 1081 (10th Cir. 1972) (discussed *supra* note 36).

99. Such criteria have been found to be legitimate factors to consider when responding to an offer. *See, e.g.*, *Citron 1989*, No. 270, 1988, slip op. at 45 (citing *MacMillan*, 559 A.2d at 1282 n.29); *Cheff*, 41 Del. Ch. at 507-08, 199 A.2d at 556; Condec Corp. v. Lunkenheimer Co., 230 A.2d 769, 776 (Del. Ch. 1967). *See also* Gelfond & Sebastian, *Reevaluating the Duties of Target Management in a Hostile Tender Offer*, 60 B.U.L. REV. 403, 438-39 (1980) (noting factors which have been found sufficient to justify resistance to tender offers to include "alteration of existing sales methods, changes in the corporation's products, damage to employee relations, and liquidation of all or part of the business"). Even in the context of a cash tender offer for all the target's shares, courts have held the bidder's plans and identity are permissible board considerations. *See, e.g.*, Paramount Communications, Inc. v. Time Inc., Nos. 284, 1989, 279, 1989, & 283, 1989, slip op. at 36-37 (Del.

Does the bidder have financing? The Securities and Exchange Commission (SEC or Commission) has opined that a would-be bidder does not violate federal law if, at the time the bid is made, the bidder does not have adequate financing available.[100] Boards of directors cannot adopt quite so cavalier an attitude. They routinely must look at transactions not just from the viewpoint of their desirability, but also from the perspective of their feasibility.

Is it appropriate for a board to reject a bid on the basis of an absence of adequate financing, or other questions concerning the bid's feasibility?[101] Once a target company evidences even the slightest

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Feb. 26, 1990) (holding that a target board reasonably perceived that an all-cash, all-shares offer posed a threat under the *Unocal* standard, where the target board, after reasonable investigation, had determined among other things, that the hostile bidder did not provide the best strategic fit in light of the target's perceived need to compete on a global basis, and threatened the target's developed and successful corporate culture).

100. In IU Int'l Corp. v. NX Acquisition Corp., 840 F.2d 220 (4th Cir. 1988), and in Newmont Mining Corp. v. Pickens, 831 F.2d 1448 (9th Cir. 1987), the SEC filed amicus curiae briefs in support of its position that neither the Williams Act nor any of the SEC's own regulations create a substantive requirement regarding the state of financing before a tender offer is commenced. *See IU Int'l Corp.*, 840 F.2d at 223-24; *Newmont Mining Corp.*, 831 F.2d at 1451-52. *See also* Branesto, *Takeover Bids and Highly Confident Letters*, Congressional Research Service, The Library of Congress 20-21 (Aug. 28, 1987) (reporting that the Commission considered the idea of requiring firm financing, but decided that, since the marketplace and courts are adequately addressing the issue, the Commission would not require bidders to have such financing commitments prior to commencing tender offers); *Williams Act Does Not Require Firm Financing to Mount Tender Offer*, 19 Sec. Reg. & L. Rep. (BNA) 1721 (Nov. 13, 1987).

There is persuasive reason for the SEC to reconsider its position. Recently, a number of announced deals, including the proposed and much-followed employee-management acquisition of United Airlines, have failed due to the bidder's inability to obtain appropriate financing. *See* Bailey, Nomani & Valente, *Banks Rejecting UAL Saw Unique Defects in This Buy-Out Deal: Collapse of Financing Set Off Market Decline, But Some May Have Misread Impact*, Wall St. J., Oct. 16, 1989, at 1, col.1. *See also* Gellene, *Death Knell for the Megadeal?: $6.75-Billion Buyout Offer for UAL Unravels as Financing Dries Up*, L.A. Times, Oct. 14, 1989, at D1, col. 2. The impact on the marketplace from the announcement of some of these failures has been severe, with some attributing the market break in October 1989 to the failure of the United Airlines transaction to obtain necessary financing. *See How to Reduce Stock Market Injury Potential*, N.Y. Times, Nov. 14, 1989, at A30, col. 4 (Letter to the Editor from Alan Greenberg, Chairman & Chief Executive Officer, Bear, Stearns & Co.). *Cf.* Valente & Smith, *Little Progress Toward a UAL Bid Seen As Board Prepares to Meet With Advisers*, Wall St. J., Dec. 13, 1989, at 8 (discussing the difficulties encountered in attempts to obtain the necessary financing for the proposed employee-buyout of United Airlines).

101. The Delaware Supreme Court has strongly suggested these considerations are a proper basis for rejecting a hostile bid. *See Citron 1989*, No. 270, 1988, slip

interest in being acquired, it is not only *likely* that *someone* will acquire the company, it is *imperative*.[102] The expression of any evidence of interest in a sale will clearly put the target company "in play," if the mere announcement of the bid has not already done so. And, once a company is put "in play," more than just a bidding contest ensues. A siege mentality also quickly develops. The employees of the target company begin to fret and worry about themselves, and neglect their official duties.[103] The management and board are totally diverted from their normal functions.

And then, what can be dubbed the "body-snatcher" syndrome commences.[104] Almost immediately, headhunters and competitors start soliciting a company's most valued employees.[105] Suppliers and customers become concerned about the long-term viability of the target company, particularly if the bidder is a financial buyer who may be expected to bust-up the company.[106] Necessary expansion or financing

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op. at 45.

Other courts also apparently respect a target's concern regarding a bidder's financial condition and consider it a material factor. *See, e.g.*, Riggs Nat'l Bank v. Albritton, 516 F. Supp. 164, 174-75 (D.D.C. 1981) (holding that a bidder's financial condition was material and thus required to be disclosed in order to facilitate shareholder evaluation of debt service requirements). *See also* FLEISCHER, *supra* note 2, at 357 ("directors would appear to be justified in opposing a bid, even if not required to do so, if the bidder's own business and financial record is unattractive").

102. *See, e.g.*, Coffee, *supra* note 61, at 1149 (citation omitted) (noting that only about 20% to 25% of target companies remain independent once a hostile offer has been commenced).

103. *See generally* Crittenden, *After Wave of Mergers, Analysts Debate Pluses*, N.Y. Times, May 31, 1982, at D1, col. 1 (discussing internal morale problems of companies that are the subject of hostile takeovers); Nussbaum & Dobrzynski, *The Battle for Corporate Control*, Bus. Wk., May 18, 1987, at 102, 103 (discussing the effect of hostile takeovers on employees); Work & Peterson, *The Raider Barons: Boon or Bane for Business?*, U.S. News & World Rep., Apr. 8, 1985, at 51 (discussing the view that hostile takeovers may result in target management's neglect of corporate responsibilities by focusing on short-term values and not on what builds long-term value). *See also Labor Letter: A Special News Report on People and Their Jobs in Offices, Fields and Factories*, Wall St. J., Nov. 14, 1989, at 1, col. 5 (reporting that, in corporate culture, fear of job loss in mergers or takeovers causes the most job-related anxiety, according to 54% of personnel officials polled by recruiter Robert Half International).

104. *See* INVASION OF THE BODY SNATCHERS (Republic Pictures, Allied Artist Pictures 1956).

