TENDER OFFERS FOR CORPORATE CONTROL: A CRITICAL ANALYSIS AND PROPOSALS FOR REFORM

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Tender offers[1] for corporate control improve the economic efficiency of the marketplace[2] and enable shareholders to sell their shares to an offeror at a substantial premium over the market price.[3] Potential acquirors, however, often face obstacles when attempting to tender their bids to target shareholders. Target management often opposes tender offers by engaging in a wide variety of defensive tactics[4] to avoid the possibility of displacement in the wake of a hostile takeover.[5] Shareholders, as a practical matter, are powerless to stem such abuse.[6] Courts, for the most part, have not been sensitive to the inherent conflict of interest between management and shareholders and permit management entrenchment efforts to succeed in all but the most egregious cases.[7] Legislative reform is therefore needed to eliminate conflicts of interest in the tender offer process and to provide shareholders with control over the ultimate destiny of the corporation in which the own stock.[8]

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1. Although there is no statutory definition of a "tender offer," it is generally defined as a public invitation addressed to all shareholders of a corporation to tender their shares for a specified price within a limited period of time. A tender offer is typically conditioned upon the receipt of a stated number of shares. *See* SEC v. Texas Int'l Co., 498 F. Supp. 1231, 1240 (N.D. Ill. 1980).

2. *See infra* notes 43-47 and accompanying text.

3. *See infra* note 26 and accompanying text.

4. *See infra* notes 15-20 and accompanying text.

5. *See infra* notes 69-77 and accompanying text.

6. *See infra* notes 9-12 and accompanying text.

7. *See, e.g.*, Panter v. Marshall Field & Co., 646 F.2d 271 (7th Cir.), *cert. denied*, 454 U.S. 1092 (1981). In *Panter*, Carter Hawley Hale's exchange offer for Marshall Field stock at $42 per share when Field's stock was trading at $22 per share was rejected by Field's board as inadequate. *Id.* at 279-80. The Seventh Circuit Court of Appeals upheld the actions taken by the Field board in opposition to the tender offer under the business judgment rule. *Id.* at 293-97. Judge Cudahy, however, voiced his concern for the protection of shareholder interests in a vigorous partial dissent to the majority opinion. Judge Cudahy stated in pertinent part:

> Unfortunately, the majority here has moved one giant step closer to shredding whatever constraints still remain upon the ability of corporate directors to place self-interest before shareholder interest in resisting a hostile tender offer for control of the corporation. There is abundant evidence in this case to go to the jury on the state claims for breach of fiduciary duty. I emphatically disagree that the business judgment rule should clothe directors, battling blindly to fend off a threat to their control, with an almost irrebuttable presumption of sound business judgment, prevailing over everything but the elusive hobgoblins of fraud, bad faith or abuse of discretion.

Id. at 299.

8. The literature which has developed on this topic is vast. *See generally* Bebchuk, *The Case for Facilitating Competing Tender Offers*, 95 HARV. L. REV. 1028 (1982) [hereinafter Bebchuk]; Coffee, *Regulating the Market for Corporate Control: A*

Part I of this article examines the motives and benefits of one firm acquiring another firm at a substantial premium over the market price. It is suggested that takeovers create wealth primarily by replacing inefficient management or by achieving operating or financial synergies. The impact of takeovers on various noninvestor constituents and target management's duty to them is discussed in Part II. Because management's fiduciary duties are owed only to its shareholders and not to noninvestor constituents, it is recommended that management generally not be allowed to consider the interests of noninvestor constituents. Part III discusses the current rules governing tender offers for corporate control and their failure to protect shareholder interests. In Part IV the British system of tender offer regulation is discussed and proposed as a model from which tender offer regulation in the United States should be developed. Part V recommends federal legislative reform which adopts a rule of auctioneering conducted by an independent committee and requires shareholder approval of all defensive tactics.

I. INTRODUCTION

The ultimate destiny of today's publicly held corporation is substantially controlled by management rather than by shareholders. Shareholders of such corporations are largely passive investors who follow the "Wall Street Rule"[9] whereby they either support incumbent management or sell their stock if dissatisfied. Dissatisfaction only results in a sell order, not new management. Although the proxy machinery is available to oust poor management, such campaigns are rarely successful[10] because of their length of time and

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Critical Assessment of the Tender Offer's Role in Corporate Governance, 84 COLUM. L. REV. 1145 (1984) [hereinafter Coffee]; Easterbrook & Fischel, *The Proper Role of a Target's Management in Responding to a Tender Offer*, 94 HARV. L. REV. 1161 (1981) [hereinafter Easterbrook & Fischel]; Gilson, *Seeking Competitive Bids Versus Pure Passivity in Tender Offer Defense*, 35 STAN. L. REV. 51 (1982-83); Lipton, *Takeover Bids in the Target's Boardroom*, 35 BUS. LAW. 101 (1979) [hereinafter Lipton]; Lowenstein, *Pruning Headwood in Hostile Takeovers: A Proposal for Legislation*, 83 COLUM. L. REV. 249 (1983) [hereinafter Lowenstein]; Manne, *Mergers and the Market for Corporate Control*, 73 J. POL. ECON. 110 (1965).

9. *See* Coffee, *supra* note 8, at 1231 (institutional investors back incumbent management or sell their stock, and never support insurgents). *But see* 3 CORPORATE GOVERNANCE BULLETIN 25-28 (June 1986). Institutional investors have recently initiated a campaign to oppose certain types of defensive tactics that are adopted by target management without shareholder approval. *Id.*

10. *See* Easterbrook & Fischel, *supra* note 8, at 1171 (passive shareholders following the Wall Street Rule are disinclined to oppose incumbent management).

prohibitive cost.[11] Investors' predisposition to vote for incumbent management undoubtedly accounts for much unearned success and tends to entrench poor management. If investors support management, they benefit from open lines of communication; a vote against management cuts them off. Furthermore, it is costly for a shareholder to monitor a corporation, especially when his investment in that corporation is but one in a portfolio.[12] Shareholders, therefore, have little practical ability to monitor or control the very corporation which they own. This problem is exacerbated in the case of a hostile takeover (a relatively new acquisition technique), where there is potential for great economic harm to shareholders.

The number of tender offers has grown from eight in 1960 to 205 in 1981.[13] Multibillion dollar takeover bids have become commonplace; in 1984 there were eighteen tender offer bids in excess of $1 billion.[14] The proliferation of tender offers has resulted in the development by target management of creative defensive tactics such as "golden parachutes,"[15] "crown jewel

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11. *See* Note, *The Developing Meaning of a "Tender Offer" Under the Securities and Exchange Act of 1934*, 86 HARV. L. REV. 1250 (1973).

12. *See generally id.* Shareholders have little incentive to monitor the corporations in which they own stock. Obtaining information is costly and once valuable information is acquired, it benefits all shareholders, not just those who incurred monitoring costs. Furthermore, once evidence of poor managerial performance is obtained by a shareholder, he must either launch a proxy campaign or convince incumbent management to replace the poor performers. Neither alternative is attractive because of the time and costs involved. Therefore, shareholders have an incentive to be passive and take a free ride on other shareholders' monitoring efforts. Each shareholder's self-interest leads him to avoid controversy and to follow the Wall Street Rule. *See, e.g.*, Andrews, *Corporate Governance Eludes the Legal Mind*, 37 U. MIAMI L. REV. 213, 216 (1983).

13. J. CHOPER, J. COFFEE & C. MORRIS, CASES AND MATERIALS ON CORPORATIONS 90 (2d ed. Supp. 1984). However, in the last several years there has been a slight decline in the number of tender offers. For an example, the number fell slightly from 142 in 1984 to 121 in 1985. *See Tender Offer Update: 1986*, 21 MERGERS & ACQUISITIONS 55 (Spring 1986).

14. *Corporate Scorecard*, AM. LAW. (Apr. 1985).

15. "Golden parachutes" are contracts made with senior management that provide substantial benefits if the executive leaves the target corporation after a change in control. An executive protected by a golden parachute may be entitled to an amount equal to several years of compensation if displaced by a hostile takeover. *See, e.g.*, Metz & Koten, *Bendix Provides Salary Guarantee for 16 Officers*, Wall St. J., Sept. 10, 1982, at 2, col. 2 (executives of Bendix Corp. entitled to three year base salary and incentive payments upon change in control). Golden parachutes have the effect of increasing the cost of a takeover but are defended as creating a parity of interest between shareholders and management which allows management to act objectively in the face of a hostile takeover bid. L. SOLOMON, R. STEVENSON & D. SCHWARTZ, CORPORATIONS 190-91 (1984 Supp.) [hereinafter SOLOMON, STEVENSON & SCHWARTZ]. On the other hand, many feel that executives

options,"[16] "poison pills,"[17] "shark repellants,"[18] "Pac-Man" defenses,[19] and "white knights"[20] in preparation for and in response to hostile tender offers. Target management almost always opposes tender offers because the offer threatens target management's ability to retain control of the corporation,[21] notwithstanding the fact that tender offers usually enable target shareholders to sell their stock at a substantial premium over the market price.[22] Defensive tactics can be and often are adopted without shareholder approval. Current rules operate on the premise that management acts objectively during a takeover; the rules fail to acknowledge the fact that management has

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who enter into such contracts are violating their fiduciary duties and wasting corporate assets. *See, e.g.*, Johnson, *Anti-Takeover Action and Defenses: Business Judgment or Breach of Duty?*, 28 VILL. L. REV. 51, 70 (1982) (prospect for financial security reduces management's loyalty to shareholders).

16. "Crown jewel options" are options granted by a target to a third party to purchase the targets' most valuable assets in order to discourage a hostile bidder from acquiring the target. *See* Oesterle, *Target Managers as Negotiating Agents for Target Shareholders in Tender Offers: A Reply to the Passivity Thesis*, 71 CORNELL L. REV. 53, 92 n.131 (1985-86).

17. "Poison pills" involve the issuance of authorized unissued preferred stock to shareholders with rights to purchase the company's stock at below market prices upon certain triggering events such as a takeover. These rights may "flip over" and allow the shareholders to acquire shares of the bidding company at below market prices. *See generally* Chittur, *Wall Street's Teddy Bear: The Poison Pill as a Takeover Defense*, 11 J. CORP. L. 25 (1985) (discussion of different types of poison pills); Note, *Protecting Shareholders Against Partial and Two-Tiered Takeovers: The "Poison Pill" Preferred*, 97 HARV. L. REV. 1964 (1984) (similar).

18. "Shark repellants" are provisions in the target company's articles of incorporation or bylaws which are designed to deter a bidder's interest in the target. Examples of shark repellants include staggering the terms of the board of directors, supermajority voting, and "fair price" provisions, which require supermajority voting unless at least a certain price is paid for the target. *See generally* Friedenberg, *Jaws III: The Impropriety of Shark-Repellant Amendments as a Takeover Offense*, 7 DEL. J. CORP. L. 32 (1982) [hereinafter Friedenberg].

19. A "Pac-Man" defense is one in which the target company defends a hostile tender offer by making its own offer for the stock of the hostile bidder in an "I'll eat you before you eat me" struggle. Martin Marietta Corp. v. Bendix Corp., 549 F. Supp. 623, 625 (D. Md. 1982). *See* Comment, *Pac-Man Tender Offers*, 1983 DUKE L.J. 116 (1983).

20. A "white knight" is a third party, friendly to target management, which rescues the target from a hostile takeover by either entering into a friendly merger with the target or assisting the target in a defensive tactic such as a crown jewel option. *See* Gutman, *Tender Offer Defensive Tactics and the Business Judgment Rule*, 1984 SEC. L. REV. 325 (solicitation of tender offer bid from a white knight is one of the most effective defensive tactics).

21. Target management's usual justification for opposing tender offers is that management has deemed the offer "grossly inadequate." Thus, management adopts defensive tactics to "protect" its shareholders from abusive acquisition techniques. *See, e.g.*, Moran v. Household Int'l, Inc., 500 A.2d 1346 (Del. 1985).

22. *See infra* notes 153-218 and accompanying text.

an inherent conflict of interest in the transaction. Not surprisingly, defensive tactics and target management's responses to tender offers have been vigorously challenged by target shareholders and bidding companies.[23] Courts, unfortunately, allow such management entrenchment schemes to continue as legitimate business decisions protected by the business judgment rule.[24] Many commentators agree that some reform is needed to place greater restraints on defensive tactics and target management's actions in response to tender offers.[25] Before discussing the current regulatory framework and suggesting proposals for reform, this article will analyze the motives for takeovers and ask whether they benefit society as a whole.

