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ANTI-TAKEOVER ACTIONS AND DEFENSES:
BUSINESS JUDGMENT OR BREACH OF DUTY?
HENRY F. JOHNSON †
I. INTRODUCTION

RECENTLY, the Landmark Banking Corporation of Florida mailed to its shareholders a proxy solicitation which contained an elaborate combination of measures aimed at warding off unfriendly takeover bids.¹ Specifically, Landmark asked its shareholders to approve amendments to its articles of incorporation which would provide for staggered three year terms for directors, eliminate shareholder ability to remove directors except for cause, and prohibit shareholders from voting their shares except at a meeting for which prior notice had been given. In addition, these amendments would require an eighty percent majority of the board of directors or a two-thirds majority of the outstanding voting shares to approve bylaw changes. Finally, any merger or business combination would have to be approved by a ninety-five percent majority of the voting shares outstanding, including a majority of the shares not held by the acquiring concern or any five percent shareholder.²

These measures and others of a similar nature ³ clearly discriminate between large and small shareholders and provide in-

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1. Wall St. J., May 13, 1982, at 28, col. 3 (s.w. ed.).
2. Id. At the time of the proxy solicitation, officers and directors of Landmark Banking owned 11% of the firm's outstanding shares. Landmark's own trust department was the largest single shareholder, owning 6.7% of the outstanding shares. At the same time, however, the bank was contractually obligated to sell some $50 million of convertible preferred stock to three individual investors who would thereafter control 28.6% of the stock. Upon consummation of this sale, the three individuals would effectively control the company, since they would have the ability to veto any and all fundamental corporate changes. Id.
cumbent management with an effective veto power over most corporate transactions. Such changes in the corporate documents tend not only to perpetuate control of the corporation by the incumbent board and management, but they also tend to discourage tender offers which may in fact be in the best interests of the shareholders. Yet, since shareholders apparently have little or no interest in anything except the stock price and dividends,\(^4\) anti-takeover measures such as those proposed by the Landmark Banking Corporation usually receive little opposition. In any event, there is little that can be done about such practices, if full disclosure has been given\(^5\) and if the “business judgment rule”\(^6\) applies.

In general, the stock market constitutes a major control upon corporate management. When the incumbent managers of a publicly-held concern do not do their jobs well, the company's shares will eventually decline in price reflecting the company's diminished prospects. Occasionally, when the shares reach that point where the corporation's assets are worth more than the total selling price of all the outstanding shares, the company becomes a

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4. See Borden & Weiner, *An Investment Decision Analysis of Cash Tender Offer Disclosure*, 23 N.Y.L. Sch. L. Rev. 553, 575-76 (1978) (“In the real world . . . price is in fact the name of the game.”); Hayes & Taussig, *Tactics of Cash Takeover Bids*, Harv. Bus. Rev., Mar.-Apr. 1967, at 135, 142 (“While the tender offer is vitally interwoven with considerations of power, job security, and other perquisites of office, for the average shareholder it is confined to the choice between holding or selling one stock.”).


6. Briefly stated, the business judgment rule was founded upon the notion that the shareholders had chosen directors to run the corporation, and therefore their management decisions, if made in good faith, should not result in liability. In other words, courts traditionally disallow shareholder challenges to decisions made by the board of directors if the board has acted in good faith. United Copper Sec. Co. v. Amalgamated Copper Co., 244 U.S. 261, 263-64 (1917). Generally, directors are only liable for their business decisions if they have acted negligently or in bad faith. See Miller v. American Tel. & Tel. Co., 507 F.2d 759, 762 (3d Cir. 1974); Maldonado v. Flynn, 413 A.2d 1251, 1255-56 (Del. Ch. 1980), rev'd on other grounds, Zapata Corp. v. Maldonado, 430 A.2d 779 (Del. 1981); Selheimer v. Manganese Corp., 423 Pa. 563, 581, 224 A.2d 634, 644 (1966).
tempting target for a takeover. With the recent economic slump fostering a declining stock market, this has occurred often over the past few years.

In response to fears of takeover attempts, the management of potential target companies have resorted to what might be termed "anti-takeover devices." While some of these tactics are subject to the federal securities laws, others are outside the reach of the securities statutes so long as management provides full disclosure to the investors. In such instances, courts analyze the propriety of these tactics against the common law fiduciary duty owed a corporation and its shareholders by directors as such duty exists against the backdrop of the business judgment rule. This article will discuss both business judgment and fiduciary duty concepts as they should apply to some of the more prevalent anti-takeover devices. It will also show how corporate management in some instances clearly breaches its fiduciary responsibilities to the company and its shareholders by proposing to adopt anti-takeover devices that place management in positions of power, perpetuity, and potential reward.

7. A simple example follows. Suppose a company's stock is selling for $10 a share while its assets per share (book value) are approximately $20. If an acquiring company offers $15 per share, it can give the target company's shareholders a 50% premium over the market price while acquiring assets for 75% of their book value. In such an instance all parties (except, perhaps, the target company's management) benefit: the shareholders receive a higher-than-market price, and the acquirer picks up assets cheaply.


9. One such device has been to move the corporate offices to a state with stringent state takeover statutes, but this method was rendered less attractive recently when the Supreme Court struck down a stringent Illinois takeover statute on the ground that it conflicted with federal tender offer legislation. See Edgar v. Mite Corp., 102 S. Ct. 2629 (1982). In particular, the Mite Corp. decision held that the Illinois statute frustrated the Congressional purpose of the Williams Act by introducing extended delay into the tender offer process and by allowing the Illinois Secretary of State to pass on the substantive fairness of a tender offer, an approach in conflict with that adopted by Congress. Id. at 2638-40. The Williams Act amended § 13 and § 14 of the Securities Exchange Act of 1934 to deal specifically with tender offers and takeovers. See 15 U.S.C. §§ 78n(d)-(e), 78n(d)-(f) (Supp. IV 1980).

10. For a discussion of the full disclosure requirements of the Securities Acts, see note 5 and accompanying text supra.

11. At this point it should be noted that this article will not discuss the Williams Act in any detail. The Williams Act has been the subject of numerous scholarly publications. See, e.g., Johnson, Disclosure in Tender Offer Transactions: The Dice Are Still Loaded, 42 U. Pitt. L. Rev. 1 (1980); Wilner & Landy, The Tender Trap: State Takeover Statutes and Their Constitutionality, 45 Fordham L. Rev. 1 (1976); Note, The Courts and the Williams Act: Try A Little Tenderness, 48 N.Y.U. L. Rev. 991 (1973).
II. ANTI-TAKEOVER DEVICES, MANAGEMENT WELFARE, AND BUSINESS JUDGMENT

Over the years, corporate managements and their legal counsel have developed various defensive tactics to deal with the prospect of a takeover. By and large, this package of defenses has concentrated primarily on beating the offeror once the offer has been put forward.\(^{12}\) In so doing, management attempts to raise a barrier to the takeover\(^ {13}\) and thus preserve its own position and concomitant economic advantages.\(^ {14}\) Such actions often result in the withdrawal of the tender offer,\(^ {16}\) with a corresponding loss to those shareholders who desired to take advantage of the offer.\(^ {16}\)

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13. The "barrier" can include the institution of an antitrust suit against the offeror, the solicitation of alternative bids from a “white knight”, the selling off of attractive lines of business or subsidiary companies, or the issuance of additional equity. See generally Brown, Changes in Offeror Strategy in Response to New Laws and Regulations, 28 CASE W. RES. L. REV. 843 (1978); Weiss, Tender Offers and Management Responsibility, 23 N.Y.L. SCH. L. REV. 445 (1978).