105. *Cf.* Leinster & Maxwell, *Is Bigger Better for Phillip Morris?*, Fortune, May 8, 1989, at 66, 70 (noting that headhunters started calling Kraft's key managers shortly after the announcement of Phillip Morris Companies' bid for Kraft).

106. *See generally* Johnson & Millon, *Misreading the Williams Act*, 87 MICH. L. REV. 1862, 1862-67 (1989) (discussing the adverse effects of takeovers on various non-shareholder interests, such as the interests of suppliers and customers, and how many state takeover statutes seek to protect these interests).

plans may come to a halt during this period of uncertainty, since financial institutions do not like to lend money to short-lived enterprises.[107]

In short, a target company can be seriously weakened, no matter how strong its management, and no matter how strong its resolve, simply by the announcement of a hostile bid.[108] And, this weakening can be exacerbated if the target appears to be even slightly interested.

If the law perceives the essential duty of directors to serve solely as "auctioneers"[109] any time a company has been put "in play" involuntarily, there is a risk of great damage to this nation's productivity and its ability to compete effectively.[110] Thus, the absence of financing, or a determination that a particular bidder is not capable of implementing its game plan, or a determination that there are other important economic factors adverse to a bid, are important facets of any bid and, in proper circumstances, should furnish an acceptable basis for rejecting the proposed acquisition.[111]

In some cases, of course, the question is not whether the bidder's game plan is *feasible*, but whether it is *desirable*. When the issues are

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107. *Cf.* Silverstein, *Campeau May Come to Terms with Lenders*, L.A. Times, Jan. 2, 1990, at D6, col. 6 (discussing Campeau Corporation's efforts to avoid defaulting on loans made to two of its recently-acquired department store divisions).

108. *See* Proxmire, *What's Right and Wrong About Hostile Takeovers?*, 1988 WIS. L. REV. 353 (1988) (describing the effects of a hostile bid on a target company even where the company is able to ward off the hostile acquiror).

109. The use of the term "auctioneers" derives from the Delaware Supreme Court's opinion in Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1986), where the court held that, once it becomes "inevitable" that the company will be sold, the directors become "auctioneers charged with getting the best price for the stockholders ...." *Id.* at 182. For a discussion of *Revlon* and the myriad of issues it raises, see Gilson, *The Revlon Auction Standard: How is the Auction Triggered, Conducted and Concluded?* in R. GILSON, THE LAW & FINANCE OF CORPORATE ACQUISITIONS 198 (Supp. 1988); Reder, *The Obligation of a Director of a Delaware Corporation to Act as an Auctioneer*, 44 BUS. LAW. 275 (1989); Gilson & Kraakman, *What Triggers Revlon?* (unpublished working paper, August 1989), *reprinted in* AMERICAN BAR ASS'N, DYNAMICS OF CORPORATE CONTROL IV: EVOLVING LEGAL STANDARDS APPLIED TO THE FRONTIERS OF CORPORATE STRATEGY 503 (1989).

110. *Cf.* Kissinger, *The Word for Takeovers: Pernicious*, N.Y. Times, Dec. 5, 1986, at A35, col. 2 (asserting that hostile acquisitions decrease the nation's productivity). *See also Corporate Governance*, *supra* note 2, at 7-9 (stating that the short-term focus of the institutional investor, whose role in corporate control has increased in recent years, has a negative impact on United States productivity); Jonas, Berger & Pennar, *Do All These Deals Help or Hurt the U.S. Economy?*, Bus. Wk., Nov. 24, 1986, at 86 (reporting the view that the increase in takeover attempt has adversely affected the ability of United States corporations to compete effectively abroad, by forcing corporate managers to focus on short-term profits).

111. *See infra* notes 242-50 and accompanying text.

dollars and cents issues, courts seem to be quite comfortable with according directors of the target company substantial discretion.[112] When the issues range beyond financing, however, the courts often adopt a less hospitable view toward a target company's defensive maneuverings.[113]

V. THE SOURCE OF STANDARDS

Having looked at the question of the proper deference, if any, to be paid to a target company's shareholders, and the extent to which a bidder's identity and plans may be evaluated by a target company's board of directors in determining how to respond to an unsolicited acquisition proposal, attention should turn to the question of *who* should set the standards by which society evaluates how well a target's directors fulfill their fiduciary duties. While it might be

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112. *See, e.g.*, *Desert Partners*, 686 F. Supp. at 1299 (target's perception that tender offer price is inadequate and therefore threatens the corporation is reasonable and merits a defensive response); *Ivanhoe*, 535 A.2d at 1341-44 (defensive scheme consisting of dividend issuance, standstill agreement and street sweep, upheld in face of an offer which the target board, after reasonable investigation, found to be inadequate); *Unocal*, 493 A.2d at 956 (target permitted to consummate selective self tender in part because of the board's determination that a hostile offer was inadequate); *In re* RJR Nabisco Shareholders Litig., [1988-89 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,194, at 91,710-12 (Del. Ch. Jan. 31, 1989) (evaluating and ascribing a value to competing bids is properly the function of outside directors); *In re* Damon Corp. Stockholders Litig., [1988-89 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,040, at 90,872 (Del. Ch. Sept. 16, 1988) (board's refusal to redeem rights plan upheld in part because of board's determination that offer was inadequate).

113. *See, e.g.*, Grand Metro. Pub. Ltd. v. Pillsbury Co., 558 A.2d 1049, 1057, 1060 (Del. Ch. 1988) (holding target directors' decision to keep poison pill in place was not protected by the business judgment rule because such was not a reasonable response to any threat posed by the all-cash, all-shares tender offer at an adequate and fair price); City Capital Assoc. v. Interco Inc., 551 A.2d 787, 797 (Del. Ch. 1988) (holding directors' decision to keep poison pill in place was not protected by the business judgment rule, indicating in *dicta* that the only threat posed by an all cash, all-shares tender offer is one to the shareholders relating only to the adequacy of the price). It is significant to note, however, that the Delaware Supreme Court has recently rejected interpretation of *Pillsbury* and *Interco* as supporting the proposition that an all-cash, all-shares offer at an adequate price cannot constitute a threat under *Unocal*. *See* Paramount Communications v. Time Inc., Nos. 284, 1989, 279, 1989, & 283, 1989, slip op. at 33-35 (Del. Feb. 26, 1990) (rejecting as "narrow and rigid," the chancery court's view that two-tiered or inadequate offers are the only types of offers that constitute a threat under the second prong of *Unocal*). Hence, while a defensive measure taken in response to an all-cash, all-shares bid at an adequate price may be examined with closer scrutiny, such may nevertheless withstand *Unocal* analysis and be protected by the business judgment rule. *See, e.g.*, *id.*

easiest simply to acknowledge that the Delaware courts are, or should be, the sole arbiter of how well a target company's directors perform (at least for Delaware corporations),[114] that would be both wrong, and untrue.