II. THE TAKEOVER RATIONALE

Several studies have shown that tender offers which result in changes of corporate control provide substantial gains to shareholders of target corporations of approximately 15% to 70% and nominal gains to shareholders of bidder corporations.[26] However, attorney Martin Lipton contends that shareholders benefit when takeovers are rejected.[27] His data shows that over half of the target firms studied later traded at prices higher than the rejected tender offer price.[28] Lipton's data has been harshly criticized because it fails to account for many post-tender offer factors such as general market movements which may well account for the higher post-tender offer price.[29] The more persuasive data is that which indicates that shareholders gain as a result of a takeover.[30]

A determination of whether and how legislation should encourage

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23. *See infra* notes 162-196 and accompanying text.

24. *Id.*

25. *See supra* note 8 and accompanying text.

26. *See* Bradley, *Interfirm Tender Offers and the Market for Corporate Control*, 53 J. BUS. 345 (1980) (target shareholders receive average premium of 49%); Dodd & Ruback, *Tender Offers and Shareholder Returns*, 5 J. FIN. ECON. 351 (1977) (target shareholders receive average premiums of 21% and bidder shareholders obtained nominal gains); Jarrell & Bradley, *The Economic Effects of Federal and State Regulations of Cash Tender Offers*, 23 J.L. & ECON. 371 (1980) [hereinafter Jarrell & Bradley] (target shareholders receive premiums of 30% to 70%).

27. Lipton, *supra* note 8, at 106.

28. *Id.* at 106-09.

29. Easterbrook & Fischel, *supra* note 8, at 1188-89.

30. *See* Jensen & Ruback, *The Market for Corporate Control: The Scientific Evidence*, 11 J. FIN. ECON. 1, 22 (1983) [hereinafter Jensen & Ruback] ("since targets gained and bidders do not appear to lose, the evidence suggests that takeovers create value").

or discourage takeovers requires an inquiry into the reasons why one firm is willing to pay a substantial premium over the current market price to acquire another firm. Public policy should generally favor acquisitions which create wealth and disfavor or remain neutral toward those which merely transfer wealth.[31] Various theories have been developed to explain why such enormous premiums are paid; however, no one theory appears to be conclusive.

A. *The Underpriced Stock Theory*

According to the "efficient capital market hypothesis," it is impossible to reap profits simply by identifying and acquiring firms whose stock is underpriced in the market.[32] Substantial evidence and literature support the view that stocks are efficiently priced.[33] Adjustments to price are made rapidly upon disclosure of new information. The price of a stock presumably embodies all currently available information and cannot be predicted by any mechanical rule.[34] No firm as it currently exists should be worth more than its price in the market.[35] Thus, based on this theory, it is unlikely that takeovers merely exploit mispriced stocks. Assuming that stocks are efficiently priced, a rational bidder must anticipate added benefit from the acquisition in order to justify the premium offered.[36]

There are, however, some perplexing questions concerning the pricing of stocks. If public trading in stocks on major exchanges results in efficiently priced stocks, then why do some firms trade at prices below their asset value?[37] Why is it that the "cheapest oil that can be found is on the floor of the New York Stock Exchange?"[38] Proponents of the view that the stock market is not efficient and that certain stocks are undervalued argue that tender offers merely exploit underpriced stocks.[39] Critics contend that such takeovers only accelerate an inevitable adjustment in the price of the target's stock

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31. *See* Coffee, *supra* note 8, at 1173 (wealth creation should be encouraged, but wealth redistribution discouraged).

32. *See* Easterbrook & Fischel, *supra* note 8, at 1165-66 (theory is widely accepted).

33. *Id.* at 1166. *See also id.* at 1166 n.15 (various types of evidence which support the theory that stock markets are efficient).

34. *Id.* at 1166 n.15.

35. *Id.*

36. *Id.* at 1169.

37. *See* Pollack, *Post* Conoco *Guessing Game*, N.Y. Times, Aug. 7, 1981, at D1, col. 3 (oil company stocks trading at about half of their asset value).

38. *The Dealmakers*, Fortune, Jan. 24, 1983, at 58.

39. *See* Lowenstein, *supra* note 8, at 274.

and does not result in any increase in the value of the target.[40] The benefit of the immediate price correction is deemed not to be worth the incremental rise in the price of the stock.[41] This view, however, ignores the cost to shareholders of perpetuating the underpricing of stock. From the shareholders' perspective, it is better to have an undervalued stock exploited now than corrected later.[42] Even if takeovers merely accelerate inevitable price corrections, they enable target shareholders to sell their stock at a fair price which the market previously failed to offer. Notwithstanding the fact that such an exploitative takeover motive does not create any new value in the target, it should be encouraged because it promotes efficient pricing of stocks in the market and prevents shareholders from selling their stock at an undervalued price. Therefore, even if stocks are not efficiently priced and takeovers merely exploit mispriced stocks, such a takeover motive should not be discouraged as a matter of public policy.

B. *The Inefficient Management Theory*

One of the most persuasive takeover theories suggests that a premium is paid in a tender offer because the target's assets will be worth more under the management of the bidder than they currently are as managed by the target.[43] Hence, the target's assets are not achieving their full potential value due to inefficient management. However, a recent survey of corporate directors concluded that bidders seek targets with excellent management.[44] While this data has been criticized as self-serving, it is consistent with an earlier study

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40. *See* Easterbrook & Fischel, *supra* note 8, at 1165-68 (takeover does not increase "true value" of target, it only makes market aware of already "existing value").

41. *Id.*

42. *See* Coffee, *supra* note 8, at 1171-72 ("Undervalued stocks can easily remain undervalued stocks, and shareholders who are 'protected' by management in this manner from an 'exploitative' offer may come to realize that a little exploitation is better than none at all.").

43. *See* Easterbrook & Fischel, *supra* note 8, at 1173 (tender offers are a method of monitoring the work of management teams). *But see* Strach, *Regulating Two-Tier Tender Offers: A Compromise Proposed with Neglible Distribution*, 22 WILLAMETTE L. REV. 41, 66-67 (1986) (disputing argument that tender offers result in removal of inefficient management).

44. In 1981, Touche Ross & Co. conducted a nationwide survey of corporate directors regarding prospective target companies. Ninety-eight percent of those surveyed found "excellent management" to be either a major or minor attraction of a prospective target company. *See* Coffee, *supra* note 8, at 1212.

which found that two-thirds of acquiring firms granted virtual autonomy to the acquired firm with respect to operating decisions.[45] These studies can be reconciled with the inefficient management theory because bidders may prefer a target which has excellent management in operating and technical departments upon whom they can rely for matters with which they are unfamiliar after the bidder has replaced inefficient management in departments such as finance, marketing and sales. Nonetheless, under this hypothesis, takeovers are economically desirable because they result in more efficient use of assets and should prompt management of potential targets to perform more efficiently.[46] Although this theory is widely accepted, commentators disagree about the number of takeovers it in fact explains.[47]

The heavy reliance by Professors Easterbrook and Fischel on the inefficient management theory[48] has been criticized by Professor Bebchuk.[49] Easterbrook and Fischel proceed on the premise that managers are tempted to perform poorly because shareholders, not the managers, enjoy the fruits of management's labors.[50] Poor managerial performance, they contend, causes the firm's stock price to drop.[51] Easterbrook and Fischel argue that since it is difficult to remedy the situation from within, takeovers serve an important function by bringing in efficient management from the outside.[52] Their premise implies that the only negative consequence to poor performance by a manager is replacement by a raider. To the contrary, such a manager can always be fired, and rapid turnover among top executives indicates a competitive employment environment.[53] Professor Bebchuk presents the more realistic approach that

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45. *Id.*

46. *See* Easterbrook & Fischel, *supra* note 8, at 1184 (takeovers benefit society by providing an incentive for managers to operate efficiently). In Edgar v. Mite, 457 U.S. 624, 643 (1982), the United States Supreme Court opined that tender offers can serve to improve management's efficiency, thus giving tacit approval to the inefficient management theory.

47. *Compare* Bebchuk, *supra* note 8, at 1031-34 (may explain some or even many takeovers) *with* Easterbrook & Fischel, *supra* note 8, at 1169 (most probable explanation for takeovers).

48. Easterbrook & Fischel, *supra* note 8, at 1175-77.

49. Bebchuk, *supra* note 8.

50. Easterbrook & Fischel, *supra* note 8, at 1169-70.

51. *Id.* at 1175.

52. *Id.* at 1170-71.

53. Although Easterbrook and Fischel acknowledge labor market constraints as a means of disciplining poor managerial performance, they do not address the

the inefficient management theory probably explains some or even most takeovers but cannot be the sole explanation.[54]

C. *The Synergistic Gains Theory*

Another persuasive explanation of high takeover premiums suggests that bidders anticipate a synergy to result from the combined firms.[55] Accordingly, the target has a unique value to the bidder that exceeds its value to the market generally.[56] Gains from synergy can be the result of greater operating efficiencies or reduced financial risks.[57] If such synergies result, takeovers are desirable because they create wealth. Bidders, however, apparently overestimate the potential for synergistic gains because studies show that such higher profits seldom result.[58] Nonetheless, a motive to create wealth should be encouraged. There is no reason to deny a bidder the opportunity to take a business risk calculated to result in a desired synergy. Easterbrook and Fischel suggest that if synergistic gains are anticipated, the takeover would be accomplished through a friendly merger.[59] Their criticism of the synergistic gains theory, however, fails to account for the fact that target management may refuse to negotiate, demand unreasonable terms, or simply not perceive the synergy that the bidder anticipates.[60] The synergistic gains theory is persuasive and suggests that takeovers benefit society because they create wealth. It is at least a partial explanation for many takeovers.

D. *The Firm Expansion Theory*

According to the "economic theory of the firm," part of a bidder's motive to pay a premium in a takeover results from its desire to expand.[61] To the extent that a premium is paid out of such a motive, the takeover merely transfers wealth from the bidder

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effect of such constraints with respect to the inefficient management theory. *Id.* at 1185.

54. *See* Bebchuk, *supra* note 8, at 1031 ("Although the expectation of managerial gains may explain some or even many takeovers, there is no basis for denying the significance of other motives.").

55. *See* Coffee, *supra* note 8, at 1166-67.

56. *Id.* Professor Coffee contends that value of the combined enterprise is expected to be greater than the sum of the separate parts as independent companies.

57. *Id.*

58. *Id.*

59. Easterbrook & Fischel, *supra* note 8, at 1169.

60. Bebchuk, *supra* note 8, at 1032.

61. *Id.* at 1033.

shareholders to the target shareholders. Although growth without profit makes little business sense, some studies seem to support the firm expansion theory. A recent study shows a high correlation between management compensation and company size but little correlation between compensation and return on equity.[62] An earlier study shows that management compensation is more closely tied to gross revenues than to profits.[63] Professor Bebchuk contends that such data support a theory of self-aggrandizing firm expansion by bidder management.[64] However, these studies cannot be viewed as providing conclusive support because executive compensation probably bears a high correlation to company size; a larger organization requires a manager to assume more responsibility, thus warranting a larger salary. Furthermore, as Professors Easterbrook and Fischel note, the firm expansion theory implicitly assumes that managers perform in an environment free of constraints against making unprofitable acquisitions.[65] The increasing importance of earnings per share as a barometer of management success indicates that managers who pursue growth without profit would not last long in their positions and would fare poorly in the employment market.

To the extent that firm expansion is motivated by the selfish interests of managers, it is a self-destructive motive. Data which shows that the price of the acquiring firm's shares steadily increase in the four to eight years before the takeover has been used to refute the argument that bidders are not managed by foolish self-aggrandizing executives.[66] Such information is unpersuasive, however, since many firms' prices may have increased over a period of eight years due to upward trends in the general market.[67] Nonetheless, the data cannot be ignored. Management's preference for expansion, therefore, probably exists as an ancillary motive in the takeover decision.

E. *Conclusion*

Although firm expansion may exist as a subordinate motive for a takeover, substantial premiums over the market price of a target's

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62. Coffee, *supra* note 8, at 1167 n.50.
63. *Id.*
64. Bebchuk, *supra* note 8, at 1033.
65. Easterbrook & Fischel, *supra* note 8, at 1185.
66. *Id.* at 1188 n.72.
67. *See generally* Booth, *Management Buyouts, Shareholder Welfare, and the Limits of Fiduciary Duty*, 60 N.Y.U. L. REV. 630 (1985).

stock appear to be paid primarily because the acquiring company anticipates economic gains to result from either replacing inefficient management or from synergy. Tender offers, therefore, are probably motivated by a desire to create wealth except to the extent that a premium is paid for the self-aggrandizement of bidder management. Indeed, empirical evidence suggests not only that takeovers create wealth, but also that resistance to tender offers causes target stocks to lose value.[68] However, the conclusion that takeovers create wealth should not end the inquiry into whether takeovers are desirable from a public policy standpoint. Additional considerations must be identified and a determination made as to whether they should be given weight in shaping laws to govern takeovers.