14. A former chairman of the Securities and Exchange Commission has stated that “[i]t would be naive to assume that tender offers are not, at times, opposed by managements motivated by their own interests in staving off a change in control.” Full Disclosure of Corporate Equity Ownership in Corporate Takeover Bids: Hearings on S. 510 Before the Subcomm. on Securities of the Senate Comm. on Banking and Currency, 90th Cong., 1st Sess. 35 (1967) (statement of Chairman Manuel F. Cohen).


16. When management succeeds in discouraging the tender offer, it is often the shareholder who takes the brunt of the blow. For example, when Carter Hawley Hale Stores offered $42 per share for Marshall Field & Co., Field's management objected to the offer as being "inadequate." Bleiberg, What Price Stewardship?, Barron's, Feb. 15, 1982 at 9, col. 1 & 11, col. 1. When Marshall Field was later acquired by Batus, Inc. (the American retailing arm of British American Tobacco which owns Saks Fifth Avenue), the price was a mere $30 per share. Wall St. J., Mar. 29, 1982, at 8, col. 1. With 10.8 million shares involved, stockholders of Marshall Field wound up with $130 million less than they would have received in the earlier transaction. See also Panter v. Marshall Field & Co., 486 F. Supp. 1168 (N.D. Ill. 1980), aff'd, 646 F.2d 271 (7th Cir.), cert. denied, 454 U.S. 1092 (1981). For a further discussion of Panter, see text accompanying notes 28-51 supra.
It has been argued that corporations have a right to remain independent and therefore corporate officers may pursue that objective by resisting tender offers by any available device.\textsuperscript{17} Conversely, some commentators have asserted that any and all attempts by a target's management to discourage takeovers should be prohibited.\textsuperscript{18} The former position asserts that management's anti-takeover actions should be "sheltered" from judicial scrutiny by application of the "business judgment rule," while the latter position argues for the inapplicability of that rule in a tender offer situation.

The fundamental premise of the business judgment rule is that corporate managers, by virtue of their role as stewards of the company, are more knowledgeable about the values and directions of the enterprise than are outsiders. Consequently, these managers

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Although there are a few instances where investors came out ahead after the termination of a tender offer, even in those cases shareholders owning stock in the target company at the time of the original offer were forced either to sell in the open market or to hold their securities for an extended period while waiting for a higher price. \textit{See The (Happily) Reluctant Brides}, \textit{Forbes}, Mar. 17, 1980, at 126.

17. \textit{See} Lipton, \textit{Takeover Bids in the Target's Boardroom}, 35 Bus. Law. 101 (1979); Lipton, \textit{Takeover Bids in the Target's Boardroom; An Update After One Year}, 36 Bus. Law. 1017 (1981). Mr. Lipton justifies the right of corporations to remain independent on a number of grounds. Relying on a survey of rejected tender offers, he first asserts that shareholders usually benefit financially in the long run when a takeover is rejected. Lipton, \textit{Takeover Bids in the Target's Boardroom}, supra, at 106-09. He also maintains that management has a duty to further interests besides those of shareholders such as the interests of employees, the public, the community, and the country as a whole. \textit{Id.} at 106. Mr. Lipton similarly argues that national policy requires long-term planning and that management is the most capable of providing this planning. \textit{Id.} at 115-16. Finally, Mr. Lipton asserts that the business judgment rule should apply to the rejection of tender offers, because tender offers are similar to any other business decision of the directors. \textit{Id.} at 120.

18. \textit{See} Easterbrook & Fischel, \textit{The Proper Role of a Target's Management in Responding to a Tender Offer}, 94 Harv. L. Rev. 1161 (1981). Professors Easterbrook and Fischel propose a rule of managerial passivity in the tender offer situation. \textit{Id.} at 1199-1204. They first point out that shareholders are deprived of the tender premium as well as possible synergistic gains and tax advantages when a tender offer is defeated. \textit{Id.} at 1164-69. They further support their view on the ground that tender offers are one of the few effective methods of monitoring management since shareholders themselves are generally too passive to be effective monitors. \textit{Id.} at 1171-73. Additionally, Professors Easterbrook and Fischel emphasize management's interest in preserving their positions and salaries when confronted with a takeover bid. \textit{Id.} at 1175. Finally, they assert that the business judgment rule is inapplicable to the tender offer situation, because that rule only applies to questions of duty and not to questions of loyalty. \textit{Id.} at 1194-99. For further works expressing similar views, see Easterbrook & Fischel, \textit{Takeover Bids, Defensive Tactics & Shareholders' Welfare}, 36 Bus. Law. 1733 (1981); Gilson, \textit{A Structural Approach to Corporations: The Case Against Defensive Tactics in Tender Offers}, 33 Stan. L. Rev. 819 (1981); Lynch & Steinberg, supra note 12; Comment, \textit{The Case for Facilitating Competing Tender Offers}, supra note 12.
are best able to make business decisions that maximize the shareholder's welfare.\textsuperscript{19} The principle involved is majority rule, in that a majority of directors should have the right to determine the business policy of the corporation, free from judicial intervention, so long as they act in good faith and do not breach their trust.\textsuperscript{20} Essentially, the business judgment rule was designed to apply to contracts or other transactions between the corporation and outsiders, where the corporation's management is usually free from conflicting interests and can be depended upon to act for the corporation's benefit.\textsuperscript{21} Even so, most recent decisions dealing with anti-takeover actions have applied the business judgment rule to uphold management's action, often disregarding the welfare of the shareholders.\textsuperscript{22}

In \textit{Johnson v. Trueblood},\textsuperscript{23} for instance, minority shareholders alleged that the corporate directors were acting under a desire to remain in control when the directors proposed a sale of new shares to one of the majority owners.\textsuperscript{24} The plaintiffs in \textit{Trueblood} claimed that this desire, by itself, was sufficient to shift the burden of proof to the defendants,\textsuperscript{25} thus precluding application of the

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\bibitem{19} See United Copper Sec. Co. v. Amalgamated Copper Co., 244 U.S. 261, 263-64 (1917) ("Courts interfere seldom to control such discretion \textit{intra vires} the corporation ... "); Miller v. American Tel. & Tel. Co., 507 F.2d 759, 762 (3d Cir. 1974) ("The sound business judgment rule ... expresses the unanimous decision of American courts to eschew intervention in corporate decision-making ... "); Zapata Corp. v. Maldonado, 430 A.2d 779, 782 (Del. 1981) ("The 'business judgment' rule evolved to give recognition and deference to directors' business expertise when exercising their managerial power ... "); Selheimer v. Manganese Corp., 423 Pa. 563, 581, 224 A.2d 634, 644 (1966) ("Courts are reluctant to interfere in the internal management of a corporation, since that is a matter for the discretion and judgment of the directors and shareholders ... "). \textit{See generally} 2 R. Magnuson, \textsc{Shareholder Litigation} § 15 (1981).

\bibitem{20} 2 R. Magnuson, supra note 19, at § 15.01. \textit{See, e.g.,} Regenstein v. J. Regenstein Co., 213 Ga. 157, 159, 97 S.E.2d 693, 695 (1957) ("No principle of law is more firmly fixed in our jurisprudence than the one which declares that the courts will not interfere in matters involving merely the judgment of the majority in exercising control over corporate affairs."); Neidert v. Neidert, 657 S.W.2d 296, 301 (Mo. App. 1982) (where the matter under consideration calls for business judgment of a majority of shareholders or of a board of directors, courts will not interfere if this judgment is exercised fairly and honestly).

\bibitem{21} F. O'Neal, "\textit{Squeeze-Outs} of Minority Shareholders: Expulsion or Repression of Business Associates" 171 (1975).


\bibitem{24} Id. at 289 & n.3. It should be noted that the corporation in question was a "close" corporation. \textit{See} note 27 infra.