As a practical matter, our standard-setting system is a fragmented one. The standard-setting function is shared by a multiplicity of persons and entities, with a minimum of coordination.[115] In fact, there occasionally has been heated competition between various standard-setting entities, perhaps best typified by the SEC's adoption of a rule designed to supersede various state takeover laws then in effect.[116] While this is often very profitable for lawyers, it is also dangerous for their clients.[117]

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114. Of course, Delaware law reaches far beyond Delaware, and influences other courts in their interpretation of directors' duties under other state corporate codes. *See Dynamics Corp.*, 805 F.2d at 708 (noting that Indiana courts look to Delaware jurisprudence for guidance in corporate law matters); Mullen v. Academy Life Ins. Co., 705 F.2d 971, 973 n.3 (8th Cir.) ("[C]ourts of other states commonly look to Delaware law ... for aid in fashioning rules of corporate law."), *cert. denied*, 464 U.S. 827 (1983).

115. Although they will be discussed in detail later in the text, it should be noted at this point that the standard-setting system is shared by: the central players in any takeover effort—that is, the bidder, target management, and target shareholders; the federal regulatory authorities (such as the SEC, Federal Trade Commission, Federal Reserve Board); state legislatures; and, of course, the courts, at both the federal and state levels.

116. *See* Exchange Act Rel. No. 16,384, [1979-80 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 82,373, at 82,577 (Nov. 29, 1979) (proposing the adoption of Rule 14d-2). Under many first generation state tender offer laws, a bidder was prohibited from commencing a tender offer until it publicly disclosed the material terms of the offer and waited a prescribed period of time after such public disclosure. The SEC, however, adopted Rule 14d-2, which provides that a tender offer is deemed to have commenced on the date which the bidder takes the first step in disseminating the tender offer, and, as such, a bidder has five days to file the appropriate documentation. *See* Exchange Act Rule 14d-2, 17 C.F.R. § 240.14d-2 (1989). The rule created a direct, and deliberate, conflict with state law because the bidder was required to commence its offer before the expiration of the minimum waiting period prescribed by state law. That conflict has been resolved for the most part by Edgar v. Mite, 457 U.S. 624 (1982), which effectively invalidated virtually all first generation takeover statutes. State takeover statutes today do not regulate the mechanics of tender offers. *See generally* Dynamics Corp. of Am. v. CTS Corp., 1481 U.S. 69 (1987) (upholding "second generation" state antitakeover statute in part by distinguishing the statute involved from the one invalidated in *Edgar*).

117. *Cf.* Note, *supra* note 97, at 761. This author notes that the takeover bar has been elevated to the lead advisor in directing boards of directors through the "minefield of potential liability that Delaware courts have created in mapping the contours of the business judgment rule." *Id.* Moreover, the author opines that, "[a]lthough the lawyer's role ... may represent good business for the legal profession, it does not translate into sound corporate management." *Id.*

The myriad standards that have to be considered can be a trap for the unwary.[118] Even more important, however, is the impact on businessmen and judges. Without a cohesive system, the process is reduced to *ad hoc* decision making and judgments more frequently than any rational system ought to tolerate. Moreover, the difficulties with our current system are exacerbated by the conflicts of interest that inhere in many of these standard-setting mechanisms.[119]

A. Internal Standard Setters

In the first instance, standards are set by those who must make decisions—bidders, target management, and the target's board of directors.

1. Bidders

Bidders establish standards of conduct by developing techniques to accomplish their acquisition objectives.[120] Although, as noted, not every acquiror is evil, and not every bid is bad,[121] acquirors have given us such acquisition devices as front-end loaded, two-tiered, coercive, bust-up, junk-bond takeovers.[122] The courts[123] and state

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118. The panoply of standards that must be considered are discussed in great detail in FLEISCHER, *supra* note 2.

119. *See infra* notes 121-221 and accompanying text.

120. It is beyond the scope of this paper to consider the fiduciary obligations of a bidder's board of directors *prior* to commencing a hostile takeover. It should suffice to note, however, that those bids which are pursued for the self-aggrandizing benefit of the bidder's managers (and there are, at least occasionally, such bids) may reflect the absence of the exercise of appropriate fiduciary obligations by the bidder's outside directors. Ironically, in the wealth of materials on hostile takeovers, very little consideration seems to have been materials on hostile takeovers, very little consideration seems to have been devoted to the obligations of the bidder and the bidder's board of directors, suggesting an inherent bias on the part of commentators that most takeover bids are legitimately structured, well thought out, or otherwise consistent with sound fiduciary principles.

121. *See supra* text accompanying note 82.

122. For a general discussion of the mechanics of this type of tender offer, see Comment, *The Front End Loaded Two-Tiered Tender Offer*, 78 NW. U.L. REV. 811 (1983); Comment, *Front-End Loaded Tender Offers: The Application of Federal and State Law to an Innovative Corporate Acquisition Technique*, 131 U. PA. L. REV. 389 (1982). *See supra* notes 80-81 and accompanying text (discussing the coercive nature of such tender offers).

123. *See, e.g.*, *Desert Partners*, 686 F. Supp. at 1295 (upholding directors' decision to adopt poison pill to protect shareholders against coercive two-tier offers); Horwitz v. Southwest Forest Indus., Inc., 604 F. Supp. 1130 (D. Nev. 1985) (same); Moran v. Household Int'l, Inc., 500 A.2d 1346, 1356-57 (Del. 1985) (allowing adoption

legislatures[124] have responded to those pressurized tactics by effectively permitting the target to nullify them. Ironically, they are now often the province of managements.[125]

The identity of the bidder, and the nature of the bid, even apart from other considerations, play an enormous role in determining what standards will apply to any particular takeover. Thus, Delaware courts have, *sub silentio*, adopted the so-called "bad man" standard. If the bidder is a bad person, the target company's range of discretion increases exponentially. How does one determine whether a particular bidder is a "bad man" within the meaning of this doctrine? It is easiest, of course, if the bidder's name is T. Boone Pickens![126] If not, one must look for other symptoms of past or present wrongful conduct by the bidder, or overtly coercive conduct.[127]

Similarly, if the bid itself is "bad"—that is, if the bid is coercive, or inadequate or unfair, or the bid has some other fairly glaring impediment—the courts universally seem to recognize that the target board's discretion is fairly large in determining precisely how to respond to such a bid.[128] Beyond that, the bidder's intentions with

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of poison pill as a means of protecting shareholders against coercive two-tier offers); *Unocal*, 493 A.2d at 956 (justifying the decision to sanction target's discriminatory self-tender by characterizing the acquiror's bid as a "coercive two-tier front-end loaded offer").

124. *See generally* Booth, *The Promise of State Takeover Statutes*, 86 MICH. L. REV. 1635, 1636-37 (1988) (describing the states' efforts to protect resident companies against abusive acquisition techniques, including two-tier offers, by adoption of antitakeover statutes). *See also* BNS, Inc. v. Koppers Co., 683 F. Supp. 458, 468 (D. Del. 1988) (describing Delaware's adoption of a "freezeout" statute and its objective of protecting shareholders against two-tier and partial bids); C. SMITH & C. FURLOW, GUIDE TO THE TAKEOVER LAW OF DELAWARE 3-4 (BNA Corporate Series 1988) (describing the central purpose behind Delaware's and other states' antitakeover statutes as the prevention of a squeeze-out merger in the second step); Sontag, *A Takeover Law Grows in Delaware*, Nat'l L.J., Apr. 11, 1988, at 1.