III. THE IMPACT ON NONINVESTOR CONSTITUENTS

Recent hostile takeovers have spawned a considerable outcry over their impact on constituencies other than bidder and target shareholders.[69] A hostile takeover may cause unexpected hardship to noninvestor groups such as employees, distributors, suppliers, and affected communities.[70] A bidder may attempt to make a newly acquired firm more profitable by cutting or replacing employees, changing suppliers and distributors or relocating manufacturing facilities to a place where operating costs are lower. Some target companies have opposed tender offer bids because the proposed takeover was perceived to have an adverse effect on certain non-

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68. Jensen & Ruback, *The Market for Corporate Control: The Scientific Evidence*, 11 J. FIN. ECON. 5 (1983).

69. *See* Proposed Purchase of Marathon Oil Co. by Mobil Oil Corp.: Joint Hearings Before Senate Comm. on Commerce, Science, and Transportation and House Comm. on Energy and Commerce, 97th Cong., 1st Sess. (1981). Three years later, a report of the House Committee on Energy and Commerce stated:

> A change in control of a company can result in plant closings, employee layoffs, a change in the location of corporate headquarters and other significant matters, which impact on the employees and communities involved. At the Subcommittee's hearings, Representative Oxley noted the disruptive effects of the proposed acquisition by Mobil Oil Company of Marathon Oil on the economy of the town of Findley, Ohio. The Mobil/Marathon takeover battle is but one of a number that have threatened to or actually have had an adverse impact on employees and communities in which major corporate operations were located.

H.R. REP. No. 1028, 98th Cong., 2d Sess. 22 (1984).

70. *See* Saul, *Hostile Takeovers: What Should be Done?*, 5 HARV. BUS. REV. 22 (1985).

investor constituents.[71] Modern shareholders, however, are primarily interested in the earnings of the corporations in which they invest and not the effect that the business or operations of the corporation may have on the surrounding community, except, of course, to the extent that the surrounding community affects profitability.[72] As corporations become larger, as they often do immediately and dramatically in the event of a takeover,[73] the potential hardship upon noninvestor constituents becomes more severe.[74] New rules governing the takeover process must grapple with the ever-increasing tension between management's fiduciary duties to shareholders and the frequently negative impact of a takeover on noninvestor constituencies.

A. *Target Management*

Managers of target companies are at the forefront of the controversy over the impact of hostile takeovers on noninvestor constituents. Professor Coffee argues that takeovers are undesirable in part because a change in control results in deterioration of managerial employee performance and loyalty which he terms a "demoralization cost."[75] Although the extent of such a cost is admittedly debatable and certainly difficult to quantify, studies showing a high rate of voluntary departure among target executives after a hostile takeover seem to indicate manager dissatisfaction.[76] Fifty-two percent of senior executives leave within three years after a takeover, and only 42% of top managers remain after five years.[77]

This data, however, can be criticized on several grounds. Because the figures show that the departure of target managers after a takeover is voluntary, it may be assumed that they entered new positions shortly thereafter and did not become unemployed. Furthermore,

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71. *See infra* notes 88-106 and accompanying text.

72. *See supra* notes 9-12 and accompanying text.

73. *See generally* Bebchuk, *supra* note 8, at 1033.

74. *See generally* Lipton, *Corporate Governance in the Age of Finance Corporatism*, 136 U. PA. L. REV. 1, 25-26 (1987) [hereinafter Lipton, *Corporate Governance*]. "The current wave of highly leveraged takeovers has threatened or caused the flight of business operations upon which communities have come to rely and disrupted settled relationships between the target companies and employees, customers, and suppliers." *Id.* at 25.

75. Coffee, *supra* note 8, at 1238 ("A takeover is a traumatic event for target management. In its aftermath, dismissals are almost inevitable, and in some cases they decimate the executive staff of the target.").

76. *Id.* at 1239.

77. *Id.*

these studies do not account for normal attrition among top executives in publicly traded firms which may indeed be similarly high. It has been noted that if attrition were a serious problem, the stock market would substantially discount the price of the stock of the combined firms after the takeover was accomplished.[78]

Notwithstanding such criticism, these studies may explain why bidders seem to concentrate on firms with valuable assets or large cash reserves.[79] It has been argued that cash depletion and illiquidity have become managerial goals because firms with particularly valuable or liquid assets appear to be prime takeover candidates.[80] If managers are striving for such goals to avoid hostile takeovers, then perhaps tender offers should be discouraged as a matter of public policy. It is difficult to believe, however, that managers of potential takeover targets would adopt a strategy of risk preference at the expense of stability and profits solely to avoid the risk of displacement. Such a theory implicitly assumes that there are no constraints to discipline poor managerial performance.[81] Although such managerial goals seem unlikely, the risk of post-acquisition displacement of employees is probably high and the managers of target companies are likely to experience considerable disruption in the wake of a hostile takeover. Approximately half will leave their jobs and, according to Professor Coffee, those who remain will suffer demoralization.[82]

B. *No Duty is Owed to Noninvestor Constituents*

The critical legal inquiry is whether a corporation's directors owe a duty to noninvestor constituencies. If there is no duty, then may or should new legislation be adopted to allow or require target management to consider the concerns of noninvestor constituents when responding to tender offers? In the landmark case of *Dodge v. Ford Motor Co.*,[83] decided in 1919, Henry Ford, who owned 58% of

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78. *Id.* at 1241. Therefore, to the extent that the bidder paid a premium for "human value" in the target firm, the bidder has overpaid. However, a rational bidder would presumably factor the cost of such employee attrition into its calculation of a tender offer price and not overpay for the target.

79. *Id.* at 1240. Takeovers tend to focus on natural resource companies where the role of human capital is of lesser importance as compared to service or high technology industries where takeovers are less frequent. *Id.*

80. *Id.* at 1243.

81. *See* Easterbrook & Fischel, *supra* note 8, at 1185 (labor market constraints operate to discipline managers).

82. *Id.*

83. 204 Mich. 459, 170 N.W. 668 (1919).

Ford Motor Company and controlled its board of directors, announced a tripartite plan to reduce the price of its cars, ban any special dividends to shareholders and expand facilities to employ more workers.[84] The court found that Henry Ford "thinks the Ford Motor Company has made too much money, has had too large profits, and that although large profits might be still earned, a sharing of them with the public, by reducing the price of the output of the company, ought to be undertaken."[85] Arguing that Henry Ford had transformed the corporation from a private business institution into a semi-eleemosynary institution, the Dodge brothers, who owned 10% of Ford Motor Company, brought an action in part to compel a large cash dividend and enjoin the proposed expansion project.[86] The Michigan Supreme Court denied the request for an injunction, but affirmed the trial court's order requiring Ford Motor Company to declare a dividend equal to one-half of its cash surplus.[87] The court stated:

> A business corporation is organized and carried on primarily for the profit of the stockholders. The powers of the directors are to be employed for that end. The discretion of directors is to be exercised in the choice of means to attain that end, and does not extend to a change in the end itself, to the reduction of profits, or to the nondistribution of profits among stockholders in order to devote them to other purposes.[88]

Thus, the court determined that the directors of Ford Motor Company could not operate the business to benefit noninvestor constituents at the expense or loss of opportunity to its shareholders.[89] A board of directors' discretion, the court noted, is limited to choosing

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84. *Id.* at 503-04, 170 N.W. at 683. Henry Ford declared the policy of Ford Motor Company as follows: "My ambition . . . is to employ still more men; to spread the benefits of this industrial system to the greatest possible number, to help them build up their lives and their homes. To do this, we are putting the greatest share of our profits back into the business." *Id.* at 468, 170 N.W. at 671.

85. *Id.* at 505, 170 N.W. at 683-84.

86. *Id.* at 504, 170 N.W. at 683.

87. *Id.*

88. *Id.* at 507, 170 N.W. at 684. *See also* Local 1330, United Steel Workers v. United States Steel Corp., 631 F.2d 1264, 1279-81 (6th Cir. 1980) (holding corporation had no common law or contractual duty to consider effects of plant closings on employees or the communities in which the plants were located).

89. *Id.* at 507, 170 N.W. at 684.

the means by which the corporation will attempt to make profits for its shareholders.[90]

On the other hand, the Tenth Circuit Court of Appeals in *Herald Co. v. Seawell*[1] determined that a newspaper company was a quasi-public entity and held that its directors have a legal duty to non-investor constituents.[92] In that case, the Herald Company, a minority shareholder of Denver Post, Inc. (Denver Post), filed a derivative action against Denver Post's officers and directors for misconduct, breach of trust and misuse of corporate assets in connection with the company purchasing its stock for an employee stock trust plan.[93] The Herald Company, wholly owned by the Newhouse newspaper chain, alleged that Denver Post paid an exorbitant price for its own stock and that the motive of the directors in authorizing the stock purchase was to retain control of the corporation.[94]

In holding for the defendants, the court determined that a newspaper owes a duty to its shareholders, its employees, and to the public.[95] Because many people read and relied upon the news reported by the Denver Post, the court reasoned, it was a quasi-public institution.[96] Further, the court found a duty running to the employees of the company because many of them were highly skilled workers who had spent much of their lives working for the newspaper.[97] The court stated that placing the public needs and good above the desire for profit was "wholly justified" and assumed that shareholders entrust their money to managers partly in anticipation of furthering the economic well-being of noninvestor constituents.[98]

This decision can be criticized on many grounds. The court apparently believed that the Denver Post had a unique relationship

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90. *Id.* Although Henry Ford did not prevail in the lawsuit filed by the Dodge brothers, he was able to ultimately resolve the controversy to his satisfaction by purchasing for $105 million all of the outstanding Ford Motor Company stock held by others. SOLOMON, STEVENSON & SCHWARTZ, *supra* note 15, at 214.

91. 472 F.2d 1081 (10th Cir. 1972).

92. *Id.* at 1095.

93. *Id.* at 1083-90.

94. *Id.* at 1091. The stock purchase was made, in part, to prevent the *Denver Post* from being acquired by the Newhouse media conglomerate. *Id.* at 1092. The court found that management's motive in purchasing the stock was not improper, given a variety of factors which indicated that the purchase by Newhouse might not be in the best interests of the company's many constituencies. *Id.*

95. *Id.* at 1095.

96. *Id.*

97. *Id.*

98. *Id.* at 1097.

with the public which made it a quasi-public institution. However, any corporation which provides important consumer goods or services arguably has a similar relationship with the public. Certainly, not all such corporations can be considered quasi-public corporations. It is also doubtful that investors in publicly-held companies are as benevolent as the court would believe.[99] Furthermore, the court not only implied that the Herald Company was less socially responsible than the Denver Post,[100] but also presumed that managers of corporations are qualified to represent noninvestor constituents.[101]

In the recent case of *Revlon, Inc. v. MacAndrews & Forbes Holdings*,[102] the Delaware Supreme Court announced its position on the extent to which a target corporation may consider the impact of a hostile takeover on noninvestor constituencies. In *Revlon*, Pantry Pride made a hostile takeover bid for Revlon.[103] Revlon thereupon adopted a poison pill and an exchange offer plan and granted a lock-up option and a no-shop clause to a white knight, Forstmann Little.[104] Although the court upheld the adoption of the poison pill and exchange offer plan under the business judgment rule, it affirmed the lower court's decision which enjoined granting the lock-up option and no-shop clause to the white knight.[105] In making that finding, the court held:

> A board may have regard for various constituencies in discharging its responsibilities, provided there are rationally related benefits accruing to the stockholders. However, such concern for non-stockholder interests is inappropriate when an auction among active bidders is in progress, and the object no longer is to protect or maintain the corporate enterprise but to sell it to the highest bidder.[106]

Thus, contrary to the holding in *Herald Co.*, the *Revlon* court determined that a board of directors does not owe a fiduciary duty to noninvestor constituents.[107] Further, it opined that a board may

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99. *See generally supra* notes 9-12 and accompanying text.

100. Friedenberg, *supra* note 18, at 80-81.

101. *Id.* at 81. This ignores management's self-interest and willingness to accept positions incapable of objective verification. *Id.*

102. 506 A.2d 173 (Del. 1986). *See also infra* notes 186-96 and accompanying text.

103. *Revlon*, 506 A.2d at 176.

104. *Id.* at 178-79.

105. *Id.* at 182-85.

106. *Id.* at 182.