\bibitem{25} 629 F.2d at 292-93.

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business judgment rule. The Third Circuit rejected both conten-
tions, stating that while the desire to remain in control, standing
alone, is an improper motive for the decisions of a director, a
director may properly decline to adopt a course of action which
would result in a shift of control so long as his actions can be
attributed to any rational business purpose. Therefore, applica-
tion of the business judgment rule is not precluded simply by
showing that a director's decision was influenced by his desire to
remain in office, unless this desire was the "sole or primary purpose"
for the decision.

Recently, the Seventh Circuit, using the Third Circuit's
opinion in *Trueblood* as precedent, rejected a shareholder chal-
lenge to management's anti-takeover actions in the case of *Panter
v. Marshall Field & Co.* In *Panter*, shareholders brought a class
action against Marshall Field & Co., alleging that Field and its

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26. *Id.* at 292-93.

27. *Id.* Even though *Trueblood* involved a close corporation, the court
did not limit the predominance standard to corporations of that type. The
court indicated that the standard actually applies to all corporations by re-
ferring to several earlier cases involving publicly held corporations. *Id.* at
293. The cases cited by the court include *Pettv v. Penntech Papers, Inc.*, 347
A.2d 140, 143 (Del. Ch. 1975) ("[I]t is unquestionably Delaware law that the
use of corporate funds to purchase corporate shares primarily to maintain
management in control is improper."); *Condec Corp. v. Lunkenheimer Co.*, 43
Del. Ch. 553, 562, 230 A.2d 769, 775 (Del. Ch. 1967) ("I have reached the
conclusion that the primary purpose of the issuance of such shares was to
prevent control [from passing to new hands]."); *Cheff v. Mathes*, 41 Del. Ch.
494, 504, 199 A.2d 548, 554 (Del. 1964) ("[I]f the board has acted solely or
primarily because of the desire to perpetuate themselves in office, the use of
corporate funds for such purposes is improper.").

Many jurisdictions, however, have weakened the business judgment rule
in the context of the closely held corporation. Generally, shareholders in a
close corporation are treated as partners and are therefore obligated by the
fiduciary duties owed by partners. See *Comolli v. Comolli*, 241 Ga. 471, 246
S.E.2d 278 (1978); *Cressy v. Shannon Corp.*, 378 N.E.2d 941 (Ind. App. 1978);
*Campbell v. Campbell*, 198 Kan. 181, 422 P.2d 932 (1967); *Cain v. Cain*, 3
Mass. App. Ct. 467, 334 N.E.2d 650 (1975). In California, for example, the
principle of fiduciary duty in the context of the close corporation has been
extended to a point where majority shareholders must exercise "good faith"
and "inherent fairness" towards the minority. If a corporate action appears
to oppress the rights of minority shareholders, the burden is on the majority
shareholders to show a "compelling business reason" for the activity under-
Rptr. 592 (1969). In Massachusetts the standard is even stricter, including a
duty of "utmost good faith and loyalty" among the shareholders of a close
 corporation subject, of course, to an exception for oppressive conduct taken
for a "legitimate business purpose." *Wilkes v. Springside Nursing Home, Inc.*, 370
Mass. 842, 353 N.E.2d 657 (1976); *Donahue v. Rodd Electrotype Co.*, 367
Mass. 578, 593, 328 N.E.2d 505, 515 (1975). While these decisions involve
closely held corporations, it seems logical that in some instances a similar
result would be desirable in publicly held companies. For arguments in favor
of extending this result to publicly held companies, see notes 64-67 and
accompanying text infra.

directors had breached their fiduciary duties by engaging in practices designed to thwart a tender offer made by Carter Hawley Hale Stores. The district court granted Field's motion for a directed verdict and held that there was neither a violation of federal securities law nor a breach of any fiduciary duty on the part of Field's directors. On appeal, the Seventh Circuit affirmed.

The plaintiffs in Panter challenged four specific actions taken by the board of directors as being breaches of the board's fiduciary duties to the shareholders. First, the shareholder plaintiffs contended that the board had adopted a "secret policy" to resist acquisition regardless of any benefits which would accrue to the corporation or its shareholders. Second, the shareholders alleged that the directors had breached their duty by failing to disclose this policy. The third and fourth grounds for asserting that the directors had breached their fiduciary duty were that the directors had made "defensive acquisitions" and filed an antitrust suit against Carter Hawley for the sole purpose of discouraging Carter Hawley's tender offer.

Initially, the Seventh Circuit turned to an analysis of the business judgment rule, rejecting the plaintiff's contention that the

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29. 486 F. Supp. 1168, 1173 (N.D. Ill. 1980), aff'd, 646 F.2d 271 (7th Cir.), cert. denied, 454 U.S. 1092 (1981). The plaintiffs also alleged violations of federal securities laws, but since these allegations do not involve the business judgment rule, a discussion of them has been omitted.
30. Id. at 1195.
31. Id.
32. 646 F.2d at 299.
33. Id. at 293.
34. Id. During the eight years prior to the Carter Hawley offer, the management of Field had rejected at least four separate takeover offers. Id. at 278. The existence of those offers was never disclosed to Field's shareholders. Id. at 296.
35. Id. at 293. Subsequent to the initiation of the tender offer, Field's directors entered into negotiations to buy the Liberty House chain of department stores. This chain operated in the Pacific Northwest, an area where Carter Hawley was already well entrenched. Additionally, Field negotiated for space in Houston's Galleria Shopping Center, intending to build a store practically next door to Carter Hawley's Neiman-Marcus store in the same center. Id. at 280-81.
36. Id. at 293. The directors of Field authorized the filing of an antitrust suit against Carter Hawley after being informed by counsel that a combination of Field and Carter would be illegal in light of the existing competition between the two company's stores and the competition between the two which would develop as a result of Field's defensive acquisitions. 486 F. Supp. at 1188-89.
37. 646 F.2d at 293. The Seventh Circuit essentially adopted the lower court's interpretation of the business judgment rule. Id. According to the lower court, the business judgment rule provides that:
defendant directors should have the burden of establishing a compelling business purpose for their actions. The court of appeals then affirmed the district court on all counts, finding that the plaintiffs, with whom the burden of proof rested, had failed to present any evidence of self-dealing, fraud, overreaching, or other bad conduct sufficient to give rise to any reasonable inference that impermissible motives predominated in the board's consideration of the situation. Furthermore, the court accepted the defendants' assertion that the desire to expand was a reasonable and natural action on the part of Field's directors and called the plaintiffs' accusations mere "Monday-morning-quarterbacking." The court also stated that even if the desire to "fend-off" the tender offer was "among the motives" of the board, the plaintiffs had failed to show that motive to be the sole or primary purpose of the board's actions and as such judicial scrutiny of the decision was precluded by the business judgment rule. Accordingly, the rationale of the Panter court implies that even actions taken with improper motives will be permitted if any valid business purpose can be attributed to those acts.

By allowing corporate directors to freely invoke the business judgment rule as a defense to any shareholder complaint challenging directors' actions, even those actions with only minimal business purposes, the Panter court has done corporate shareholders an injustice. While it is true that the officers and directors of a corporation are in a unique position of "expertise" and "knowledge" in corporate matters, the question remains whether a tender offer is a corporate matter or a personal matter to be decided by the share-

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486 F. Supp. at 1194 (citations omitted).