125. *See* Grundfest, *supra* note 81; *Concerns About Two-Tier Tender Offers are Misplaced, Grundfest Says*, Sec. Wk., June 1, 1987, at 6.

126. *Cf. Ivanhoe*, 535 A.2d at 1342; Note, *The Reasonableness of Defensive Takeover Maneuvers When the Corporate Raider is Mr. T. Boone Pickens*, 57 U. CIN. L. REV. 739 (1988).

127. *See, e.g.*, *Desert Partners*, 686 F. Supp. at 1298 (citations omitted) ("[T]he court may consider an offeror's past acquisition history in deciding whether a takeover poses a threat to the corporation.").

128. *See, e.g.*, *Desert Partners*, 686 F. Supp. at 1299-301 (upholding target's refusal to redeem poison pill in face of coercive offer); Martin Marietta Corp. v. Bendix Corp., 549 F. Supp. 623 (D. Md. 1982) (upholding a target board's decision to make a tender offer for shares of a hostile bidder in response to the hostile bidder's coercive two-tiered tender offer); *Unocal*, 493 A.2d at 955 (upholding exclusionary self-tender in response to coercive and inadequate offer).

respect to the target company can play a meaningful role in determining what standards will be brought to bear.[129]

Although often overlooked because of the intense scrutiny given to the target company and its board, bidders are not free from conflict in their role as an integral part of the takeover standard-setting process. The interests of many bidders are antagonistic to the very shareholders whose rights they often purportedly seek to vindicate.[130] Coercive tactics and inadequate bids make this point forcefully. Conversely, a well-financed, noncoercive,[131] and responsible bidder may be accorded standing to assert that the target company's shareholders ought to be allowed, absent unusual circumstances, to make their own decisions on the merits of any particular tender offer proposal.[132] This standing derives not so much

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129. *See MacMillan*, 559 A.2d at 1282 n.29 (noting that a target board may properly consider a bidder's plan and intentions in considering a response to a hostile offer). *See also Cheff*, 41 Del Ch. at 507-08, 199 A.2d at 556 (same).

130. *See generally* Bradley & Rosenzweig, *Defensive Stock Repurchases*, 99 HARV. L. REV. 1377 (1986) (outlining conflicts between bidders and target shareholders).

131. A bid should be regarded as "noncoercive" if it is an all cash bid for any and all of the target's stock, with a commitment to freezeout non-tendering shareholders at the cash bid price, at a price that fairly compensates the target shareholders for their ownership interest, and that offers a control premium. *See* Gilson & Kraakman, *Delaware's Intermediate Standard for Defensive Tactics: Is There Substance to Proportionality Review?*, 44 BUS. LAW. 247, 254 (1989). Furthermore, if offers from two different parties are made, management-endorsed offers cannot be structured in such a manner as to preclude meaningful shareholder choice. *See, e.g.*, AC Acquisitions Corp. v. Anderson, Clayton & Co., 519 A.2d 103, 113-14 (Del. Ch. 1986) (target's alternative offer to shareholders held to be coercive because it was structured so that shareholders were forced to accept prior to completion of the third party offer). Thus, the offer can be neither "structurally" nor "substantively" coercive. *See* Gilson & Kraakman, *supra*, at 260-66.

132. This proposition, advanced by bidders and against the desires of the target management, has found a modicum of sympathy in Delaware's Chancery Court. In two recent cases, with far-reaching implications, the court ordered the target company to redeem a poison pill and allow the target company's shareholders to judge the merits of an all-cash, all-shares bid against a transaction supported by the target's board. *See* Grand Metro., PLC v. Pillsbury Co., 558 A.2d 1049 (Del. Ch. 1988) (hostile offer versus target plans for a spinoff and sale of divisions); City Capital Assocs. v. Interco, Inc., 551 A.2d 787 (Del. Ch.) (hostile offer versus board-sponsored restructuring), *appeal dismissed*, 556 A.2d 1070 (Del. 1988). Significantly, in both cases the court expressed reservations about the target's claim of inadequacy of the hostile offer, but did not find any bad faith on the part of the respective boards, nor did the court make an independent finding that the offers were inadequate. *But see supra* note 113 (discussing the Delaware Supreme Court's recent decision in *Paramount Communications*, which leaves questionable the continued vitality of the *dicta* in *Pillsbury* and *Interco*).

from the bidder's self-proclaimed role as the representative of the target company's shareholders, as it does from the bidder's standing, in its own right, to present its business proposal to important business decision-makers.[133]

2. Target Management

The target company's management is also an integral part of the standard-setting mechanism. Very often, the first initiative in what turns out to be either a hostile or a friendly acquisition effort is made to the target's management.[134] This is so because many transactions can be effected far more cheaply, and far more effectively, if the target's management already has agreed to the proposition when the transaction is unveiled to the public. There really are no well-defined standards as to how the target company's management must respond, and the process is something of an *ad hoc* adventure in every transaction.

The lawyer's rubric, of course, is that the target's management does have well-defined responsibilities. But, this usually is nothing

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133. This seems to be the current attitude of the Delaware Chancery Court, as evidenced by the court's opinions in *AC Acquisitions*, *Interco*, *Grand Metropolitan*, and Robert M. Bass Group, Inc. v. Evans, 552 A.2d 1227 (Del. Ch. 1988). This "right" to judge the merits of tender offers was forcefully articulated by a federal district court in Conoco, Inc. v. Seagram Co., 517 F. Supp. 1299, 1303 (S.D.N.Y. 1981):

> To be sure, the Board of Directors are under a duty to exercise their best business judgment with respect to any proposal pertaining to corporate affairs, including tender offers. They may be right; they may know what is best for the corporation, but their judgment is not conclusive upon the shareholders. What is sometimes lost sight of in these tender offer controversies is that the shareholders, not the directors, have the right of franchise with respect to the shares owned by them; "stockholders, once informed of the facts, have a right to make their own decisions in matters pertaining to their economic self-interest, whether consonant with or contrary to the advice of others, whether such advice is tendered by management or outsiders or those motivated by self-interest."

Id. (citation omitted). This passage was cited with approval by the *Grand Metro.* court. *Grand Metro.*, 558 A.2d at 1060 n.10. *But see* Moran v. Household Int'l, Inc., 490 A.2d 1059, 1079 (Del. Ch.) (shareholders' "right" to gain premiums through tender offer process subject to good faith judgment of its board of directors), *aff'd on other grounds*, 500 A.2d 1346 (Del. 1985).