107. *Id. But see* Norlin Corp. v. Rooney Pace, Inc., 744 F.2d 255, 266 (2d

only act for the benefit of such constituencies if the action is calculated to generate profits for the corporation.[108] Indeed, ostensibly charitable deeds of corporations are often undertaken only for an underlying profit motive. A study of Fortune 500 companies shows that they typically spend more money advertising their charitable deeds to the public to generate goodwill than on the charitable deeds themselves.[109] Such benevolence should pass the rational relationship test set forth in *Revlon*. The *Revlon* court also decided that if an auction for control of a corporation develops, a target board may not concern itself with noninvestor constituents (nor, presumably, with future goodwill or profitability), because its only concern at that point is selling the corporation to the highest bidder.[110] The *Revlon* court's decision is consistent with the *Ford Motor Company* rule that a corporation is organized primarily for the profit of its stockholders. Hence, the more persuasive view, articulated in *Ford Motor Company* and *Revlon*, is that management does not owe a legal duty to such groups. Nevertheless, the question remains whether new legislation should require or even allow management to consider the impact of a hostile takeover on noninvestor constituents.

C. *Rejecting A Rule of Divided Loyalty*

The interests of shareholders in profit maximization will undoubtedly often conflict with the interests of noninvestor constituents. A requirement that managers represent the interests of both groups imposes a rule of divided loyalty which would be difficult, if not impossible, to implement.[111] In any event, such a rule would inevitably result in decreased managerial accountability to its owners.[112] Prudent shareholders would not readily entrust their money to man-

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Cir. 1984) (noting that a board must be permitted to protect interests of noninvestor constituents such as employees when considering a takeover bid); GAF Corp. v. Union Carbide Corp., 624 F. Supp. 1016, 1019-20 (S.D.N.Y. 1985) (stating that board of directors should consider the interests and concerns of employees and management of the target company when deciding the proper response to a hostile takeover bid); Enterra Corp. v. SGS Assoc., 600 F. Supp. 678, 687 (E.D. Pa. 1985) (opining that management may consider interests of suppliers, customers, lenders, and stability of the company when considering a takeover bid).

108. *Revlon*, 506 A.2d at 176.

109. SOLOMON, STEVENSON & SCHWARTZ, *supra* note 15, at 753.

110. *Id.* at 182.

111. Easterbrook & Fischel, *supra* note 8, at 1191-92.

112. *Id.*

agers who would be answerable to groups with conflicting interests.[113] Indeed, such a rule would result in abrogation of the fiduciary principle in corporate governance.[114] Consideration of noninvestor constituencies would also dramatically alter the purpose for which the organization was formed—from a private for-profit corporation to a quasi-charitable partly-not-for-profit organization. Private corporations are not entitled to the benefits accorded to charitable organizations, are not organized expressly for charitable purposes and should not be operated for charitable purposes at the expense of shareholders.[115]

Martin Lipton strongly supports the view that the long-term interests of the company and its noninvestor constituencies are more important than the short-term interests of shareholders in making a profit.[116] Easterbrook and Fischel have criticized Lipton for failing to explain precisely how long-term planning or the economy is adversely affected by hostile takeovers.[117] They note that takeovers generally improve economic efficiency and suggest persuasively that a rational acquiror would not discard valuable employees, suppliers, or distributors of a newly acquired firm.[118] Without citing authority, Lipton speaks of a movement that has expanded a corporation's responsibilities beyond the interests of its shareholders[119] and suggests that such macrosocioeconomic issues could be an independent justification for target management to reject a tender offer.[120] However, consideration of noninvestor constituencies which is not calculated to generate profits would involve a radical departure from the traditional notion that a corporation is an entity formed for the express purpose of generating profits for its owners.[121]

The risk of displacement or other hardship upon noninvestor constituencies should remain an inevitable and necessary characteristic of a free economy.[122] Noninvestor constituencies may reap substantial gains or suffer adverse consequences as a result of a hostile

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113. *Id.*
114. *Id.* at 1190 n.82.
115. *See* H. Henn & J. Alexander, Law of Corporations § 1, at 3 (1983).
116. Lipton, *supra* note 8, at 115-16; Lipton, *Corporate Governance*, *supra* note 73, at 36-37.
117. Easterbrook & Fischel, *supra* note 8, at 1183.
118. *Id.* at 1190.
119. Lipton, *supra* note 8, at 106.
120. *Id.* at 119-20.
121. *See supra* notes 83-90 and accompanying text.
122. Easterbrook & Fischel, *supra* note 8, at 1190 n.83.

takeover. Proponents of protecting noninvestor interests favor anticompetitive rules enabling such groups to reap the profits of a takeover, but preventing them from suffering the losses.[123] If noninvestor constituencies are allowed to enjoy the benefits of the wealth created by a takeover, it only seems fair that they should also have to endure hardships such as displacement.

There is little justification for placing the burden of protecting noninvestor constituencies on shareholders. Many noninvestor constituencies are already well protected by other laws. For example, employees are protected by labor laws, and suppliers are protected by bankruptcy, antitrust and contract laws.[124] Furthermore, municipalities can resort to economic development initiatives and property tax laws to relieve economic hardships created by takeovers.[125] Should the hardships of noninvestors become severe, the government, not the corporation upon which they came to depend, should rescue them. Legislation governing hostile takeovers should not attempt to minimize noninvestors' risks at the expense of our free market system.[126]

D. *Conclusion*

Because a corporation is formed for the express purpose of generating profits for its stockholders and not for carrying out charitable acts for the general public, concerns of noninvestors should not be given weight in the takeover process. Moreover, management should not be asked or allowed to attempt to carry out the impossible task of acting as fiduciaries for groups with competing interests. It is recommended, therefore, that consideration of noninvestor con-

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123. *Id.*

124. *See generally* Labor Management Relations Act, 29 U.S.C. § 158 (1982) (protecting employees' right to organize); The Bankruptcy Reform Act of 1978, 11 U.S.C. § 1101 (1982) (business may reorganize with protection from creditors); Sherman Antitrust Act, 15 U.S.C. § 1 (illegal restraint of trade).

125. *Cf.* W. HELLERSTEIN, STATE AND LOCAL TAXATION OF NATURAL RESOURCES IN THE FEDERAL SYSTEM, Legal, Economic, and Political Perspectives 37-55 (1986) (discussion of how states and localities value property).

126. Easterbrook & Fischel, *supra* note 8, at 1190-92. Legislative proposals to date, however, appear to favor rules which protect noninvestors. On July 13, 1983, Representatives Rodino and Seiberling introduced H.R. 3561, which would require the Assistant Attorney General or the Federal Trade Commission to determine the likelihood of certain acquisitions serving the public interest and whether or not judicial relief will be necessary to protect noninvestor constituencies. H.R. 3561, 98th Cong., 1st Sess. (1983).

stituencies should not be required of target management, nor should it even be allowed unless calculated to generate profits for shareholders. Since takeovers create wealth and benefit both shareholders and the economy in general, laws governing the takeover process should be structured to facilitate takeovers notwithstanding possible adverse consequences for noninvestors.

Current federal and state laws governing the takeover process will be discussed and analyzed before addressing the remaining issues which concern who should decide whether or not to oppose a tender offer and how the existing regulatory framework should be amended.

IV. CURRENT TENDER OFFER REGULATION

A. *The Williams Act*

The Williams Act was enacted by Congress in 1968 to regulate the flurry of activity in the market for corporate control.[127] The Act was a federal legislative response "to the increased use of cash tender offers in corporate acquisitions, a device that had 'removed a substantial number of corporate control contests from the reach of existing disclosure requirements of the federal securities laws.' "[128] Congress intended the Williams Act to ensure that the bidder and the target furnish target shareholders with a full and fair disclosure of information within a sufficient period of time to allow the share-

127. Securities Exchange Act of 1934, §§ 13(d)-(e), 14(d)-(f), 15 U.S.C. §§ 78m(d)-(e), n(d)-(f) (1986).

128. Edgar v. Mite Corp., 457 U.S. 624, 632 (1982) (quoting Piper v. Chris-Craft Indus., Inc., 430 U.S. 1, 22 (1977)). Former Senator Williams, sponsor of the Williams Act, explained the need for such legislation as follows:

> By use of a cash tender offer the person seeking control can operate in almost complete secrecy. He need not state the source of his funds; who his associates are; why he wants to acquire control of the corporation; and what he intends to do with it if he gains control.
>
> Today, the public shareholder in deciding whether to reject or accept a tender offer possesses limited information. No matter what he does, he acts without adequate knowledge to enable him to decide rationally what is the best course of action. This is precisely the dilemma which our securities laws are designed to prevent.
>
> The competence and integrity of a company's management, and of the persons who seek management positions, are of vital importance to stockholders. Secrecy in this area is inconsistent with the expectations of investors and impairs public confidence in our Nation's securities markets.

113 CONG. REC. 24,664 (1967) (remarks of Sen. Williams).

holders to make an informed decision about the offer.[129] The Williams Act is intended to "protect the investor not only by furnishing him with the necessary information but also by withholding from management or the bidder any undue advantage that could frustrate the exercise of an informed choice."[130] Thus, the Williams Act is intended to be neutral toward takeovers and attempts to treat bidders and targets evenhandedly.

The Williams Act requires persons who acquire five percent or more of a target's stock to file a disclosure statement within ten days of the acquisition.[131] The disclosure statement must include information about the bidder's background, financing plans and proposals for the target.[132] The offer must be held open for a minimum of twenty days,[133] and shareholders have the right to withdraw tendered shares within stated time periods.[134] If a tender offer is made for less than all of the securities of a particular class, and more than the number of shares bid for are tendered, the bidder must purchase the tendered shares on a pro rata basis.[135] Target management must disclose its position with respect to the tender offer within ten days after its commencement.[136] The Williams Act also prohibits fraudulent, deceptive and manipulative practices in connection with any tender offer.[137]

Although the Williams Act has succeeded in furnishing target shareholders with information concerning the tender offer, it has generally failed to ensure evenhanded treatment of bidders and targets. Rather than simply disclosing its position with respect to tender offers to the shareholders, target management often opposes tender offers and through defensive tactics attempts to prevent them from ever reaching the shareholders.[138] Thus, target management has a

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129. H. REP. No. 1711, 90th Cong., 2d Sess. 2 (1968), *reprinted in* 1969 U.S. CODE CONG. & ADMIN. NEWS 2811.

130. *Mite*, 457 U.S. at 634.

131. 15 U.S.C § 78n(d)(1) (1982).

132. Rule 14d-6, 17 C.F.R. § 240.14d-6 (1987).

133. Rule 14e-1, 17 C.F.R. § 240.14e-1 (1987).

134. Rule 14d-7(a)(1), 17 C.F.R. § 240.14d-7(a) (1987).

135. Rule 14d-8, 17 C.F.R. § 240.14d-8 (1985).

136. 17 C.F.R. § 240.14d-9(e)(3) (1985).

137. 17 C.F.R. § 240.14(e), 15 U.S.C. § 78n(e) (1982). The Act expressly proscribes any untrue statement of a material fact or omission of fact with respect to a tender offer. *Id.*

138. *See supra* text accompanying notes 15-22. One such defensive tactic which can prevent the tender offer from reaching target shareholders is the poison pill. The hallmark of most poison pills is the severe and immediate equity dilution

distinct advantage over the bidder because of its power to resist the bidder's offer. Therefore, the Williams Act would have to be amended in order to achieve its original goals. However, reform aimed at achieving neutrality and evenhandedness would be misdirected. Rules governing takeovers should operate to achieve what is most beneficial for the corporation, its owners and the economy rather than attempt to lay down neutral rules for combatants on a corporate battleground. Thus, laws governing takeovers should operate to facilitate rather than remain neutral toward tender offers.

In addition to redirecting the overall aim of the Williams Act to encourage tender offers, certain technical provisions of the Williams Act should also be amended. Under the prevailing rule, initial bidders are allowed to purchase up to five percent of a target company's stock prior to filing a disclosure statement with the Securities and Exchange Commission. Once this threshold amount is reached, the bidder has ten days to file.[139] Hence, a bidder can purchase five percent of a target company's stock and continue to make purchases during what is commonly referred to as the "ten day window of opportunity."[140] It is suggested that the ten day window be closed because it defeats the purpose of having a threshold at any level. In addition, the twenty day minimum offering period has been criticized as being too short a period to allow full evaluation and negotiation of a tender offer.[141] It is suggested that federal legislation designed to promote tender offers would require a longer minimum offering period.

B. *The Business Judgment Rule*

Although the disclosure requirements and timing rules for making tender offers are governed by federal law under the Williams

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inflicted upon a potential acquiror. Thus, the poison pill serves as a deterrent to any tender offer which has not been negotiated and approved by a target board of directors. *See, e.g.*, Horwitz v. Southwest Forest Indus., Inc., 604 F. Supp. 1130, 1132-33 (D. Nev. 1985) (poison pill serves to render merger with target company unfeasible). *See generally* Matheson & Norburg, *Hostile Share Acquisitions and Corporate Governance:A Framework for Evaluating Antitakeover Activities*, 47 U. PITT. L. REV. 407 (1986) (authors provide comprehensive discussion of deterrence aspects of defensive tactics in general, and poison pills specifically).