38. 646 F.2d at 295.
39. Id. at 295-98.
40. Id. at 297.
41. Id.
42. For discussions concerning the inapplicability of the business judgment rule in the takeover situation, see Easterbrook & Fischel, Takeover Bids, Defensive Tactics & Shareholders' Welfare, supra note 18, at 1745-47; Easterbrook & Fischel, The Proper Role of a Target's Management in Responding to a Tender Offer, supra note 18, at 1194-99; Gilson, supra note 18, at 822-24.
This point was raised in the well-reasoned dissent in *Panter*. While the dissent agreed with many of the majority’s views concerning the alleged violations of the securities laws, the dissent rather vehemently disagreed with the majority concerning the plaintiff’s fiduciary duty claims.

In dissent, Judge Cudahy emphasized that directors of a corporation have but two functions: first, they must manage the business enterprise, and second, they must act as a “vehicle” for collecting and using capital and for distributing profits. The former function involves the corporate decision-making process; the latter involves only the corporation-shareholder relationship. Therefore, when an activity involves only the latter function, fiduciary duties should be recognized, applied to any and all actions taken by management, and be subject to judicial review unrestrained by the business judgment rule. As to the required level of director self-interest necessary to shift the burden of proof to the director defendants, Judge Cudahy stated that “[u]nder the business judgment rule, once a plaintiff demonstrates that a director had an interest in the transaction at issue, the burden of proof shifts to the director to prove that the transaction was fair and reasonable to the corporation.” He stressed that the business judgment rule should not clothe directors with an “almost irrebuttable presumption of sound business judgment, prevailing over everything but the elusive hobgoblins of fraud, bad faith or abuse of discretion.”

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43. See Gilson, supra note 18, at 845-48; Lynch & Steinberg, supra note 12, at 910-13.

44. 646 F.2d at 299 (Cudahy, J., concurring in part and dissenting in part). The dissenting judge generally agreed with the majority’s view of the alleged securities law violations, but he disagreed with the majority’s holding that the withdrawal of the tender offer prior to the tender of any shares rendered the Williams Act inapplicable. Id.

45. Id. Judge Cudahy expressed the concern that the majority’s holding removed “whatever constraints still remain upon the ability of corporate directors to place self-interest before shareholder interests” in tender offer situations. Id.

46. Id. at 299-300 (Cudahy, J., concurring in part and dissenting in part) (quoting Note, Protection for Shareholder Interests in Recapitalizations of Publicly Held Corporations, 58 COLUM. L. REV. 1030, 1066 (1958)).

47. 646 F.2d at 299-300 (Cudahy, J., concurring in part and dissenting in part). In addition, the dissent in *Panter* recognized that whenever a plaintiff in a takeover situation demonstrates that a director has an interest in the transaction, the burden of proof should shift to the director to prove that the transaction was fair and reasonable. Id. at 301 (Cudahy, J., concurring in part and dissenting in part) (citing Treadway Cos. v. Care Corp., 638 F.2d 357, 382 (2d Cir. 1980)).

48. 646 F.2d at 301 (Cudahy, J., concurring in part and dissenting in part).

49. Id. at 299 (Cudahy, J., concurring in part and dissenting in part).
approach, he argued, would "virtually immunize" a target company's directors from liability to shareholders in a takeover situation.\footnote{50} Finally, the dissent noted that even if the predominant motive standard of Trueblood was the correct standard, it should be up to the jury to decide whether the directors' improper motives were indeed the sole purpose behind the directors' actions. It is not a question of law to be decided by the court.\footnote{51}

If it is generally accepted that directors of a corporation stand in a fiduciary relationship to their corporation\footnote{52} and its shareholders,\footnote{53} and are bound by the principles of fairness, morality, and honesty,\footnote{54} then any breach of these principles is sufficient to sustain an action against the violator. When shareholders elect directors to manage the enterprise, these principles are well understood. The directors are to manage the company with the corporation's welfare and the shareholder's welfare in mind.

So long as the shareholder is content with his dividends and stock price, the director's role is merely to make informed business decisions that will permit the company to prosper,\footnote{55} and the business judgment rule will properly apply to those decisions involving the ordinary affairs of the corporation and transactions between it and third parties.\footnote{56} In the tender offer situation, however, an offer to contract is really being made to the target company's shareholders, thus making the tender offer situation clearly distinguish-

}\footnote{56. See F. O'Neal, supra note 21.}}
able from contract negotiations between the corporation and unrelated third parties. In the latter situation the business judgment of the directors should prevail since they have been elected to manage the affairs of the corporation, but in the former situation they should have little direct involvement since a tender offer involves only the affairs of the shareholders. The shareholders did not consult management when buying their shares, nor did management intervene in the purchase. Why, then, should corporate management become directly (and expensively) involved in a potential transfer of shares between a buyer and seller? While it is true that dicta in *Northwest Industries, Inc. v. B.F. Goodrich Co.* suggests that management should actively resist any takeover attempt that may be detrimental to the corporation and its shareholders, recent changes in Section 14(e) of the Securities Exchange Act of 1934 (Williams Act) should provide management a sufficient forum for disclosing the possible detrimental effects to shareholders without direct interference in the tender offer process. These changes, as implemented by rule 14e-2, require an affirmative disclosure by

57. See generally Easterbrook & Fischel, *The Proper Role of a Target's Management in Responding to a Tender Offer*, supra note 18. Professors Easterbrook and Fischel argue that since resistance to tender offers by target management ultimately decreases shareholder welfare, target directors should be effectively precluded from intervening. While their article is premised largely on economic factors (the cost of lawsuits, defensive acquisitions, and hiring of "expert appraisers"), their approach gives an inordinate amount of weight to such considerations. It would be simpler to preclude extensive management activity in the tender offer area merely because the offer to purchase securities has not been made to management, but to the shareholders.


59. Id. at 712. This dicta has been subsequently cited with approval. See, e.g., Panter v. Marshall Field & Co., 646 F.2d at 288; Treadway Cos. v. Care Corp., 638 F.2d 357, 381 (2d Cir. 1980); Heit v. Baird, 567 F.2d 1157, 1161 (1st Cir. 1977). Some commentators assert that director's resistance to tender offers may result in higher tender premiums. See Herzel, Schmidt & Davis, supra note 3. While this possibility exists, the problem, however, remains that such actions may well succeed in having the offeror terminate the offer entirely. See notes 15-16 and accompanying text supra.

60. 15 U.S.C. § 78n(e) (1976). For the text of § 14(e), see note 75 infra. Senator Harrison Williams, in presenting his Act to Congress, pointed out that the public shareholder possesses limited knowledge when a tender offer commences, because he is not adequately protected by the disclosure requirements of the securities acts. See 113 Cong. Rec. 24,664 (1967) (statement of Sen. Williams). The legislation, however, still permitted target companies to remain silent when a tender offer was proposed. Rule 14e-2 was proposed in order to alleviate this shortcoming.

61. 17 C.F.R. § 240.14e-2 (1981). This rule provides:
(a) Position of Subject Company. As a means reasonably designed to prevent fraudulent, deceptive or manipulative acts or practices within the meaning of section 14(e) of the Act, the subject company, not later than 10 business days from the date the tender offer is first
the target company of its position, if any, with respect to the tender offer. This statement must be made to its shareholders within ten days of the publication of a tender offer. It is at this point that management has the opportunity to raise its objections and propose its recommendations to the shareholders. These objections and recommendations could range from generalized factual matters that management feels warrant rejection of the offer, to detailed discussions of potential antitrust or securities violations, the inadequacy of the offer, or management’s long range plans that may make the offer less attractive. The forum provided by rule 14e-2 reaches all shareholders of record and effectively informs them of management’s position.\(^{62}\) Once management makes its objections and recommendations known, it should then remove itself from the tender offer process.\(^{63}\)

If, rather than simply informing shareholders of their position, corporate directors choose to intervene in the offer due to their published or sent or given, shall publish, send or give to security holders a statement disclosing that the subject company:

1. Recommends acceptance or rejection of the bidder’s tender offer;
2. Expresses no opinion and is remaining neutral toward the bidder’s tender offer; or
3. Is unable to take a position with respect to the bidder’s tender offer. Such statement shall also include the reason(s) for the position (including the inability to take a position) disclosed therein.