134. *See* FLEISCHER, *supra* note 2, at 185; 1 M. LIPTON & E. STEINBERGER, TAKEOVERS AND FREEZEOUTS § 81.06 (Supp. 1989); Flom, *Forcing a Friendly Offer*, 32 BUS. LAW. 1319, 1319 (1977).

more than a lawyer's injunction that, should a bidder surface, management should initially discourage all *informal* feelers and other indications of interest, and show no signs of encouragement.[135] This is not just *correct* advice, it is the *only* advice, whether or not management is interested in seeing the company sold. No one ever received the highest premium possible by "just saying yes."[136] There are no statistics regarding just how many feelers are turned away by management's cold shoulder but, at a minimum, management should advise the board of directors of all informal feelers or other initiatives, so that a contrary view, if one exists, can surface fairly quickly, and thaw out management's cold shoulder.[137]

The conflicts that beset a target's management are fairly self-evident and do not require great elaboration.[138] Good counseling would suggest that management should always avoid putting itself in a position where it can later be accused of having acted for itself instead of the corporation's various constituencies. This requires disabusing successful managers of the notion that they know what is best, and can act dispassionately. Outside directors can, and should, be used either to make material decisions, or to ratify them. This is not a theoretical proposition. As a practical matter, managements that take on too much responsibility in the context of a hostile acquisition effort will find themselves challenged by plaintiffs' lawyers, bidders' lawyers, perhaps the SEC,[139] and most assuredly by the courts.[140]

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135. *See generally* FLEISCHER, *supra* note 2, at 188-89 (outlining the adverse consequences resulting from management's informal contacts with a prospective unsolicited bidder).

136. *See generally* Oesterle, *supra* note 57, at 122-23 (citing Jarrell, *The Wealth Effects of Litigation by Targets: Do Interests Diverge in a Merge?*, 28 J.L. & ECON. 151 (1985)) (discussing study indicating that target managers who initially resist an offer obtain higher premiums for their shareholders).

137. *Cf.* Fogel v. Chestnutt, 533 F.2d 731, 750 (2d Cir. 1975) (finding breach of fiduciary duty of management directors for failing to inform nonmanagement directors of possible recapture of excess securities brokerage commissions), *cert. denied*, 429 U.S. 824 (1976).

138. Numerous articles have been written about target management's conflict of interest in responding to a tender offer. *See, e.g.*, McCord, *supra* note 2; Oesterle, *supra* note 4; Romano, *The Future of Hostile Takeovers: Legislation and Public Opinion*, 57 U. CIN. L. REV. 457 (1988); Rosenbaum, *The Presumptions and Burdens of the Duty of Loyalty Regarding Target Company Defensive Tactics*, 48 OHIO ST. L.J. 273 (1987); Siegel, *supra* note 4.

139. *See, e.g.*, *In re* Spartek, Inc., Exchange Act Release No. 15,567, 16 SEC Docket 1094 (Feb. 14, 1979).

140. *See, e.g.*, Hanson Trust, PLC v. ML SCM Acquisition, Inc., 781 F.2d

3. The Target's Board

Once an unsolicited acquisition offer surfaces, a high level of responsibility is imposed on a target company's board of directors.[141] By virtue of that responsibility, there also is no doubt that the most important standard-setter in our multi-layered system of decision-making is the target company's board of directors. It should be noted that there is a critical distinction between the management of a target company, and its board of directors.[142] And, for these purposes, references to the target's board of directors pointedly exclude from that group any member of management who also may sit on the target's board.[143] There is no justification for allowing management directors to determine the ultimate fate of the target company in the face of a hostile bid, although they certainly have an important role to play.[144]

It is not difficult to detect, in some quarters, a fundamental cynicism about the role a target's outside directors play in the hostile

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264, 277 (2d Cir. 1986) (invalidating lock-up granted to management-sponsored third party on grounds that outside directors delegated their oversight and supervision to interested management); *MacMillan*, 559 A.2d at 1281 (invalidating lock-up granted to management-sponsored third party in an auction for target company because inside, interested directors, rather than independent directors, supervised the conduct of the auction). *See also* Block & Hoff, *The Emerging Role of Special Committees*, N.Y.L.J., June 15, 1989, at 5 (discussing *MacMillan* and *Hanson Trust*).

141. The target board of directors must meet its obligations under both state and federal law. *See supra* notes 6 (discussing obligations under federal law) and 71 (discussing obligations imposed under state law fiduciary principles).

142. *See, e.g.*, *Citron 1989*, No. 270, 1988, slip op. at 40 (noting that, in change of control acquisitions, "sole reliance on ... management can 'taint[] the design and execution of the transaction'") (citation omitted). *See generally* Note, *The Propriety of Judicial Deference to Corporate Boards of Directors*, 96 HARV. L. REV. 1894 (1983) (discussing the relationship between a corporation's board of directors and its management, the company's senior officers, and asserting that a board is likely to acquiesce with management's decisions).

143. Such persons are referred to as "inside" directors. *See generally* Karmel, *The Independent Corporate Board: A Means to What End?*, 52 GEO. WASH. L. REV. 534, 545 (1984) (discussing the American Law Institute's provisions relating to board composition and structure, and the trend towards having outside, independent directors serve as board members).

144. The Delaware courts are willing to give more deference to the decisions of a target's board when a majority of the board consists of "outside independent directors." *See Ivanhoe Partners*, 535 A.2d at 1343; *Moran*, 500 A.2d at 1356; *Unocal*, 493 A.2d at 955. *See also* Polk v. Good, 507 A.2d 531, 537 (Del. 1986) (citations omitted) ("With 10 of the 13 directors being independent, the plaintiffs thus bore a heavy burden of overcoming the presumptions thus attaching to the board's decisions."). Courts outside Delaware have made the same observation. *See, e.g.*, *Panter*, 646 F.2d at 294, *cert. denied*, 454 U.S. 1092 (1981); *Enterra*, 600 F. Supp. at 685.

takeover process.[145] But, history demonstrates that outside directors are not automatically subject to the purported conflicts of which they are so routinely accused.[146] It is *not* true, for example, that outside directors are so enthralled with their corporate sinecures that they will fight to avoid giving up those position.[147] On the other hand, it *is* true that outside directors are most often chosen for the board based upon their personal, professional or social relationships with management.[148] That fact alone, however, should not automatically

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145. This cynicism exists among courts and commentators. *See, e.g.*, Dynamics Corp. of Am. v. CTS Corp., 794 F.2d 250, 256 (7th Cir. 1986) (management conflict of interest not cured by vesting decisional power in majority of outside directors; "[t]he so-called outsiders moreover are often friends of the insiders. And since they spend only part of their time on the affairs of the corporation, their knowledge of those affairs is much less than that of insiders, to whom they are likely therefore to defer."), *rev'd on other grounds*, 481 U.S. 69 (1987); *Norlin Corp.*, 744 F.2d at 266 n.12 (noting that the court was "not persuaded that a different test applies to 'independent' as opposed to 'inside' directors"); Brudney, *The Independent Director—Heavenly City or Potemkin Village?*, 95 HARV. L. REV. 597, 610-11 (1982) (commenting that management's approval of outside directors influences those directors' independence); Chittur, *Ventriloquism for Corporate Directors: Special Litigation Committees in Derivative Suits*, 9 CORP. L. REV. 99, 116 (1986) (asserting that since management selects directors, they are predisposed to be sympathetic to management's views); Werner, *Corporation Law in Search of its Future*, 81 COLUM. L. REV. 1611, 1663 (1981) (suggesting that the intimate relationship between management directors and outside directors creates a "structural bias against action by outside directors that appears contrary to the interests of their inside colleagues"); Note, *supra* note 142, at 1896-902 (discussing the psychology of group dynamics as it relates to directors' informational dependence on inside management).