139. 15 U.S.C. § 78n(d)(1) (1982).

140. See 15 U.S.C. §§ 78m(d), 78n(d) (1982). *See also* Goelzer, *Disclosure and Preliminary Negotiations*, 46 MO. L. REV. 974, 979 (1987).

141. H.R. REP. No. 98-1028, 98th Cong., 2d Sess., *Equity in Foreign and Domestic Credit and Tender Offer Reform*, Report to accompany H.R. 5693 (Sept. 7, 1984) (submitted by Mr. Dingell).

Act,[142] the conduct of target management in preparing for or responding to a tender offer is largely governed by state law.[143] Under the present corporate governance system, shareholders act through elected directors who are fiduciaries bound by the duties of care and loyalty.[144] The duty of care is a common law principle, now codified in many states, requiring a director to perform his functions in good faith, in a manner in which he reasonably believes to be in the best interest of the corporation and with such care as an ordinarily prudent person in a like position would use under similar circumstances.[145] Judicial inquiry into director compliance with the duty of care is limited by the business judgment rule,[146] which insulates directors from liability for losses that result from honest errors in judgment and relieves the courts of the burden of judging the propriety of complex business decisions.[147] The duty of loyalty requires directors

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142. *See supra* notes 127-41 and accompanying text. Discussion of state statutes regulating tender offers is beyond the scope of this article. *See generally* Bartell, *State Take-Over Laws: A Survey*, Ninth Annual Institute on Securities Regulation 499 (1978). Although the United States Supreme Court's decision in Edgar v. Mite, 457 U.S. 624 (1982), cast doubt upon the constitutionality of many such state statutes, a more recent United States Supreme Court decision upheld an Indiana antitakeover control share statute. *See* CTS Corp. v. Dynamics Corp. of Am., 107 S. Ct. 1637 (1987).

143. Some commentators have called for the federalization of corporate law in light of the alleged inadequacy of state law. *See* Jennings, *Federalization of Corporate Law: Part Way or All the Way*, 31 BUS. LAW. 991 (1976) (state laws used by management for entrenchment purposes).

144. Aronson v. Lewis, 473 A.2d 805, 811 (Del. 1984).

145. *See* N.Y. Bus. Corp. Law § 717 (McKinney Supp. 1986). *See also* MBCA § 8.01. The MBCA provides: "A director shall perform his duties as a director, including his duties as a member of any committee of the board upon which he may serve, in good faith and with that degree of care which an ordinarily prudent person in a like position would use under similar circumstances."

146. Auerbach v. Bennett, 47 N.Y.2d 619, 629, 419 N.Y.S.2d 920, 926 (1979). The business judgment rule has been the subject of extensive discussion by commentators. *See generally* Block & Miller, *The Responsibilities and Obligations of Corporate Directors in Takeover Contests*, 11 SEC. REG. L.J. 44 (1982); Brown, *Recent Developments Relating to the Business Judgment Rule*, 6 DEL. J. CORP. L. 538 (1981); 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); Walsh, *Defensive Tactics and the Fiduciary Obligations of the Target Board of Directors*, 7 J. CORP. L. 579 (1982).

147. *See Auerbach*, 47 N.Y.2d at 630, 419 N.Y.S.2d at 926. The business judgment rule has been justified on several grounds. First, it affords directors the necessary discretion to make business decisions while acting as fiduciaries. Second, it protects directors from personal liability for honest errors in judgment. *See* Cramer v. General Tele. & Elec. Corp., 582 F.2d 259, 274 (3d Cir. 1978), *cert. denied*, 439 U.S. 1129 (1979). Finally, it relieves courts from the burden of second-guessing complex business decisions, a task which they are ill-equipped to handle. *See* Joy

to act for the benefit of the corporation and prohibits them from having an interest in the transaction.[148] If it is shown that the directors had an interest in the transaction, or acted in bad faith or for some improper purpose, the protection of the business judgment rule cannot be invoked.[149]

Once a tender offer has been rejected or successfully resisted by target management, it seems inevitable that lawsuits filed by disgruntled shareholders will follow.[150] Many shareholders charge that management is more concerned with entrenching itself than with maximizing shareholder profits.[151] For this reason, most tender offers pose a conflict of interest for target management.[152] Target management is typically faced with the dilemma of choosing between approving the tender offer, enabling the shareholders to sell their stock at a substantial premium over the market price but risking their own displacement,[153] or opposing the tender offer and defending against inevitable lawsuits filed by shareholders, but retaining control.

Traditionally, most courts found that responses to tender offers and tactics adopted to deter them were like any other business decision made by directors, and therefore within the province of the business judgment rule.[154] The business judgment rule was routinely applied to such decisions as a presumption that the directors acted properly and in good faith.[155] To overcome the presumption, the plaintiff was

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v. North, 692 F.2d 880, 886 (2d Cir. 1982), *cert. denied*, 460 U.S. 1051 (1983). *See generally* Arsht, *The Business Judgment Rule Revisited*, 8 HOFSTRA L. REV. 93 (1979) (opining that the business judgment rule is misunderstood by critics distrustful of state corporate laws who suggest it promises more in the way of immunity from liability than it really does).

148. *See* Guth v. Loft, Inc., 23 Del. Ch. 255, 270, 5 A.2d 503, 510 (1939); Litwin v. Allen, 25 N.Y.S.2d 667, 677 (Sup. Ct. 1940).

149. Treadway Cos. v. Care Corp., 638 F.2d 357, 383 (2d Cir. 1980).

150. *See* Lipton, *supra* note 8, at 101.

151. *See* Feinberg, *The Directors' Dilemma in the Takeover Crisis: A Special Report*, Institutional Investor 32 (June 1979).

152. This conflict of interest was recognized and acknowledged by the Delaware Supreme Court in Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985). *See infra* notes 161-73 and accompanying text.

153. *See* McCord, *Limiting Defensive Tactics in Tender Offers: A Model for the Protection of Shareholder Decisionmaking*, 21 HARV. J. LEGIS. 489 (1984).

154. *See, e.g.*, Jewel Cos. v. Pay Less Drug Stores Northwest, Inc., 741 F.2d 1555, 1560 (9th Cir. 1984) (target board's decision to negotiate a merger transaction with another corporation shielded under the business judgment rule). Indeed, courts have made clear that once a target board concludes that a takeover proposal is detrimental to the corporation and its shareholders, it is the directors' duty to oppose it. *See* Hewitt v. Baird, 507 F.2d 1167 (1st Cir. 1977).

155. *See, e.g.*, Moran v. Household Int'l, Inc., 500 A.2d 1346 (Del. 1985)

required to show that the directors acted improperly or in bad faith.[156] Such an evidentiary burden was not only difficult to sustain, but courts were loathe to bar application of the business judgment rule even upon a clear showing of blatant conflicts of interest.[157] However, because of the potential for conflict of interest, many urge that it is inappropriate to extend the protection of the business judgment rule to actions taken by target management in the context of an actual or threatened takeover.[158] Some critics believe that the business judgment rule allows management to carry out disguised programs of resistance in order to retain control of the corporation.[159] Although some courts are beginning to acknowledge the inherent conflict of interest problem,[160] the business judgment rule remains an unsatisfactory standard by which to judge actions taken by target management in corporate control transactions.[161]

C. *Management Entrenchment*

In *Norlin Corp. v. Rooney Pace, Inc.*,[162] the Second Circuit found that the purpose of target management's transfer of newly-issued stock to a newly-created employee stock option plan shortly after an unfriendly suitor began buying large blocks of the company's stock was "not to benefit the employees but rather to solidify management's control of the company."[163] Having failed to prove that the trans-

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(adoption of poison pill defense as preventive mechanism protected by business judgment rule).

156. *See, e.g.*, *Treadway Cos.*, 638 F.2d at 382 (initial burden of proving director's interest or bad faith always rests with the plaintiff); Hanson Trust PLC v. ML SCM Acquisitions, Inc., 781 F.2d 264 (2d Cir. 1986) (under New York law, initial burden rests with plaintiff).

157. Note, *The Misapplication of the Business Judgment Rule in Contexts for Corporate Control*, 76 Nw. U.L. REV. 980, 1013-14 (1982).

158. *See* Bebchuk, *supra* note 8, at 1054-55; Easterbrook & Fischel, *supra* note 8, at 1175. On the other hand, Martin Lipton supports the traditional application of the business judgment rule and also argues that directors have no duty to accept a takeover bid even at a substantial premium over the market price. Lipton, *supra* note 8, at 109.

159. *E.g.*, Easterbrook & Fischel, *supra* note 8, at 1203 (timing of defensive tactics by directors useful in determining whether the directors are fulfilling their fiduciary duties).

160. *See, e.g.*, Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985).

161. *See* Gelfond & Sebastian, *Reevaluting the Duties of Target Management in a Hostile Tender Offer*, 60 B.U. L. REV. 403 (1980); Note, *Tender Offer Defensive Tactics and the Business Judgment Rule*, 58 N.Y.U.L. REV. 621 (1983).

162. 744 F.2d 255 (2d Cir. 1984).

163. *Id.* at 265. The court characterized the employee stock option plan as a "tool of management self-perpetuation." *Id.* at 266.

action was fair and reasonable in order to overcome the prima facie showing of self-interest, target management was found to have breached its duty of loyalty.[164] The court properly noted that the business judgment rule does not apply where directors are shown to have an interest in the transaction.[165] The court observed that "[o]nce self-dealing or bad faith is demonstrated, the duty of loyalty supercedes the duty of care, and the burden shifts to the directors to prove that the transaction was fair and reasonable to the corporation."[166] This decision represents a proper rejection of the business judgment rule and application of the duty of loyalty where a conflict of interest is shown. However, Norlin Corporation's directors would have enjoyed the protection of the business judgment rule if the transaction was deemed fair and reasonable despite a showing of self-interest.[167] Although the *Norlin* court was one of the first to recognize that defensive tactics adopted by target management may actually be management entrenchment schemes, it implicitly condoned management entrenchment efforts which can survive a showing of fairness and reasonableness. Such a rule tends not only to erode the fiduciary principles of corporate governance, but also to preclude the maximization of corporate wealth.

The Delaware Supreme Court, recognizing that target management may have an entrenchment motive in opposing a hostile takeover, has also begun to shift the initial burden of proof to the directors of the target company to show that they have fulfilled their duty of loyalty before being afforded the protection of the business judgment rule. This heightened sensitivity to the conflict of interest problem was first demonstrated in *Unocal Corp. v. Mesa Petroleum Co.*[168] In that case, the Unocal board of directors reacted to a hostile two-tier cash tender offer[169] made by a minority shareholder, Mesa Petroleum,[170] by effecting a self-tender offer which excluded Mesa

164. *Id.* at 266.
165. *Id.* at 265.
166. *Id.* (citations omitted).
167. *Id.* at 266.
168. 493 A.2d 946 (Del. 1985).
169. A two-tier tender offer involves an offer to acquire 100% of the target company in two steps with a two-tier pricing arrangement. The price offered in the first step is usually higher than that offered in the second step. Thus, the offer is usually referred to as "front-loaded." *See* Comment, *Front-End Loaded Tender Offers: The Application of State Law to an Innovative Corporate Acquisition Technique*, 132 U. PA. L. REV. 389 (1982).
170. T. Boone Pickens is the principle shareholder of Mesa Petroleum.

Petroleum from participation.[171] Unocal's self-tender offer was designed to either defeat Mesa Petroleum's inadequate offer or at least to provide 49% of the shareholders with senior debt rather than junk bonds if Mesa Petroleum's offer succeeded.[172]

Although the Delaware Supreme Court stated that decisions made by the board of directors of a target company in response to a pending takeover bid are no different from other board decisions and are entitled to the same degree of judicial deference,[173] it determined that "[b]ecause of the omnipresent specter that a board may be acting primarily in its own interests, rather than those of the corporation and its shareholders, there is an enhanced duty which calls for judicial examination at the threshold before the protections of the business judgment rule may be conferred."[174] The court stated that to satisfy the threshold examination, the directors would be required to prove that they had "reasonable grounds for believing that a danger to corporate policy and effectiveness existed."[175] This burden is met "by showing good faith and reasonable investigation."[176] In addition, the court required that the actions taken by the target directors be "reasonable in relation to the threat posed" in order to be protected by the business judgment rule.[177] The court summarized its position as follows: "[U]nless it is shown by a preponderance of the evidence that the directors' decisions were primarily based on perpetuating themselves in office, or some other breach of fiduciary duty . . . a Court will not substitute its judgment for that of the board."[178] Thus, although the court acknowledged the inherent conflict of interest problem and imposed the initial burden of proof upon the target directors, the court will refuse to apply the business judgment rule only if entrenchment was the primary motive of target management.[179] In finding that Unocal

171. *Unocal*, 493 A.2d at 950-51. The validity of the discriminatory self-tender exchange offer has been called in question in light of the SEC's recent enactment of the All-Holders Rule.