(b) Material Change. If any material change occurs in the disclosure required by paragraph (a) of this section, the subject company shall promptly publish or send or give a statement disclosing such material change to security holders.

Id.

62. An example of the proper use of rule 14e-2 occurred recently when Occidental Petroleum Corporation offered $50 per share for 49% of the outstanding stock of Cities Service Company. The Cities Service board of directors sent a letter to shareholders describing the Occidental offer as “inadequate,” informing shareholders that the board was actively seeking more favorable offers, and advising them to “make his or her own decision” regarding the tender of shares. Wall St. J., Aug. 24, 1982, at 3, col. 1 (s.w. ed.). Shortly thereafter, Occidental raised its overall offer to $55 per share, and its offer for 45% of the shares to $55. Occidental also improved the terms of a proposed “second step” merger, which would have affected the holders of untendered shares. Wall. St. J., Aug. 26, 1982, at 3, col. 1 (s.w. ed.).

63. See Gilson, supra note 18, at 895-98. It is not suggested that rule 14e-2 preempts the business judgment rule in tender offers. Rather, because the tender offer is made to shareholders and not management, there is no true “business decision” to be made, even though the target’s management is required to make some form of “recommendation” to shareholders. The required statement should be more an analysis of the facts than a mere opinion, because a mere opinion might lead to liability for misrepresentation of material facts. See 15 U.S.C. § 78n(e) (Supp. IV 1980). For the text of this section, see note 75 infra.
fiduciary obligation to the company, they risk initiating a delay that may result in the withdrawal of the offer itself. Such a result would obviously be adverse to shareholder welfare since the shareholders would never have an opportunity to accept an offer which, in essence, had been made directly to them. Consequently, if management is responsible for frivolous litigation or other actions that result in withdrawal of the offer, it should be open to shareholder suit. More importantly, the shareholders should be entitled to a jury's determination of the propriety of the directors' actions free of the presumptions created by the business judgment rule.

III. ONE COURT'S APPROACH: MOBIL CORP. v. MARATHON OIL

When Mobil Oil Corporation publicly announced its intention to make a cash tender offer for control of Marathon Oil, Marathon's directors quickly decided that Mobil's offer was inadequate and not in the best interests of Marathon Oil or its shareholders. Marathon promptly filed suit to enjoin the proposed merger, claiming a violation of Section 7 of the Clayton Act, and began a search for a friendly suitor.

64. As previously noted, several courts have recognized a duty on the part of directors to oppose takeovers which they have determined are not in the corporation's best interests. See note 59 and accompanying text supra.


66. See text accompanying note 57 supra.

67. For example, management will often raise antitrust claims whether or not the circumstances warrant it. One prominent attorney has observed that counsel's view on antitrust is often, "I'll argue the antitrust defense today and I'll worry about the complications tomorrow. I need every argument I can get." See Wachtell, Special Tender Offer Litigation Tactics, 32 Bus. Law. 1433, 1439 (1977).

68. See Mobil Corp. v. Marathon Oil Co., 669 F.2d 366, 367 (6th Cir. 1981). See also Radol v. Thomas, 534 F. Supp. 1302, 1304-05 (S.D. Ohio 1982). In fact, as early as five months before Mobil announced its offer to purchase 40 million shares of Marathon stock, Marathon's management had decided to resist a hostile takeover. Id. at 1305.

69. See Mobil Corp. v. Marathon Oil Co., 669 F.2d 366, 367 (6th Cir. 1981). The Clayton Act provides in relevant part:

No corporation engaged in commerce shall acquire, directly or indirectly, the whole or any part of the stock or other share capital . . . where in any line of commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition, or tend to create a monopoly.


70. Mobil Corp. v. Marathon Oil Co., 669 F.2d 366, 367 (6th Cir. 1981). One tactic often used by incumbent managements to forestall takeovers is the solicitation of alternative bids from a "white knight." If a company is an attractive acquisition, multiple bidders are often located, after which a "bidding
Marathon's search for a "white knight" was successful, and in mid-November, 1981, United States Steel Corporation agreed to offer $125 per share for 51% of Marathon's outstanding common stock. This offer, however, was conditioned on the issuance of two options by Marathon: the first, a nonrevocable option that allows U.S. Steel to purchase ten million authorized but unissued shares of Marathon's common stock for $90 per share, and the second, an option which would allow U.S. Steel to purchase Marathon's interest in the West Texas Yates Oil Field for $2.8 billion, exercisable only if Marathon was later acquired by a third party (such as Mobil).

The Sixth Circuit Court of Appeals, in Mobil Corp. v. Marathon Oil Co., held that the two options granted to U.S. Steel constituted "manipulative acts" within the meaning of the Williams Act because the options, both individually and in combination, might ensue, thus raising the price of the takeover. If management is successful in finding such a bidder, the shareholders may well reap higher values for their shares. If, however, management cannot find a suitor and succeeds in delaying the tender, the original offeror might well withdraw, thus resulting in a perceived economic loss for all shareholders. See E. Aranow, H. Einhorn & G. Berlestein, Developments in Tender Offers for Corporate Control 201 (1977); Brown, supra note 13, at 875; Gilson, The Case Against Shark Repellent Amendments: Structural Limitations on the Enabling Concept, 34 Stan. L. Rev. 775 (1982); Steinhrink, supra note 3, at 893; Ingrassia, Employees at Acquired Firms Find White Knights Often Unfriendly, Wall St. J., July 7, 1982, at 23, col. 3; The (Happily) Reluctant Brides, supra note 16, at 126.


72. Id. In a tender offer situation, the purpose of issuing a share purchase option to a "white knight" is to make the transaction more expensive to the hostile offeror. In this instance, assuming that U.S. Steel had exercised its option and the original Mobil offer had been raised to $125 per share, the total cost to Mobil or any other bidder would be 1.1 to 1.2 billion dollars in addition to its original offer. Id. at 375.

73. Id. at 367. The issuance of an option which allows a "white knight" to buy attractive assets is an effective way to ward off an unwanted tender. Arguably, if a company is worth $85 per share to an acquirer with its attractive assets, it should be worth less without such assets. In this instance, Marathon's disposal of the Yates Field would make it much less attractive to another oil company (but would also remove any valid antitrust arguments). See generally Wall St. J., May 15, 1980, at 12, col. 1 (s.w. ed.); Barron's, April 28, 1980, at 33, col. 2.

74. 669 F.2d 366 (6th Cir. 1981).

75. Id. at 377. Section 14(e) of the Securities Exchange Act of 1934, as amended by the Williams Act, provides that "[I]t shall be unlawful for any person to . . . engage in any fraudulent, deceptive or manipulative acts or practices in connection with any tender offer or request or invitation for tenders, or any solicitation of security holders in opposition to or in favor of any such offer, request, or invitation." 15 U.S.C. § 78n(e) (1976). The Supreme Court has defined the term "manipulative acts" as referring "generally to practices, such as wash sales, matched orders, or rigged prices that are intended to mislead investors by artificially affecting market activity." Santa Fe Indus. v.
had the effect of "circumventing the natural forces of market demand" in this tender offer contest. The court, however, expressly stated that the decision in this case did not extend to all forms of options which might be created to lock-up takeover battles or otherwise discourage competing tender offers.