146. *See, e.g.*, Stewart & Hertzberg, *Landmark Victory: Outside Directors Led the Carbide Defense That Fended Off GAF*, Wall St. J., Jan. 13, 1986, at 1, col. 6 (discussing Union Carbide Corporation's successful defense against GAF Corporation's takeover attempt, noting that Carbide's Board was "genuinely independent," and in no sense "captive of management").

147. *See* Johnson & Siegel, *Corporate Mergers: Redefining the Role of Target Directors*, 136 U. PA. L. REV. 315 (1987). As these commentators have stated:

> [I]t is unlikely that the typical outside director will be completely docile and merely rubberstamp all management decisions . . . it is difficult to believe that directors are economically dependent on these relatively low paying positions . . . it is [also] questionable whether corporate directorships are so attractive that outside directors become psychologically dependent on management.

Id. at 383. *But see Panter*, 646 F.2d at 300 (Cudahy, J., concurring in part, dissenting in part) ("Directors of a New York Stock Exchange-listed company are, at the very least, 'interested' in their own positions of power, prestige and prominence (and in their not inconsequential perquisites)."), *cert. denied*, 454 U.S. 1092 (1981).

148. *See, e.g.*, Brudney, *supra* note 145, at 610; Longstreth, *Fairness of Management Buyouts Needs Evaluation*, Legal Times, Oct. 10, 1983, at 15.

taint the outside directors, or deprive them of the right, and the obligation, to execute their fiduciary responsibilities.[149] This is not to say that a target company's outside directors are devoid of conflicts. But, with a proper contextual framework, good counselling, and proper judicial guidance, the outside directors of a target company may often be in the best position to resolve certain of the issues and competing claims that arise in the course of a hostile battle.[150]

4. The Target's Outside Advisors

The philosophical underpinnings of the business judgment rule are well known.[151] One of the major tenets of that rule is that outside directors may rely upon the advice of experts.[152] At least since the

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149. *See generally* Johnson & Siegel, *supra* note 147, at 383 (arguing that several factors militate against the conclusion that structural bias prevents truly independent decision making by outside directors). *See also* Stewart & Hertzberg, *Landmark Victory: Outside Directors Led the Carbide Defense that Fended Off GAF*, Wall St. J., Jan. 13, 1986, at 1, col. 6 (discussing the role of independent directors in responding to a hostile takeover).

150. The Delaware Supreme Court's recent opinion in *MacMillan* emphasizes the critical importance of outside directors in the context of a hostile battle, especially where management is one of the competing bidders. In *MacMillan*, the court found that the target's board improperly had delegated the structure and conduct of the auction to an interested director and his hand-picked advisors, thereby resulting in the impermissible granting of a lock-up to the interested director's ally. *See MacMillan*, 559 A.2d at 1281. The court emphasized the need for independent directors to exercise meaningful hands-on responsibility "in a matter as significant as the sale of corporate control." *Id.* The court reemphasized the importance of outside directors in a change of control setting in *Citron 1989*. *See Citron 1989*, No. 270, 1988, slip op. at 39-40.

On the other hand, some commentators question the wisdom of using independent directors as the primary decision-makers on behalf of the target corporation. Several commentators have noted that, since management of the target company provides much of the information upon which the independent directors must rely in evaluating the effects of the takeover and the merits of the bid, the directors' ability to evaluate the proposed takeover objectively may be handicapped. *See* Steinberg, *Attorney Conflicts of Interest in Corporate Acquisitions*, 39 HASTINGS L.J. 579, 588-91 (1988); Note, *supra* note 142, at 1898 ("Confronted by difficult issues of business policy and largely dependent upon management for information, [outside] directors are likely to believe that management's views and judgments are worth adopting.").

151. For a discussion of the business judgment rule and its philosophical underpinnings, see Arsht, *supra* note 71; Hinsey, *Business Judgment and the American Law Institute's Corporate Governance Project: The Rule, the Doctrine, and the Reality*, 52 GEO. WASH. L. REV. 609 (1984).

152. *See* DEL. CODE ANN. tit. 8, § 141(e) (1988). *See also MacMillan*, 559 A.2d at 1281, where the court stated that "a board of directors may rely in good faith upon 'information, opinions, reports or statements presented' by corporate officers, employees and experts 'selected with reasonable care'." *Id.* (citing DEL. CODE ANN. tit. 8, § 141(e) (1988)).

Delaware Supreme Court decided *Smith v. Van Gorkom*,[153] target directors have looked to lawyers and investment bankers, not just for guidance, but for leadership, in traversing the difficult path from a hostile bid to a firm corporate response.[154] Lawyers and bankers are called upon to tell their clients when and how long to meet,[155] what constituencies they can consider,[156] whether to adopt so-called "poison pills,"[157] whether to redeem poison pills,[158] what constitutes an unfair bid,[159] whether

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153. 488 A.2d 858 (Del. 1985).

154. *See* Manning, *supra* note 71; Note, *supra* note 97, at 761 & n.7 (1988) (noting the expanded role of lawyers since *Van Gorkom* and the elevation of form over substance).

155. The amount of consideration a board gives issues affecting corporate control is clearly relevant to the courts. *See, e.g.*, *Moran*, 490 A.2d at 1065 (finding a board's two-hour consideration of a "poison pill" plan before adopting it, to be adequate consideration where directors had received information concerning the plan before the meeting), *aff'd*, 500 A.2d 1346 (Del. 1985); *Van Gorkom*, 488 A.2d at 874 (finding a board's two-hour consideration of a proposal to sell the company engineered by the corporation's CEO and chairman of the board, before approving the proposal, to be inadequate consideration where directors received no information concerning the proposal prior to meeting).

156. As noted above, see *supra* notes 28-49 and accompanying text, it is sometimes permissible and appropriate for directors to consider the interests of a variety of corporate constituencies in determining what position to take with respect to an unsolicited acquisition attempt. Once the directors determine to sell their company, however, the consideration of constituencies other than shareholders is problematic. *See, e.g.*, *MacMillan*, 559 A.2d at 1284-85 (citing Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1986)) (when a board determines to sell target, its sole concern must be to maximize shareholder value). Some states have adopted a different approach by legislative directive. *See, e.g.*, FLA. STAT. ANN. § 607.111.9 (West 1989) (authorizing target directors to consider interest of nonshareholder constituencies even when directors have determined to sell the company); ILL. ANN. STAT. ch. 32, § 8.85 (Smith-Hurd 1989) (same).

157. Counsel and bankers advising target boards routinely issue opinion letters in connection with a target board's decision to adopt a poison pill. *See Dynamics Corp. of Am.*, 794 F.2d at 257-58 (noting that target's investment banker structured its poison pill and wrote an opinion that a hostile tender offer was "unfair"). *See generally* Note, *supra* note 97 (discussing the lawyer's role in the takeover context, and how lawyers have been called upon to design or recommend various defensive tactics such as poison pills).