172. *Id.* at 951.

173. *Id.* at 954. *Accord* Lipton, *supra* note 8, at 131.

174. *Unocal*, 493 A.2d at 954.

175. *Id.* at 955.

176. *Id.* According to the court, the burden becomes easier to meet when a majority of the directors are both independent and disinterested. *Id.*

177. *Id.* This has come to be known as the "balance" requirement in that the medicine (defense) cannot be disproportionate to the disease (acquisition technique).

178. *Id.* at 958.

179. *Id.*

fulfilled its fiduciary duties and was entitled to the protection of the business judgment rule, the court vacated a preliminary injunction which would have prohibited Unocal from proceeding with its self-tender offer.[180] Presumably, where entrenchment clearly exists as a motive which is inconsistent with the duty of loyalty, but is not the primary motive, the court will not find that the directors breached their fiduciary duty.

Following its ruling in *Unocal*, the Delaware Supreme Court imposed the initial burden of proof on the target board in *Moran v. Household International, Inc.*[181] In *Moran*, shareholders brought suit to invalidate a poison pill rights plan adopted by the target board as a deterrent device in anticipation of a hostile takeover.[182] As in *Unocal*, the court required the Household board to show that it acted in good faith and made a reasonable investigation, and that the defensive mechanism adopted was reasonable in relation to the threat posed.[183] The *Moran* court distinguished this case from *Unocal* because Household adopted a defensive mechanism to deter possible hostile takeovers rather than to defend against a pending takeover bid.[184] Implying that actions taken by a target board in anticipation of a hostile takeover will receive less judicial scrutiny, the court stated that there is less risk that management will fail to exercise reasonable business judgment when it adopts defensive mechnisms in advance of possible hostile tender offers.[185] On the other hand, the court apparently did not consider the fact that it might be giving less scrutiny to management entrenchment schemes which a target board has had more time to devise.

While the court has granted a target board the benefit of the doubt in its adoption of defensive tactics, it has shown a willingness to enjoin some tactics which were egregiously detrimental to target shareholders. In *Revlon, Inc. v. MacAndrews & Forbes Holdings*,[186] the Revlon board adopted a poison pill plan and announced an exchange

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180. *Id.* at 959.

181. 500 A.2d 1346 (Del. 1985).

182. *Id.* at 1348-49. The plan, known as a "Preferred Share Purchase Rights Plan," entitled target shareholders to purchase $200 worth of the prospective acquiror's common stock for $100 in the event that a merger or consolidation occurred. *Id.*

183. *Id.* at 1356-57.

184. *Id.* at 1350.

185. *Id.*

186. 506 A.2d 173 (Del. 1986).

offer for approximately one-fourth of its outstanding shares in response to a hostile takeover bid by Pantry Pride.[187] Pantry Pride's acquisition strategy involved "junk bond" financing followed by the break-up and sale of Revlon's assets.[188] While Pantry Pride continued to increase the amount of its bids for Revlon, the Revlon board agreed to a leveraged buyout by a white knight, Forstmann Little, whose acquisition plans also involved the sale of certain Revlon assets.[189] In response to higher bids made by Pantry Pride, Revlon granted a lock-up option and no-shop clause to Forstmann Little.[190]

The court applied the standards set forth in *Unocal* and upheld the poison pill and the exchange offer.[191] With regard to the board's other actions, however, the court stated:

> [Once] it became apparent to all that the break-up of the company was inevitable . . . the duty of the board . . . changed from the preservation of Revlon as a corporate entity to the maximization of the company's value at a sale for the stockholders' benefit. . . . The directors' role changed from defenders of the corporate bastion to auctioneers charged with getting the best price for the stockholders at a sale of the company.[192]

Thus, the court held that Revlon's "auction-ending lock-up agreement with Forstmann" constituted a breach of the directors' duty of loyalty.[193] In determining that the Revlon board did not properly fulfill its obligation to conduct an auction for control of the company, the court found that Pantry Pride was not accorded the same treatment as Forstmann Little.[194] Unlike Pantry Pride, Forstmann was given the advantage of cooperation from management, access to information and the opportunity to present merger proposals directly to the board.[195] Accordingly,

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187. *Id.* at 176-79.
188. *Id.* at 177.
189. *Id.* at 178-79.
190. *Id.* at 178.
191. *Id.* at 181.
192. *Id.* at 182.
193. *Id.*
194. *Id.* at 184.
195. *Id.* The court stated that

> [f]avoritism for a white knight to the total exclusion of a hostile bidder might be justifiable when the latter's offer adversely affects shareholder interests, but when bidders make relatively similar offers, or dissolution of the company becomes inevitable, the directors cannot fulfill their enhanced *Unocal* duties by playing favorites with the contending factions.

Id.

the court enjoined the lock-up option and the no-shop clause.[196]

D. *Corporate Due Process*

Not only have some courts begun to modify their application of the business judgment rule, but they have also begun to superimpose what may be termed a "corporate due process standard" on the decision-making process of a target board facing an actual or threatened takeover bid. The Delaware Supreme Court announced the corporate due process standard which a target board must meet in order to invoke the protection of the business judgment rule in *Smith v. Van Gorkom*.[197] In *Smith*, the chief executive officer of Trans Union Corporation, Jerome Van Gorkom, approached Marmon Group, Inc., controlled by the Pritzker family, with a plan to accomplish a cash-out merger of Trans Union into one of Marmon's wholly-owned subsidiaries.[198] The proposed cash-out merger would allow Trans Union to sell investment tax credits from which Trans Union could not otherwise benefit.[199] Pritzker made an offer based on Van Gorkom's suggested price of $55 per share and gave Trans Union seventy-two hours to accept.[200] The board of directors was called to meet on one day's notice without being told the purpose of the meeting.[201] The meeting, which lasted for two hours, included a twenty-minute presentation by Van Gorkom.[202] No copies of the merger agreements or any related documents were distributed for the board to review before voting on the proposal.[203] Investment bankers were not consulted to prepare a valuation study or a fairness opinion.[204] An agreement was reached the same day between Van Gorkom and Pritzker during an intermission at the opera.[205] Neither Van Gorkom nor any other director read the merger agreement prior to its execution.[206] The shareholders subsequently approved the

196. *Id.* at 185.
197. 488 A.2d 858 (Del. 1985).
198. *Id.* at 866-67.
199. *Id.* at 864-65.
200. *Id.* at 867.
201. *Id.*
202. *Id.* at 868-69.
203. *Id.* at 867.
204. *Id.*
205. *Id.* at 869.
206. *Id.*

cash-out merger at the $55 price which would have provided the shareholders with a premium of nearly fifty percent over the market price.[207]

The court presumed that the directors had fulfilled their duty of loyalty because there were no allegations of fraud, bad faith or self-dealing.[208] However, the court found that the directors breached their duty of care because they

> (1) did not adequately inform themselves as to Van Gorkom's role in forcing the "sale" of the Company and in establishing the per share purchase price;
> (2) were uninformed as to the intrinsic value of the Company; and
> (3) given these circumstances, at a minimum, were grossly negligent in approving the "sale" of the Company upon two hours' consideration, without prior notice, and without the exigency of a crisis or emergency.[209]

The court remanded the case to the court of chancery to "conduct an evidentiary hearing to determine the fair value of shares represented by the plaintiffs' class based on the intrinsic value of Trans Union" and to enter an award of damages equal to "the extent that the fair value of Trans Union exceeds $55 per share."[210]

Although the *Van Gorkom* decision has been harshly criticized,[211] the court noted the similarity of the facts and holding to an earlier case, *Gimbel v. Signal Oil*.[212] In *Signal*, the board was given three days to respond to an offer to purchase one of its subsidiaries.[213] A board meeting was called on one-and-a-half days' notice without informing its outside directors of the purpose of the meeting.[214] The board failed to obtain a current appraisal of its assets and approved a sale of assets worth $480 million during a meeting which lasted only a

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207. *Id.* at 870.
208. *Id.* at 873.
209. *Id.* at 874.
210. *Id.* at 893.
211. *See* Fishel, *The Business Judgment Rule and the* Trans Union *Case*, 40 BUS. LAW. 1437, 1455 (1985) [hereinafter Fishel] ("surely one of the worst decisions in the history of corporate law").
212. 316 A.2d 599 (Del. Ch.), *aff'd*, 316 A.2d 619 (Del. 1974).
213. *Id.* at 612.
214. *Id.*

few hours.[215] Notwithstanding the sophistication and experience of the board, the court found that the board had violated its fiduciary duties.[216]

Delaware courts have not been alone in refusing to extend the protections of the business judgment rule to an "uninformed" decision made by a target board of directors. In *Hanson Trust PLC v. ML SCM Acquisition, Inc.*,[217] a case decided by the Second Circuit Court of Appeals, SCM, desiring to discourage a hostile tender offer by Hanson Trust, granted to Merrill Lynch, a white knight, a "crown jewel" lock-up option[218] to buy SCM's two most profitable businesses.[219] The SCM directors granted the lock-up option after meeting for only three hours and relied upon their financial advisor's opinion that the option prices were within a range of fair value when in fact such a range of value was never calculated.[220] The financial advisor never prepared a written opinion of the value of the two optioned businesses.[221]

The SCM directors failed to make several important inquiries, according to the Second Circuit. First, they never attempted to determine the top value of the two businesses.[222] Second, the SCM directors did not ask why the two businesses which generated half of the corporation's total profits were being sold for only one-third of the total purchase price of the entire corporation under the terms of a leveraged buyout merger agreement with Merrill Lynch.[223] Finally, they never considered the consequences for the corporation if the lock-up option was exercised.[224]

Although the court determined that the actions of the SCM directors did not rise to the level of gross negligence found in *Van Gorkom*,[225] it held that the SCM directors breached their duty of care

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215. *Id.*
216. *Id.* at 613-14.
217. 781 F.2d 264 (2d Cir. 1986).
218. *Id.* at 266. *See supra* note 16.
219. *Hanson Trust*, 781 F.2d at 267. The two businesses generated approximately 50% of SCM's net operating income over the past several years. *Id.*
220. *Id.* at 271.
221. *Id.*
222. *Id.* at 275.
223. *Id.*
224. *Id.*
225. *Id.*

under New York law by failing to exercise "reasonable diligence."[226] The court reasoned that "directors have some oversight obligations to become reasonably familiar with an opinion, report or other source of advice before becoming entitled to rely on it."[227] The SCM directors not only failed to "read or review carefully" the proposed agreements but also baldly relied upon oral opinions as to fairness.[228] The court noted that had the SCM directors inquired into the range of fair values for the optioned assets, they might have discovered that the optioned assets were more valuable than the strike price of the lock-up options given to Merrill Lynch.[229] As a result of "the SCM directors' paucity of information and their swiftness in decision-making," the court refused to extend the protection of the business judgment rule.[230]

E. *Conclusion*

The Williams Act was intended to provide full and fair disclosure to shareholders to enable them to make an informed decision with respect to a tender offer.[231] However, defensive tactics adopted by the target board of directors often prevent the tender offer from reaching the shareholders.[232] Moreover, the target board of directors is often afforded the protection of the business judgment rule even though it has an inherent conflict of interest in the transaction.[233] Its decision will have a greater economic impact on the shareholders than many other actions which require prior shareholder approval.[234] Although some courts are becoming more sensitive to the conflict of interest problem and are giving more weight to evidence of entrenchment,[235] abuses by target management continue. Even courts

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226. *Id.* at 274.

227. *Id.* at 275.

228. *Id.* at 276.

229. *Id.*

230. *Id.* at 275. According to the court, "while directors are protected to the extent that their actions evidence their business *judgment*, such protection assumes that courts must not reflexively decline to consider the content of their 'judgment' and the extent of the information on which it is based." *Id.*

231. *See supra* notes 129-30 and accompanying text.

232. *See supra* note 138 and accompanying text.

233. *See supra* notes 142-61 and accompanying text.

234. *See* DEL. CODE ANN. tit. 8, § 242 (1983) (shareholder approval required to amend certificate of incorporation); *id.* § 251 (shareholder approval required to merge or consolidate); *id* § 271 (shareholder approval reuired to sell, lease or exchange all or substantially all of the corporation's assets).