While there are several difficulties inherent in the Sixth Circuit's opinion in Mobil, the importance of the decision lies in Green, 430 U.S. 462, 476 (1977). Manipulative acts connote "intentional or willful conduct designed to deceive or defraud investors by controlling or artificially affecting the price of securities." Ernst & Ernst v. Hochfelder, 425 U.S. 185, 199 (1976). See also E. Aranow, H. Einhorn & G. Berlstein, supra note 70, at 144, 275.

76. 669 F.2d at 376. In the course of its opinion, the Sixth Circuit accepted the Supreme Court's definition of "manipulation" as an affecting of the market for, or price of securities by artificial means. Id. at 374 (quoting Santa Fe Indus. v. Green, 430 U.S. 462, 476 (1977) and Ernst & Ernst v. Hochfelder, 425 U.S. 185, 199 (1976)). In this instance, the "lock-up" options granted to U.S. Steel acted to make its offer an artificial ceiling on the takeover price, because it discouraged competitive bidding for Marathon shares. 669 F.2d at 375.

77. Id. at 377. Presumably, the court would permit "lock-up" options in a non-hostile tender offer contest, since the possibility of a bidding contest is remote when both managements agree to the takeover.

78. The primary difficulty with the Sixth Circuit's decision is the application of the business judgment rule to the acts of the target company's directors. If one reads Panter as giving target company management unbridled discretion to act in a tender offer situation, no breach of fiduciary duty will accrue. Similarly, without an allegation of manipulation or nondisclosure, no federal cause of action will lie. See, e.g., Santa Fe Indus. v. Green, 430 U.S. 462, 479 (1977). Thus, if the granting of an option is perceived by the court to be a valid business decision, minority shareholders will be denied effective access to both state and federal courts. By permitting an action under the anti-manipulative section of the Williams Act, the court is recognizing that minority owners should be able to challenge management's decisions in the takeover process. This, however, is an entirely new development in takeover law and faces a difficult future. In fact, the Seventh Circuit recently affirmed a district court's decision that Mobil was not applicable where a target company entered into a binding agreement to sell its major asset in order to frustrate a potential takeover. Whittaker Corp. v. Edgar, 535 F. Supp. 933 (N.D. Ill.), aff'd, -- F.2d -- (7th Cir. 1982). The district court concluded that the net economic effect of the asset sale was not a "lock-up" of the target in favor of one of two bidders. Id. at 949.

Similarly, a federal district court in New York refused to accept the reasoning of the Mobil decision, stating that the rule of law in the Second Circuit could not bar management from combatting a takeover attempt that it believes in good faith to be harmful to its shareholders. Marshall Field & Co. v. Icahn, 537 F. Supp. 413, 422 (S.D.N.Y. 1982). The court went on to say, however, that the rule would be otherwise on a showing that management was acting for "its own interests in violation of its fiduciary duty to its shareholders." Id. (emphasis added). Presumably, had the Icahn group been successful in proving self-interest as a motive for delay on the part of the target management, a federal action would have been allowed to proceed under the manipulative theory of Mobil.

In both Mobil and Whittaker it might be argued that the sale of assets constituted a violation of state corporate law because such transactions were consummated without an affirmative vote of the target company's shareholders.
its recognition of the unfair nature of lock-up options in the hostile tender offer situation.\textsuperscript{79} In such instances, corporate management occasionally oversteps the boundaries of fair play in its attempts to fend off the initial thrust of a hostile offeror. When this occurs, \textit{Mobil}, by analogy, suggests that shareholders should be afforded an opportunity to voice their displeasure in an action based on the anti-manipulative provisions of the Williams Act. In such actions, the test should be whether the lock-up option effectively deters competing offers, thereby depriving shareholders, the parties to whom a tender offer is addressed, of their decision-making rights.\textsuperscript{80}

If courts limit permissible director action once a tender is announced to the making of recommendations to shareholders,\textsuperscript{81} then any additional actions taken by the board, including the grant of lock-up and share purchase options, should be subject to shareholder suit in state court with a judicial scrutiny that is free of the business judgment rule.\textsuperscript{82} In addition, if these actions result in artificial ceilings on tender prices and inhibit competitive bids, the target company's board of directors should be held liable for violation of the Williams Act. In both situations, the directors should be held responsible and accountable to the shareholders for any economic loss suffered as a result of their actions.\textsuperscript{83}

\textit{See}, e.g., \textit{Del. Code Ann. tit. 8, § 271 (1953); Model Business Corp. Act Ann. § 79 (1971) (Sales of Assets Other Than in Regular Course of Business)}. This argument, however, was not raised in either case.

79. \textit{See generally} Gilson, \textit{supra} note 18, at 878-79 (arguing that once management has reason to believe that a tender offer may be made, all action that could interfere with the offer should be prohibited). \textit{But see} Black & Smith, \textit{supra} note 12; Herzel, Schmidt & Davis, \textit{supra} note 3.

80. See 669 F.2d at 377. As one commentator has observed, "if management can use defensive tactics to obtain a degree of control over tender offers similar to that given it over mergers and sales of assets, then the corporate structure is fundamentally altered in a fashion which allows management effective monopoly power over corporate control." Gilson, \textit{supra} note 18, at 846.

81. \textit{See} text accompanying notes 60-67 \textit{supra}.

82. It seems obvious that a finding of manipulative practices on the part of target management would result in the finding of a breach of fiduciary duty in spite of the application of the business judgment rule. Similarly, where shareholders allege violations of state corporate law, such as failure to obtain the required shareholder vote in a sale of assets situation, the board's decision may be \textit{ultra vires} and the business judgment rule will not apply. \textit{See} Regenstein v. J. Regenstein Co., 213 Ga. 157, 97 S.E.2d 693 (1957); Lafayette Realty Corp. v. Moller, 247 Ind. 433, 436-38, 215 N.E.2d 859, 861 (1966).

83. While the exact amount of any economic loss may be difficult to calculate, courts could adopt methods used in similar situations. In statutory mergers, for example, state law generally gives dissenters the right to raise objections to the proposed transaction and provides alternative means of stock valuation through the statutory appraisal process for the shares owned by the dissenters. In the Mobil-Marathon transaction, Marathon's internal appraisal value of the company's shares ranged from $276 to $323 a share, compared to the $125 "ceiling" placed on the shares through the U.S. Steel "lock-up" option. \textit{See} Wall St. J., Mar. 10, 1982, at 4, col. 4.
IV. Pre-Takeover Corporate Changes: A "Per Se" Breach of Fiduciary Duty

While most takeover defenses are initiated by target management after a tender offer has been announced, some incumbent managers are "gun-jumping" any would-be takeover attempts by amending their corporate charters, or by initiating similar tactics designed to discourage potential suitors. The object of these maneuvers is to deny the successful tender offeror effective control of the corporation, or to make the cost of the offer so prohibitive that any potential acquirer will think twice about making a tender offer. Some of these "pre-tender" actions, however, clearly involve conflicts of interest, oppression of minority shareholders, or "non-businesslike" judgments, and if not completely prohibited, they should at least be subject to judicial scrutiny free of the business judgment rule.