158. Until a pill is actually triggered, the rights can always be redeemed at a relatively nominal cost by the target's board of directors. Such a redemption effectively removes the pill's deterrent impediments, see, e.g., Harvard Indus., Inc. v. Tyson, [1986-87 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 93,064, at 95,294 (E.D. Mich. Nov. 25, 1986), and allows the takeover to proceed, see, e.g., *Grand Metro.*, 558 A.2d at 1058, 1061. *See also* Block & Hoff, *The Duties of Boards to Redeem Poison Pills*, N.Y.L.J., Dec. 15, 1988, at 5, col. 3; Lesser, *The "Poison Pill" Defense*, 22 REV. OF SEC. & COMM. REG. 11 (Jan. 25, 1989).

159. Any bid may be deemed "unfair" because of its structure, timing or other coercive aspects. *See, e.g.*, *Horwitz*, 604 F. Supp. at 1133 (two-tier offer is

the bid is adequate, as opposed to fair,[160] and how to marshall litigation strategies so as to avoid the unwanted unsolicited acquisition effort.[161]

Lawyers[162] and investment bankers[163] are, however, subject to potential conflicts. In some cases the potential structure of various forms of remuneration, including performance-based feeds for bankers,[164] and even some lawyers,[165] may create conflicts of interest. In some cases, pre-existing relationships arising out of a successful takeover may create conflicts.[166] Is a lawyer who serves on the target's

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coercive and thus unfair to shareholders); *AC Acquisitions*, 519 A.2d at 114 (self-tender deemed coercive and thus unfair because offer was timed such that shareholders were not left with autonomy to decide the merits of competing bids).

160. An adequate bid generally means that the bid falls within the "reference range" that the target's investment banker has determined to be an indication of the company's intrinsic value. *See* Note, *Shareholder Rights Plans: Saying No To Inadequate Tender Offers*, 57 FORDHAM L. REV. 803, 817 n.90 (1989) (citation omitted). Fairness differs from adequacy in that a bid may be within the "reference range," and thus adequate, but suffer from other deficiencies that make it unfair.

161. *See* FLEISCHER, *supra* note 2, at 388.53-.85; Rosenzweig, *Target Litigation*, 85 MICH. L. REV. 110 (1986).

162. *See* Steinberg, *supra* note 150, at 584-90 (potential conflicts faced by counsel in representing a target company and its incumbent directors can be alleviated by the appointment of a "consultant attorney or law firm"). *See also infra* note 165 and accompanying text.

163. *See* Stein, *Investment Banking's Dirty Little Secret*, N.Y. Times, June 8, 1986, § 3, at 2, col. 3 (stating that the "the supposedly independent investment bank writing the 'fairness letter' is entirely in the pocket of management, owes all its loyalty to management and makes the big bucks only if it helps the deal to go management's way"); McGough, *Fairness for Hire*, Forbes, July 29, 1985, at 52. *But see* Fleischer, *A "Fairness Letter" is Just an Opinion*, N.Y. Times, June 8, 1986, § 3, at 2, col. 3 (defending the objectivity and expertise of investment bankers in issuing fairness opinions).

164. In many deals, both friendly and unfriendly, an investment banker's fee is payable on a contingency basis, which may be derived from the seller's or target's sale price. *See, e.g.*, Radol v. Thomas, 534 F. Supp. 1302, 1315 & n.19 (S.D. Ohio 1982) (unfriendly deal; bankers received base fee plus 1% of the consideration to be received by shareholders in excess of a predetermined share price). *Cf. Dynamics Corp. of Am.*, 794 F.2d at 257 (target's investment advisor received substantial bonus if raider was unsuccessful). *See also* Carrington, *Merger Advisers Say the Big Fees They're Charging are Warranted*, Wall St. J., July 17, 1981, at 29 (seller's banker typically receives percentage fee in friendly deals); Forstmann, *Corporate Finance, 'Leveraged to the Hilt': Violating Our Rules of Prudence*, Wall St. J., Oct. 25, 1988, at A26 ("the bigger the deal, the bigger the fees").

165. *See* Kaplan, *M&As: Should Congress Act? Public Says the Process is Corrupt*, Nat'l L.J., Feb. 27, 1989, at 1 (mergers and acquisitions law firm reportedly received $20 million for two weeks' work on the Phillip Morris/Kraft merger, which was based on the percentage of the total value of the deal).

166. *See, e.g.*, L. SOLOMON, R. STEVENSON & D. SCHWARTZ, CORPORATIONS:

board of directors able to function effectively in both roles?[167] Are investment bankers being paid based to render dispassionate opinions,[168] or are they being paid based on the outcome of the matter? Should it matter?[169]

Should the target company obtain separate counsel and investment bankers for the outside directors, or a special committee thereof?[170] Should the ESOP to which the target intends to sell a

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LAW AND POLICY 1100 (1982) (stating that where the takeover is successful, "[t]he [target's] professional advisors, whether they are investment bankers or lawyers, are likely to lose a client, and, especially in the case of a lawyer, the loss may have serious consequences"). *Cf.* Avacus Partners, L.P. v. Brian, No. 11,001 (Del. Ch. Jan. 23, 1990) (disqualifing law firm from representing plaintiff challenging the fairness of a merger since plaintiff's claim might challenge the fairness opinion of an investment banker with whom the law firm has an existing relationship).

167. *See, e.g.*, *In re* Kern, (Allied Stores Corp.), [1988-89 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,342, at 89,580 (Nov. 14, 1988). In *Kern*, the SEC brought an enforcement proceeding against George Kern, Allied Stores' principal outside counsel and a director of the Company. The action arose out of Allied Stores' defensive response to a tender offer by Campeau Corp. The SEC alleged, and the Chief Administrative Judge agreed, that Kern caused Allied to fail to comply with § 14(d)(4) of the Exchange Act and Rule 14d-9 thereunder. *Id.* at 89,592. *Kern* illustrates the potential conflicts that may arise where outside counsel also sits on the target's board of directors. *See also* Pitt & Shapiro, *supra* note 60, at 265-71 (discussing the significance of the *Kern* proceedings).

168. *See, e.g.*, *Dynamics Corp. of Am.*, 794 F.2d at 257 (noting that the target's banker was to receive a bonus if its client was able successfully to fend off takeover); *Interco*, 551 A.2d at 793 (because target had agreed to compensation arrangement fee with its banker that gave the banker a substantial contingency fee if the target's restructuring was successfully completed, the banker was faced with a "rather straightforward and conventional conflict of interest" when it opined on the value of a third party's offer).

169. It obviously will matter to the target company's board of directors. The ability to obtain dispassionate expert advice is critical to the effective functioning of a board of directors, as is the ability to rely upon that advice once received. If the courts are disdainful of certain types of advisors, certain types of relationships, and certain types of remuneration agreements, directors need to be apprised of these views in advance of selecting professional advisors and structuring their relationships with them.