235. *See, e.g.*, Mesa Petroleum Co. v. Unocal Corp., 493 A.2d 946 (Del. 1985)

which recognize the conflict of interest problem approve of defensive measures which were designed in part to entrench management, as long as entrenchment was not the primary motive.[236]

The recent emphasis on proper boardroom procedures not only undermines the business judgment rule, but also primes target boards for ritualistic decision making. The business judgment rule is based in part on the fact that courts are ill-equipped to review business decisions. Presumably, they are also ill-equipped to review the procedures which businessmen follow to reach business decisions. Many prudent businessmen do not rely upon elaborate procedures or outside consultants to reach sound business decisions. A judicially imposed corporate due process standard for the target boardroom will both burden the business decision making process and allow target management to accomplish entrenchment schemes more easily by engaging in perfunctory procedures solely to pass judicial muster. A target board is now more likely to be able to successfully accomplish an entrenchment scheme by going through the motions of obtaining a written fairness opinion from an outside consultant, meeting over a period of days rather than hours to discuss the transaction and actually reading and reviewing the information upon which they are supposedly relying and the agreements necessary to effect the transaction.[237]

In light of present widespread abuses of power by target management and the inherent conflict of interest problem, it is recommended that new federal legislation be adopted to protect target shareholders. The business judgment rule, as applied to takeovers, has simply failed in this regard. The Williams Act has not achieved its original goal of evenhandedness. Federal law would better serve shareholders and the national economy if its underlying policy were to promote tender offers rather than remain neutral toward them. Furthermore, tender offers affect the national securities markets which are appropriately governed by the federal government rather than by the individual states. The rules governing tender offers in the United Kingdom may serve as a foundation for developing certain aspects

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(acknowledging inherent conflict of interest in takeover situations, but refusing to find entrenchment motive in director's decision to adopt a selective self-tender offer which excluded the hostile bidder from participation).

236. *Id.*

237. *See* Fischel, *supra* note 211, at 1453 (after *Van Gorkom*, no firm will consummate a corporate control transaction without first obtaining a fairness letter from an outside consultant).

of new federal legislation in the United States. Therefore, before discussing proposals for reform of tender offer regulation in the United States, the British system of tender offer regulation will be discussed briefly.

V. BRITISH TENDER OFFER REGULATION

In the United Kingdom, tender offers are governed by the City Code on Take-Overs and Mergers which is administered by a non-governmental entity known as the Panel on Take-Overs and Mergers.[238] Like the Williams Act, the City Code is designed to provide disclosure with respect to a tender offer to target shareholders and the investing public.[239] Unlike the Williams Act, however, the City Code recognizes target management's conflict of interest and prevents them from frustrating tender offers.[240]

Under the British rules, responding to a tender offer is considered an incident of share ownership—an aspect of the shareholder's property right.[241] Accordingly, General Principle 4 of the City Code provides that:

> [a]t no time after a bona fide offer has been communicated to the board of an offeree company or after the board of an offeree company has reason to believe that a bona fide offer might be imminent shall any action be taken by the board of the offeree company in relation to the affairs of the company, without the approval in general meeting of the shareholders of the offeree company, which could effectively result in any bona fide offer being frustrated or in the shareholders of the offeree company being denied an opportunity to decide on its merits.[242]

Thus, in the United Kingdom, if a takeover bid is pending or appears imminent, the target board cannot adopt defensive measures without the approval of a majority of its shareholders.[243]

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238. The City Code on Take-Overs and Merger for the Securities Industry, 5th rev. ed. 1981) [hereinafter City Code].

239. *See* Demott, *Current Issues in Tender Offer Regulation: Lessons From the British*, 58 N.Y.U. L. REV. 945, 959 (1983) [hereinafter Demott].

240. Another goal underlying the City Code which distinguishes it from the Williams Act is the equality in the treatment of target company shareholders. *See id.* at 960.

241. *Id.* at 1014.

242. City Code, *supra* note 238, rule 4.

243. *Id.*, rule 38.

Rule 38 of the City Code, promulgated under General Principal 4, requires shareholder approval for the adoption of many defensive tactics which are commonly adopted by target companies in the United States without shareholder approval.[244] These restricted transactions include the sale or acquisition of significant corporate assets and the issuance of authorized but unissued shares.[245] Defensive tactics adopted prior to the threat of a hostile takeover bid, however, appear to be as unrestricted in the United Kingdom as they are in the United States.[246]

Once a tender offer is made, the City Code requires target management to obtain competent independent advice about the offer and disclose that information to the shareholders.[247] Although the British rules require that outside independent advice be given to shareholders, incumbent management is permitted to negotiate with prospective white knights and disclose its views on the tender offer to the shareholders.[248]

VI. PROPOSALS FOR REFORM

A. *Shareholder Approval*

Because target management has a troublesome conflict of interest problem in most takeovers, federal legislation should prohibit management's involvement in all aspects of the tender offer process.[249] The decision to accept or reject a takeover bid is fundamental to the shareholders' investment in the target corporation.[250] Defensive

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244. *Id.* In the United States, defensive tactics typically adopted without shareholder approval include the poison pill, pac-man, crown jewel, and lock-up options. In fact, the only defensive tactics which must be aproved by shareholders are "shark repellants" or charter amendments. *See* DEL. CODE ANN. tit. 8, § 262 (1983).

245. City Code, *supra* note 238.

246. Shareholder approval of a defensive tactic is only required under the City Code if it is adopted while a takeover bid is pending or appears imminent. *See* Demott, *supra* note 239, at 1016.

247. City Code, *supra* note 238, rule 4.

248. *See* Demott, *supra* note 239, at 1016.

249. However, Martin Lipton contends that a tender offer does not present the type of self-interest conflict that warrants management abstention. Lipton, *supra* note 8, at 123, n.68.

250. As one court recently stated, corporate governance is predicated upon a division of powers between shareholders and the board of directors. The two basic attributes of common stock ownership are the right to vote and the right to make independent decisions concerning the purchase or shale of stock. *See* Minstar Acquiring Corp. v. AMF, Inc., 621 F. Supp. 1252 (S.D.N.Y. 1985). Certainly the

tactics or unilateral board decisions to reject a tender offer constitute an unwarranted infringement upon the exclusive province of the owners of the corporate entity.[251] To treat management's decision to resist a hostile takeover as just another business decision seriously undermines corporate governance and is not in the best interest of shareholders.[252] Thus, resistance to a tender offer should be prohibited unless approved by the shareholders. Although the directors of some target companies already delegate the tender offer decision to their shareholders without interference,[253] most directors oppose a tender offer because of their interest in retaining control of the company. The *Norlin* court stated that decisions affecting the ultimate destiny of a company should be made by its shareholders in accordance with democratic procedures.[254] Unfortunately, shareholders of large publicly traded corporations have little or no control over the ultimate destinies of the companies which they own.[255] Therefore, rather than allowing such decisions to be made by management under the mantle of the business judgment rule, the decisions should be submitted directly to the shareholders for their approval without interference from management. Since the shareholders are the real targets of a takeover bid, they should dictate the nature and degree of management's response.

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decision to accept or reject a takeover implicates the fundamental right of stock ownership.

251. The corporate laws in the United States universally endorse the concept that stockholders are the legal owners of the entity. While a board of directors is charged with the responsibility of managing the business affairs of the corporation, its powers are limited in the sense that a board may use its statutory authority only to decide those matters related to the corporation's business. *See* Eisenberg, *The Legal Roles of Shareholders and Management in Modern Corporate Decision Making*, 57 CALIF. L. REV. 1 (1969). Thus, it could be argued that a decision to adopt a defensive tactic, or reject a tender offer, in an effort to prevail in a battle for corporate control amounts to a decision far beyond that which is related to the corporation's "business." This type of decision can largely control the ultimate destiny of the corporation. As such, it should be left to the shareholders, for it is they who risk the investment in the corporation.

252. *See* E. BALLANTINE, PRIVATE CORPORATIONS § 97, 321 (1927). *Accord* 15 W. FLETCHER, CYCLOPEDIA OF THE LAW OF CORPORATIONS § 7063 (rev. ed. 1983).

253. *See Reliance Electric Doesn't Oppose Exxon's Proposal*, Wall St. J., June 13, 1979, at 6, col. 1.

254. *Norlin*, 744 F.2d at 258. In refusing to allow management to unilaterally adopt a defensive tactic, the court stated, "Were we to countenance that, we would be in effect approving a wholesale wrestling of corporate power from the heads of shareholders, to whom it is entrusted by statute, and into the hands of the officers and directors." *Id.* at 267.

255. *See supra* notes 9-12 and accompanying text.

The British rules prohibit a target board from adopting defensive measures without the approval of a majority of its shareholders if a takeover bid is pending or appears imminent.[256] The effect of a defensive tactic, however, is the same whether it is adopted prior to the threat of a takeover bid, in the midst of an imminent takeover bid or during a pending takeover bid. Any managerial action which frustrates a tender offer should be prohibited irrespective of when such action is taken, unless shareholder approval is obtained.

B. *Resolving Self-Interest: The Independent Committee*

Although the ultimate tender offer decision should rest with the shareholders without interference from management, shareholders are presumably not competent to evaluate or negotiate the transaction. Laws governing corporations in the United States presently allow directors to rely on the advice of outside experts,[257] but they are not required to seek outside advice. Under the British rules, target management is required to obtain competent independent advice with respect to pending takeover bids and disclose that information to the shareholders.[258] Assuming that target management has an inherent conflict of interest largely due to the high risk of displacment,[259] there is little reason why it should be allowed any role in the transaction other than disseminating information to the independent advisors. If permitted to negotiate with prospective white knights, incumbent managers would be free to secure for themselves, at the expense of shareholders, such benefits as consulting contracts, retirement plans, and severance payments, that they may not otherwise receive.[260]

The United Kingdom's requirement of using outside independent experts can be taken one step further to eliminate such risks.

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256. *See supra* text accompanying note 243.

257. *E.g.*, DEL. CODE ANN. tit. 8, § 141(e) (1984) (directors protected for reliance on records of the corporation, its books of account, and reports made to the corporation by its officers, independent certified public accountants, and appraisers); N.Y. BUS. CORP. LAW § 717 (1979) (directors entitled to rely upon information, reports, or statements presented by officers and employees of the corporation, counsel, public accountants, and committees of the board); MODEL BUSINESS CORP. ACT §§ 35, 48 (1977) (similar).

258. *See* Demott, *supra* note 239 at 1023.

259. *See supra* notes 152-53 and accompanying text.

260. *See* Easterbrook & Fischel, *supra* note 8, at 1180 n.49 (target management can misappropriate shareholder gains by accepting such "disguised bribes" in exchange for nonresistance to a takeover).

Once a tender offer is made or appears imminent, target managers should be required to remove themselves from the tender offer process entirely and concern themselves only with the day-to-day business affairs of the corporation. An independent committee of outside experts should be retained to evaluate, negotiate, and make recommendations to shareholders concerning all aspects of the bid.[261] Implementing an independent committee would also substantially reduce the potential for "greenmail."[262] Indeed, if allowed to control the decision, target management would hire such professionals anyway to evaluate the bid and possibly to structure defensive maneuvers.

Under the British rules, shareholders must also consent by majority vote to defensive tactics proposed by management while a tender offer is pending or appears imminent.[263] It is uncertain what effect the "Wall Street Rule"[264] would have on pre-tender offer defensive tactic proposals submitted for shareholder approval in the United States. It is possible that shareholders would either blindly approve of any defensive tactic that management proposed or simply sell their stock if dissatisfied.[265] Therefore, it is recommended that all defensive tactics proposed by management, whether prospective or reactive, be submitted to an independent committee for review. As with a tender offer, the independent committee would make recommendations to the shareholders concerning the nature and effect of the proposed defensive tactic.[266] The decision to accept or reject the proposed defensive tactic would be made by a majority of the shareholders. Although it may be argued that such a procedure adds undue costs, it accomplishes several important goals. First, it prevents the adoption of tactics designed wholly or in part to entrench management. Second, it avoids the adverse effects of the "Wall Street Rule" because the independent committee would control the voting process and the dissemination of information. Finally, it requires the ultimate decision to be made by the shareholders. The independent committee, therefore, will temporarily step into the shoes of target

261. *See* Wyser-Pratte, N.Y.L.J., June 4, 1979, at 25, col. 5 (suggests that an independent "takeover panel" oversee tender offers).

262. "Greenmail" is the practice of purchasing stock in a target company, threatening a hostile takeover, and receiving a large premium for the stock by the target company in exchange for agreeing not to purchase any target shares for a considerable period of time. Dann & DeAngelo, *Standstill Agreements, Privately Negotiated Stock Repurchases, and the Market for Corporate Control*, 11 J. FIN. ECON. 275 (1983).