The common law doctrine of fiduciary duty, in the corporate context, dictates that directors and officers owe loyalty and allegiance to the corporation, and that loyalty must be undivided while at the same time allegiance must be influenced only by corporate considerations. One who is in such a fiduciary position cannot manipulate the affairs of his corporation in disregard of the standards of common decency and honesty. He cannot serve himself first and the shareholders second. The fiduciary cannot use his

84. See Steinbrink, supra note 3, at 903.
85. Some of the more prevalent methods of accomplishing this result include amending the certificate of incorporation to require a supermajority shareholder vote to approve business reorganizations, staggering the terms of directors, eliminating the shareholders' right to call special meetings, allowing the board to create new directorships, prohibiting the removal of directors except "for cause," requiring a "supermajority" shareholder vote to amend any of the "revised" charter provisions, creating "golden parachute" separation agreements, and approving loans to officers and directors at low or no interest. See generally note 65 supra. The use of defensive charter provisions so upset the SEC that it considered barring the shares of companies with such provisions from being traded in the national market system. Wall St. J., Feb. 20, 1980, at 2, col. 3. See also The SEC Redefines Tender Offers, Bus. Week, Mar. 17, 1980, at 43.
86. Presently, if lack of business judgment or independence on the part of the directors can be shown, the business judgment rule will yield provided the allegations are justified. See generally Cramer v. General Tel. & Elecs. Corp., 582 F.2d 259 (3d Cir. 1978), cert. denied, 439 U.S. 1129 (1979); Crouse-Hinds Co. v. Inter-North, Inc., 634 F.2d 690 (2d Cir. 1980).
89. See id. The diversion of corporate opportunity doctrine prevents a director from taking for himself any business opportunity which properly belongs to the corporation. See generally General Automotive Mfg. Co. v. Singer, 19 Wis. 2d 528, 120 N.W.2d 659 (1963).
power for personal advantage, to the detriment of stockholders and creditors, no matter how absolute his power is perceived to be and no matter how meticulous the fiduciary is to satisfy technical requirements. Should a fiduciary violate or attempt to violate these principles, a court of equity has the power to undo the wrong or intervene to prevent its consummation. In this respect, however, it should be noted that while fiduciary duties are elastic and that the liability of an officer or director varies directly with the culpability of his conduct, some anti-takeover defensive tactics are by definition attempts to deprive shareholders of potential takeover profits. As such, these tactics constitute such clear breaches of fiduciary duty that they should not survive a shareholder action for breach.

One of the most popular anti-takeover tactics in use today is the so-called "golden parachute." This device enables directors of a company to enter into binding contracts to pay severance benefits to officers and high ranking employees in the event of a takeover, friendly or otherwise. Often, these severance agreements permit the officers to resign after a change in control and still retain benefits.

91. Id.
92. See generally 1 R. Magnuson, supra note 19, at § 9.03 (1982). In application of this elastic fiduciary duty model, it is probable that some pre-takeover defensive tactics will be viewed as being more onerous than others. "Golden parachute" agreements may very well be perceived differently than those devices which are neutral on their face such as a supermajority vote requirement. In this respect, however, it should be remembered that regardless of intention, pre-takeover defensive tactics all lead to the same result, namely a reduction in shareholder welfare.
93. See, e.g., Forbes, Nov. 22, 1982, at 238. A recent study has shown that golden parachutes have become more common in the past three years. In fact, "60% of the top executives of America's 1,000 largest firms have such protection." Id. Phillips Petroleum, for example, recently voted to pay its six top executives all of their salaries and benefits for a period of three years after any change in "control" of the company. The total cost to Phillips, in the event of a takeover, would be 9.1 million dollars. Wall St. J., Mar. 31, 1982, at 8, col. 1 (s.w. ed.); Proxy Statement of Phillips Petroleum, Mar. 1982. See also David, Thiokol's Davis has a $2.6 million "Parachute," Phila. Bus. J., July 26-Aug., 1982, at 1, col. 1; Ingrassia, supra note 70.
94. See David, supra note 93. The answer to the question of what constitutes a "change in control" is not clear. While the normal definition, and perhaps the intended one, might be acquisition of 51% of the outstanding stock by an outsider, control in many cases can be obtained with less than a majority of the shares. See, e.g., Essex Universal Corp. v. Yates, 305 F.2d 572 (2d Cir. 1962); In re Caplan's Petition, 20 A.D.2d 301, 246 N.Y.S.2d 913 (App. Div.), aff'd, 14 N.Y.2d 679, 198 N.E.2d 708, 249 N.Y.S.2d 877 (N.Y. 1964); Berle, "Control" in Corporate Law, 58 Colum. L. Rev. 1212 (1958). Thus, if the "golden parachute" agreement so specifies, even a small percentage of shares or an investment block of 20% could trigger the payoff provisions. See generally Meyer, Lawyer's Lament, Arbitrager's Delight, Forbes, May 24, 1982, at 31.
While it might be argued that such contracts encourage top management to remain with the company and eliminate possible management distraction in the event of a change in control, the reality of the situation should prove otherwise. Faced with a potential takeover, management of the target company must represent the interests of the corporation's shareholders and must report their opinions on the takeover to the shareholders as required under rule 14e-2. The quality of that report might well suffer if management has become complacent due to the severance contract. Worse yet, any incentives to inform and protect shareholders might well take second place to the financial windfall which would accrue to the benefit of the officers and directors. As a matter of common sense, the potential for officer and director negligence and abuse of the "undivided loyalty" owed the corporation and its shareholders is greater when "golden parachutes" are in place.

In addition, since officers and directors must dedicate their uncorrupted business judgment to the corporation and its shareholders, and since any potential conflict of interest must be resolved in a manner that is fair and reasonable to the corporation and its shareholders, it is difficult to perceive how there can be any justification for a multi-million dollar payout to former employees triggered simply by a change in corporate control. Furthermore, if the economics are crucial to the proposed takeover, it seems logical that an acquiring company might well reduce its tender offer to shareholders to reflect the drain on the corporate treasury to be caused by severance agreements. Thus, if Company X was willing to offer $20 per share for Company Y's shares, it might offer $18 instead, which would take into account the $2 per share cost of severance benefits. Clearly, the "golden parachute"

95. See Wall St. J., Mar. 31, 1982, at 8, col. 3.
99. The total cost of severance benefits are by no means a trifling sum. Such payments would total $9.1 million in the case of Phillips Petroleum.
agreement is prejudicial to corporate shareholders, includes self-dealing on the part of corporate directors and officers, and results in a “raid” of the corporate treasury. It therefore should be prohibited as it constitutes a breach of fiduciary duty.

Another common anti-takeover tactic is to adopt a charter amendment requiring a “supermajority vote” to approve all major corporate decisions. These provisions tie the hands of a potential tenderor by requiring the approval of as much as ninety-five percent of the outstanding shares to consummate a takeover. Once such a provision is adopted, management can effectively grant itself a veto power over all tender offers if it accumulates only five percent of

See note 98 supra. In the case of Sunbeam Corporation, the total cost was nearly $10 million. Wall St. J., July 7, 1982, at 23, col. 3. And in the case of Gulf Resources and Chemical Corporation the cost approached $13 million. Wall St. J., Apr. 7, 1982, at 18, col. 2 (S.W ed.). See also David, supra note 93.

100. In some situations only nonemployee directors are permitted to vote to establish “golden parachute” provisions. Even so, too many variables exist to permit “outside” directors to exercise this power. For instance, “outside” directors often owe their positions to “insiders,” or the outside directors may not be able to gather sufficient data on which to base a decision on how much is “fair value,” how much is excess compensation, or the probable effect of these provisions on stockholder welfare. See generally Galef v. Alexander, 615 F.2d 51 (2d Cir. 1980); Brudney, The Independent Director—Heavenly City or Potemkin Village?, 95 HARV. L. REV. 597, 604-07 (1982); Marsh, Are Directors Trustees? Conflict of Interest and Corporate Morality, 22 Bus. LAW. 35 (1966).

101. It should be noted that severance payments, bonus contracts and similar fringe benefits are common in industry. Therefore, it is not suggested that these forms of incentives be prohibited in all cases. Only when the “golden parachute” payments are directly related to a change in corporate control should they be disallowed. Thus, a prospective employee would still be free to negotiate an employment contract with the firm. If such severance payments are desired as part of the contract package, it would normally be coupled with a covenant not to compete or a consulting arrangement. To pay enormous salaries for nothing more than resigning, however, may well be grounds for director negligence and unbusinesslike judgment. See generally 2 R. MAGNUSON, supra note 19, at § 15.05.