170. The textual inquiry divides into two sub-inquiries. First, is there a need for separate counsel and investment bankers at all? This is a question that is often asked of corporate counsel at the outset of a representation involving an unsolicited acquisition offer. As a matter of sound practice, corporate counsel should advise the directors that, if they feel (or any member thereof feels) the need for separate representation, such representation should be provided by the company. This is not the same, however, as encouraging such representation. Indeed, the existence of multiple advisors can sometimes create chaos where order would otherwise reign. This is so because there is no "absolute truth" regarding the handling of unsolicited acquisition proposals, and each situation is *sui generis*. A board confronted with conflicting advice may not be able to act decisively. Moreover, under certain

large block of its own voting stock have separate counsel and separate investment bankers?[171]

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circumstances, the creation of a *de facto* or *de jure* special committee replete with separate advisors, where no need for such a committee has as yet arisen, can create the impression that the entire board is conceding that it is not capable of acting independently and in the best interests of all the target company's constituencies. *Cf.* Abbey v. Computer & Communications Technology Corp., 457 A.2d 368, 373 (Del. Ch. 1983) (by referring plaintiff's demand to special litigation committee, board had conceded that it was disqualified from acting as a body, and, therefore, demand was thus futile).

There are, however, circumstances where the assistance of independent experts for outside board members is not merely discretionary. For example, where the board has created a special committee of outside directors, it is inevitable that the committee will be counselled by its own investment bankers and attorneys. This is important because the act of creating a special committee suggests that the company and its management want to insulate the important corporate control decisions required to be made from the hands of management. In that circumstance, if the outside directors comprising the special committee do not have their own advisors, they are apt to be seen as less independent, or perhaps, not independent at all. *Compare MacMillan*, 559 A.2d at 1281 (court concerned with special committee's lack of independent advisors) *with In re* RJR Nabisco, Inc. Shareholders Litig., [1988-89 Transfer Binder] (CCH) ¶ 94,194, at 91,710 (Del. Ch. Jan. 31, 1989) (special committee's independence was beyond reproach).

The second inquiry is whether, once it has been determined to provide separate counsel and/or investment bankers for the outside directors, the company can or should pay for their services. The Delaware Supreme Court recently expressed great dissatisfaction with a situation in which the outside advisors for a special committee were not selected by the committee itself, but instead were selected by corporate management. *See MacMillan*, 559 A.2d at 1281. *See also In re* Fort Howard Corp. Shareholders Litig., No. 9991, slip op. at 30-31 (Del. Ch. Aug. 8, 1988), *reprinted in* 14 DEL. J. CORP. L. 699, 720 (1989) (court was critical of the fact that the target's Chief Executive Officer chose the special counsel for the committee). As a matter of prudence, it is useful for the special committee to select its own chairperson and its own advisors. While the *MacMillan* decision expressed reservations about management even recommending who might serve as outside advisors, those reservations appear to reflect more the peculiar circumstances found by the court to exist in that case than a general view by the judiciary that corporate management is disabled from making recommendations about counsel and investment bankers. The special committee can make matters easier for all concerned if they request recommendations rather than imposing upon management to decide whether to make a recommendation and whom to recommend. The essence is substance, not form, however, and that means that the advisors ultimately chosen should be advisors that conform to the needs and desires of the special committee, and not solely the desires of management.

Having selected outside advisors, the special committee appropriately may turn to management to compensate those advisors. It is preferable for the advisors to submit their fee requests and statements to the special committee, and to allow the special committee to pass the request on to the company's managers. The resolution appointing the special committee should be quite clear that the company itself has no discretion with respect to whether or how the special committee's advisors are

These are sensitive subjects, which many may think are best left unspoken. But, whether or not they are spoken, they are thought—by the various players, by the regulators[172] and by the courts.[173]

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to be compensated. If there are practical limitations, these should be communicated to the members of the special committee at the time the committee is established.

171. The use of ESOPs—employee stock option plans—has proliferated in recent times. *See generally* Block & Hoff, *supra* note 8 (discussing cases where target managements have utilized an ESOP as an antitakeover devise); Note, *Employee Stock Ownership Plans and Other Defenses to Hostile Tender Offers*, 21 WASHBURN L.J. 580 (1982) (discussing the use of ESOPs to defend against hostile tender offers). These vehicles are either already in existence or are created in response to the exigencies of an unsolicited acquisition effort. If the ESOP is leveraged, borrows the funds necessary to allow the plan to purchase the securities, the ESOP either borrows directly from the lending institution or the employer incurs debt and makes a loan to the ESOP on similar terms. Restrictions on ESOPs abound, not the least of which is compliance with the myriad of requirements under the Employee Retirement Income Security Act of 1974 (ERISA) and the Internal Revenue Code. *See, e.g.*, 26 U.S.C. §§ 133, 404(a)(9), 404(k) (1990) (compliance under Internal Revenue Code); 29 U.S.C. §§ 1054, 1104, 1108 (1983) (compliance under ERISA).

The trustees of an ESOP owe fiduciary duties to the plan beneficiaries, and that duty is statutorily imposed. *See* ERISA, 29 U.S.C. § 1104 (1976 & Supp. V 1981) (trustee must act "solely in the interest of the participants and beneficiaries" of the plan). The statutory responsibilities imposed transcend state corporate law, and make it difficult for corporate management to fulfill both the role of corporate managers and ESOP trustees. *See, e.g.*, Donovan v. Bierwirth, 680 F.2d 263, 271-73 (2d Cir.), *cert. denied*, 459 U.S. 1069 (1982). The Department of Labor, which administers ERISA, has proposed rules requiring ESOP plans to obtain independent counsel and investment banking advice before acquiring target company stock in the face of an unsolicited acquisition bid. *See* Rappaport & Cannon, *Counseling Corporate Clients in the Uses and Implications of Leveraged ESOPs*, 21st Ann. Inst. on Sec. Reg. 747 (Pitt, Nathan & Volk eds. 1989). The Department of Labor's enforcement staff has also spent time inquiring into the bona fides of decisions to purchase target shares at prices apparently influenced by an unsolicited acquisition bid for purposes of opposing the bid. *See* Skrzycki, *U.S. Acts to Halt Misuse of Pension Funds*, Wash. Post, Mar. 31, 1989, at F1, col. 1.

172. Former SEC Commissioner Bevis Longstreth stated that fairness opinions are often "boiler-plated passkeys ... effective in protecting a conflicted management from successful attack, but inadequateto give shareholders full value for their shares." *Longstreth Says Federal, State Laws Are Not Assuring Fairness in Buyouts*, 15 Sec. Reg. L. Rep. (BNA) 1908, 1909 (1983) (quoting Commissioner Beris Longstreth's 1983 address to the International Bar Association in Toronto, Canada).

173. *See, e.g.*, *Dynamics Corp. of Am.*, 794 F.2d at 257 (noting that the investment banker "would have lost its $75,000 bonus if it had advised the board that the tender offer was fair"); *Hanson Trust*, 781 F.2d at 275 (questioning investment banker's "conclusory opinion"); *Interco*, 551 A.2d at 795 (characterizing investment banker's opinion as "inherently a debatable proposition"); Joseph v. Shell Oil Co., 482 A.2d 335, 344 (Del. Ch. 1984) (referring to "questionable methodology" and "quick and cursory" analysis with respect to investment bankers' opinions); *Weinberger*, 457 A.2d at 712 (criticizing cursory preparation of fairness opinion). *See also* Bartlett, *Delaware Courts Get Tough On Investment Bankers*, N.Y. Times, May 30, 1989, at D3, col. 1.