263. City Code, *supra* note 238, rule 38.

264. *See supra* note 9 and accompanying text.

265. *See supra* notes 9-12 and accompanying text.

266. *See supra* notes 257-58 and accompanying text.

management for takeover matters and assume similar fiduciary duties to the shareholders. Furthermore, the independent committee would incur the same liability to shareholders as management would if a breach of fiduciary duties was revealed.

C. *Rejecting Managerial Passivity*

Assuming that "management" during a takeover battle consists of an independent committee of outside experts, what should their proper role be? Easterbrook and Fischel propose a theory of managerial passivity.[267] They argue that any resistence to a tender offer by management, even to trigger a bidding contest, decreases shareholder welfare.[268] Shareholders as a whole lose, they insist, by the amounts spent on resistance and overcoming resistance to tender offers.[269] Resistance, they contend, leads to higher bids and fewer tender offers; consequently, they argue that the economy will benefit from more takeovers, albeit at a lower price.[270] Much of their thesis is based on the premise that there is no incentive to be the first bidder for control of a corporation because of the substantial costs incurred in searching for an appropriate target.[271] The initial bidder incurs the costs of researching many companies, while subsequent bidders need only study the target firm identified by the initial bid.[272] Since subsequent bidders take a "free ride" on much of the research done by the initial bidder, no one will want to be the first bidder unless there is some other advantage to compensate for the search costs.[273]

There are several weaknesses in this argument. Evidence shows that search costs are but a fraction of one percent of the target's value.[274] Moreover, all but a nominal amount of these fees are often contingent on the success of the takeover.[275] It does not appear, therefore, that search costs deter prospective bidders from being first. Contrary to Easterbrook and Fischel's position, shareholders as a whole do not seem to lose when resistance leads to a higher bid.

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267. Easterbrook & Fischel, *supra* note 8, at 1164.
268. *Id.*
269. *Id.* at 1175.
270. *Id.* at 1177.
271. *Id.* at 1178.
272. *Id.* at 1177.
273. *Id.* at 1178-79.
274. Bebchuk, *supra* note 8, at 1037.
275. *Id.*

Assuming that takeovers generally create wealth, any premium paid regardless of resistance efforts represents anticipated gains to result mostly from either synergy or replacing inefficient management.[276] Professor Bebchuk criticizes managerial passivity in part because it bars solicitation of a white knight.[277] This particular criticism is unpersuasive because a white knight may simply be a firm willing to provide greater autonomy, soft jobs, or large severance arrangements at the expense of target shareholders.[278] Bebchuk more persuasively contends, however, that the initial offeror may not be the firm that attaches the highest value to the target's assets.[279] Indeed, it is axiomatic that the firm which makes the highest bid values the target the most. Presumably, that firm will also be the most efficient user of those assets. Professor Coffee suggests that the absence of competing bids under a "zero premium policy" may prevent assets from moving to the most efficient user of the assets.[280] Although a rule of managerial passivity would certainly reduce transaction costs,[281] it is undesirable primarily because it prevents the target from being acquired by another firm which could make better use of the assets and pay a correspondingly higher premium.[282]

D. *Proposed Rule of Auctioneering*

Professor Bebchuk presents a convincing case for a rule of auctioneering.[283] He endorses regulations that provide time for competing bids. Tender offer premiums will be increased, he contends, by ensuring that no acquisition will occur before other bidders have had time to advance a competing bid.[284] The target will then presumably be acquired by the firm that values it the most.[285] Although the Securities and Exchange Commission does not specifically recommend a rule of auctioneering, it recognizes auctions as an element

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276. *Id.*
277. *Id.* at 1029.
278. *See supra* note 20 and accompanying text.
279. *See* Bebchuk, *supra* note 8, at 1041.
280. *See* Coffee, *supra* note 8, at 1164-66.
281. *Id.* at 1165 n.42.
282. Bebchuk, *supra* note 8, at 1041. *See also Revlon*, 506 A.2d at 184 ("market forces must be allowed to operate freely to bring the target's shareholders the best price available for their equity"). It should be noted that Easterbrook and Fischel's position has been widely rejected by both courts and commentators.
283. Bebchuk, *supra* note 8, at 1030.
284. *Id.* at 1045.
285. *Id.* at 1041.

of a free market and recognizes auction potential as an acceptable by-product of a system with a minimum offering period.[286]

A rule of auctioneering provides two critical advantages according to Professor Coffee. First, the risk of bad business judgment should be lessened by the fact that a substantial premium will be offered.[287] Where there is less money at stake, a bidder can afford a greater margin of error. Although Easterbrook and Fischel suggest that the highest bidder is the most likely to suffer from unfulfilled expectations,[288] it may be assumed that bidders are rational; they therefore should be allowed to take such calculated business risks. Second, an auction market gives an advantage to the firm with more information.[289] Under present rules, management is permitted to provide information to prospective white knights and withhold information from hostile bidders until an auction develops.[290] Such a practice, however, causes the auction rule to fall short of its full potential. In order to ensure that the target is acquired by the firm that values it most highly, all serious bidders must be given full access to information concerning the target company. Otherwise, hostile bidders will be forced to make less than fully informed decisions which inevitably increases the risk of the takeover and makes such bidders less willing to offer a large premium. Bebchuk's rule of auctioneering should be adopted, but to maximize its benefits it should be amended to include the British requirement (under Rule 12 of the City Code) that information given to a white knight be made available to all bona fide offerors.[291]

E. *Ten Percent Threshold Proposal*

As Bebchuk admits, a rule of auctioneering is subject to the criticism that it reduces the number of acquisitions by decreasing incentives for search.[292] A study by Jarrell & Bradley shows that auctions increase tender offer premiums but decrease the number of

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286. Securities and Exchange Commission, Advisory Committee on Tender Offers, *Report of Recommendations*, July 8, 1983 at 13.

287. Coffee, *supra* note 8, at 1232.

288. Easterbrook & Fischel, *supra* note 8, at 1188.

289. Coffee, *supra* note 8, at 1233.

290. However, where a break-up of the corporation becomes inevitable and an auction to purchase the corporation develops, management must treat friendly and hostile bidders equally. *See supra* note 180 and accompanying text.

291. City Code, *supra* note 238, rule 12.

292. Bebchuk, *supra* note 8, at 1046.

tender offers.[293] Although the extent to which the number of tender offers will be reduced is uncertain, it does seem likely that there will be some reduction unless the initial bidder is given additional incentive to search. Easterbrook and Fischel argue that the initial bidder is at a disadvantage unless the tendering period is very short.[294] While evidence does show that only 25% of initial bids are successful,[295] this low success rate may well indicate only that initial bidders frequently underbid and that an auction is necesary to discover the firm that values the target most highly.

Additional incentive for initial bidders to search for acquisition targets can be provided by closing the ten day filing period and increasing the five percent threshold to ten percent.[296] Once the ten percent threshold is reached, the bidder must cease purchasing additional shares until a disclosure statement is filed with the Securities and Exchange Commission. Even if the initial bid proves to be ultimately unsuccessful, the bidder will reap the profits of selling to a higher bidder. Furthermore, even if no tender offer is successful, the post-offer share price is likely to exceed the price that the initial bidder paid for its shares.[297] Although such a proposal may arguably be undesirable because it delays disclosure, it is suggested that a ten percent threshold is sufficiently below the amount required to attain control that the market will be adequately alerted and shareholders well protected. This recommendation should both provide an incentive for search and prevent a reduction in the number of tender offers.

F. *Proposed Sixty Day Offering Period*

Under the prevailing rule, a tender offer must remain open for a period of twenty business days.[298] This minimum offering period has been harshly criticized as being too short for a tender offer to be fully evaluated and negotiated.[299] In any event, it is too short a time to conduct an auction. The minmum offering period should therefore be extended to sixty calendar days. This should provide

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293. Jarrell & Bradley, *supra* note 26, at 398-403.

294. Easterbrook & Fischel, *supra* note 8 at 1179.

295. Ruback, *Assessing Competition in the Market for Corporate Acquisitions*, 11 J. FIN. ECON. 141 (1983).

296. Bebchuk, *supra* note 8, at 1038, 1054.

297. *Id.* at 1035.

298. *See supra* note 133 and accompanying text.

299. Bebchuk, *supra* note 8, at 1053.

ample time for prospective bidders to research the target and make offers and to permit the independent committee to negotiate, evaluate and make recommendations to shareholders. Some might argue that such an extended offering period will adversely affect the number of hostile tender offers because it locks in the tender offer price for an unreasonably long period of time. It is feared that if the market drops, the bidder will have overpaid. This concern, however, seems unwarranted. If, for example, the market drops precipitiously on day three, the bidder will have overpaid regardless of whether the bid was accepted on day two or day sixty. The argument against locking in the price of the bid seems to assume that the bidder should be allowed to revoke his offer at a certain point. However, if the bidder was willing to purchase the target at a specific price and live with the consequences on day one, it should be required to abide by its offer for a reasonable time and not be allowed to sit on the sidelines and watch the market.[300]

VII. CONCLUSION

The separation of ownership and control in large public corporations has gone awry.[301] Managers are exploiting shareholders by

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300. In February, 1983, the Securities and Exchange Commission (SEC) established the Tender Offer Advisory Committee to investigate takeover practices and make recommendations for legislative changes. SEC Release No. 19,528, 48 Fed. Reg. 9111 (1983). The Advisory Committee's report was presented to the Chairman of the SEC in July, 1983. Advisory Committee on Tender Offers, U.S. SEC, *Report of Recommendations* (1983). Soon thereafter, members of the House and Senate introduced a number of bills aimed at curbing abuses in the tender offer process. *See* H.R. 5693, 98th Cong., 2d Sess. (1984) (limit greenmail practices, require shareholder approval, close ten-day window, increase tender offer period); S. REP. No. 2851, 98th Cong., 2d Sess. (1984) (prohibit greenmail and golden parachutes); S. REP. No. 2777, 98th Cong., 2d Sess. (1984) (refine business judgment rule); S. 2783, 98th Cong., 2d Sess. (1984) (prohibit two-tier tender offers); S. REP. No. 2784, 98th Cong., 2d Sess. (1984) (close ten-day window, require shareholder approval); H.R. 1100, 99th Cong., 1st Sess. (1985) (no deduction for interest on junk bonds). The SEC and the Administration have been opposed to remedial federal legislation. The 1985 Economic Report of the President stated that such legislation "would be premature, unnecessary and unwise." Council of Economic Advisors, *1985 Economic Report of the President* 216 (1985).

301. The Berle and Means classic "separation of ownership and control" thesis is summarized by Professor Easterbrook as follows:

> Berle and Means portrayed managers as out of control. Berle and Means attributed this to the "separation of ownership and control"—another term for a division of labor in which some people specialize in risk-bearing through investment, while others specialize in management. When thou-

engaging in defensive tactics designed to thwart unwanted tender offers and perpetuate managerial control. As a result, shareholders are being deprived of the opportunity to sell their stock at a substantial premium over the market price and corporate assets are not being allocated to their best use. The business judgment rule, designed to protect managers from liability for honest errors in judgment, has proven to be an unsatisfactory standard by which to judge management's actions in response to tender offers. Although courts are beginning to acknowledge management's inherent conflict of interest in corporate control transactions, they are still willing to condone defensive tactics where an entrenchment motive is shown. Because managers are able to preempt tender offers by adopting defensive tactics, the Williams Act has fallen short of its goal of treating bidders and targets evenhandedly. However, evenhandness itself is an inappropriate goal. Legislation should encourage takeovers because they are good for shareholders and the economy.

Rules governing tender offers in the United Kingdom protect shareholder interests and provide a basis from which new federal legislation in the United States can be developed. The legislative proposals made in this article are designed to maximize shareholder wealth and improve economic efficiency through the tender offer process. The inherent conflict of interest between management and shareholders is resolved by the proposal to replace incumbent management with an independent committee comprised of outside experts to advise shareholders during the tender offer process. The proposal to require shareholder approval of all defensive tactics will allow shareholders the opportunity to make the investment decision of whether or not to sell their stock in response to a tender offer without being preempted by management. Finally, a rule of auctioneering is proposed to ensure that target companies are acquired by companies which value their assets the most. These legislative proposals comport with the realities of the takeover process and should serve to protect the investing public and the integrity of the securities markets.

> sands of people hold investment interests in a firm, none has much incentive to oversee the managers. Each investor, rightly thinking that his efforts can do little, will be passive. The investors are scattered, uncoordinated, and helpless. They have ownership without control; the managers have control without ownership.

Easterbrook, *Manager's Discretion and Investors' Welfare: Theories and Evidence*, 9 DEL. J. CORP. L. 540, 540 (1984).