102. Usually these provisions apply only to votes on major corporate decisions such as mergers and sales of assets and are usually conditioned on factors such as lack of director approval of the transaction. In this way the supermajority provision does not unduly hamper the current management. The required "supermajority" can range from 75% to as high as 95%. The charter or by-law amendment creating the supermajority vote requirement is usually coupled with an amendment requiring a similar supermajority vote for any future amendment of the charter or by-laws. In this way a successful acquirer is precluded from using a simple majority to adopt an amendment eliminating the supermajority provision. See Sellers v. Joseph Bancroft & Sons Co., 23 Del. Ch. 13, 2 A.2d 108 (Del. Ch. 1938). See generally Black & Smith, supra note 12; Smith, Fair Price and Redemption Rights: New Dimensions in Defense Charter Provisions, 4 DEL. J. CORP. L. 1 (1978); Contra Young v. Valhi, 382 A.2d 172 (Del. Ch. 1978); E. ARANOW, H. EINHORN & G. BERLSTEIN, supra note 70, at 195; Gilson, supra note 18; Gilson, supra note 70; Mullaney, Guarding Against Takeovers—Defensive Charter Provisions, 25 Bus. LAW. 1441 (1970).
the outstanding stock or places five percent of the stock in "friendly" hands. Such a concentration of power is alarming, especially in the context of a publicly held corporation.

While most corporate statutes specifically permit supermajority voting requirements, most courts have lost sight of the fact that high voting majorities were originally of interest only to small closely-held corporations. When adopted by a close corporation, supermajority voting requirements serve to prevent oppression or squeeze-out of the minority. In the context of the publicly held corporation, however, the supermajority vote provision usually facilitates these evils since the very purpose for its adoption is to give incumbent corporate management control over future tender offers. Thus, the supermajority vote tends to create an oppressive atmosphere because future generations of shareholders will be unable to replace officers and directors, or to accept a tender, without the required percentage of votes, even though a clear majority of shares would vote in favor of the change or the tender.

Not only are supermajority voting provisions oppressive when adopted in the context of a publicly held corporation, but these provisions also involve a degree of self-dealing on the part of management. Since a takeover by a tender offer would normally lead


104. See E. FOLK, THE NEW DELAWARE CORPORATION LAW 8 (1967). An excellent discussion of this point can be found in Gilson, supra note 70. Professor Gilson points out that "[w]hile these statutory provisions are not on their face limited to close corporations, the legislative history is quite clear in pointing to the relationship between the needs of the close corporation and statutory authorization of supermajority voting requirements." Id. at 813. But see Smith, supra note 102, at 10 (no sound public policy against the supermajority voting requirement has been voiced); E. FOLK, THE DELAWARE GENERAL CORPORATE LAW 13 (1972).

105. See generally W. PAINTER, CORPORATE AND TAX ASPECTS OF CLOSELY-HELD CORPORATIONS 163, 201 (1981). But see Smith, supra note 102, at 13 (describing how a supermajority vote provision may be used in a public issue corporation to protect the minority where the tender offeror attempts to freeze out the remaining minority subsequent to a successful tender).

106. See, e.g., W. CARY & M. EISENBERG, CASES AND MATERIALS ON CORPORATIONS 461 (5th ed. 1980) (observing that "[a]lthough often cast in the guise of protecting shareholders against 'raiders' or conflict of interest transactions, in fact they are normally adopted for the sole purpose of insuring that incumbent management will not lose their positions as a result of the take-over bid."). Even the proxy statements distributed to shareholders in connection with the adoption of supermajority vote provisions point out that the provision will tend to perpetuate the incumbent board and management, and will tend to discourage some tender offers. See Proxy Statement of Landmark Banks, Inc., April, 1982. See also Buford, Amending the Corporate Charter, 32 Bus. Law. 1335, 1355 (1977); Cary, Corporate Devices Used To Insulate Management From Attack, 25 Bus. Law. 839 (1970).
to a change in control by the new shareholders, provisions perpetuating the control of incumbent management are clearly at odds with shareholder interests. Moreover, since tender offers are actually offers made directly to shareholders, any attempt to enhance management’s power to deny shareholders the ability to accept such an offer should be struck down as a breach of management’s fiduciary duty.

Finally, in light of the holding in Mobil Oil that certain defensive tactics employed by Marathon Oil resulted in a “circumvention of the natural forces of market demand,” it could be argued that as pre-tender charter amendments tend to perpetuate incumbent management and reduce shareholder welfare, they also tend to circumvent normal market demand and act as a restraint on the normal trading of securities. As such, those devices, at least where they are sufficiently connected with a tender offer, should give rise to a federal cause of action for violation of the Williams Act in addition to the state cause of action for breach of fiduciary duty.

While similar arguments could be raised against the remaining catalogue of pre-tender defensive tactics, it seems unnecessary to belabor the point. Common sense dictates that pre-tender offer amendments which enhance management power and control at the expense of shareholder welfare should be prohibited in publicly held companies. The market place should dictate management’s future, not deliberately conceived plans to further management’s economic and personal well-being. It remains, however, for

107. See notes 57-60 and accompanying text supra; Gilson, supra note 70, at 776.

108. 669 F.2d at 376.

109. See notes 75-80 and accompanying text supra. For the text of § 14(e) of the Securities Exchange Act of 1934, see note 75 supra.

110. For example, low or no interest term loans structured to provide for forgiveness if management is replaced or control is changed obviously benefit the recipients and harm shareholders. Eliminating the right of shareholders to call “special meetings” enhances management’s control at the expense of shareholder power. Finally, while staggering the terms of the directors may provide continuity of management, it also promotes directorial control and inhibits shareholder welfare through its deterrent effect on tenders and the inability of minority groups to place a director on the board. For a description of other pre-tender defensive tactics, see Gilson, supra note 70, at 775; Reuben & Elden, How To Be A Target Company, 23 N.Y.L. Sch. L. Rev. 423 (1978).

111. Clearly, if management is successful at its job, the stock price will remain high and that in itself should deter most tender offers. Additionally, if an offeror pays a high price, he is often buying management as well as plant, because he is impressed with the target’s performance. For example, when Britain’s Imperial Group tendered for the Howard Johnson Company, management was offered continued employment by the acquirer. Faces Behind The
courts and legislatures to recognize this principle and bring reality into the tender offer arena.

V. Conclusion

This article has attempted to show that a breach of management's fiduciary duty, through self-dealing, conflicts of interest, or negligence, is present in tender offer responses and in pre-tender offer defensive tactics. Through the use of such methods as super-majority voting requirements and golden parachutes, incumbent corporate managements have attempted to thwart hostile takeovers even before they have begun. Nonetheless, by application of the business judgment rule, courts have traditionally upheld managements' actions in resisting hostile offers regardless of the effect on shareholder rights and welfare. A more balanced approach is necessary. Both courts and legislatures should recognize the proprietary needs of the shareholders when a tender offer occurs. Management should be precluded from involving itself directly in a tender offer and any involvement that does occur should be subject to judicial scrutiny without the protection of the business judgment rule. Furthermore, management should be uniformly precluded from advocating corporate charter amendments that are designed to enhance its power, position, and prestige to the detriment of shareholder well-being. The marketplace should be the primary factor influencing the making of a tender offer and shareholders should have the opportunity to accept or reject an offer based on these conditions free from any takeover barriers raised by management.

Figures: Too Good To Resist, Forbes, Oct. 15, 1979, at 194. It is only when management isn't performing well that its employment is in jeopardy.