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EXTENSION OF THE MINIMUM OPEN TENDER OFFER PERIOD: REGULATION OF DEFENSIVE TAKEOVER TACTICS VIA THE BUSINESS JUDGMENT RULE

Prior to the enactment of the Williams Act,[1] federal securities laws did not require corporate raiders to make any disclosure relating to cash tender offers.[2] Shareholders of a target corporation had to decide whether to tender their shares with little or no information about the raider.[3] Subsequent to the enactment of the Williams Act, however, the federal securities laws required corporate raiders that wished to issue securities pursuant to an exchange offer to register the securities and to make disclosures concerning the offer.[4] The registration requirement provided target shareholders with information about the raider, and the Securities and Exchange Commission's (SEC) preclearance of registration statements prevented exchange offers from

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1. 15 U.S.C. §§ 78m(d)-(e), 78n(d)-(f) (1982).

2. *See* W. Cary & M. Eisenberg, Cases and Materials on Corporations 1563 (5th ed. 1980) (discussing advantage of cash tender offers over exchange offers prior to enactment of Williams Act). A majority of corporate acquisitions are the result of negotiations between management of the acquiring and acquired firms. *Proposals Affecting Corporate Takeovers,* 55 A.E.I. Legislative Analyses 1 (1985) [hereinafter cited as Legislative Analyses]. Recently, firms that wish to gain control of another firm acquire in the open market or through negotiated purchases a substantial number of the shares of a publicly traded corporation, known as the target. *Id.* After identifying the target corporation, the potential acquiror or bidder chooses an opening move based, for example, on the bidder's budget. Lerner, *Checkmate—Takeover Litigation Strategy,* 11 Litigation 27, 27 (1985) (discussing initial actions of parties involved in corporate takeover transactions). The bidder may choose to obtain a sufficient amount of the target's stock through open-market purchases and block trades to acquire control of the target. *Id.* In takeover terminology, open market purchases and block trades are creeping tender offers. *Id.* Alternatively, if the bidder's budget permits, the bidder may choose to make a public announcement of an offer for the balance or a controlling percentage of the target firm's shares. Legislative Analyses, *supra,* at 1. The offer is a formal tender offer, and the bidder promises to pay a price for the target's shares greater than the prevailing market price. *Id.*

Tender offers are friendly in nature when the bidders make the offers in accordance with an agreement reached during negotiations with the target firm's management or when the board of directors of the target firm recommends the offer as in the best interests of the target and the target shareholders. *See id.* at 53 n.1 (characterizing tender offers) (citing Manne, *In Defense of the Corporate Coup,* Reason, Jan. 1984, at 41-42). If a target board of directors neither negotiates nor recommends, and opposes the offer, the offer is hostile, and the bidder is a raider. *Id.* A target firm's management may oppose a tender offer to avoid losing jobs and control, often to a bidder that has no interest in the target firm's welfare. W. Cary & M. Eisenberg, *supra,* at 1563. Confronted with the threat of a hostile tender offer, the target firm's management may resort to defensive measures or "tactics" to block the raider's action. *See infra* notes 29-47 and accompanying text (discussing structural and financial defensive tactics that target may employ to block hostile tender offer).

3. *See* Legislative Analyses, *supra* note 2, at 11 (discussing federal regulation of tender offers prior to enactment of Williams Act).

4. *Id.; see infra* note 13 and accompanying text (discussing disclosures limited to exchange offers prior to Williams Act and applicable to cash tender offers under Williams Act).

proceeding too quickly, eliminating the key element of pressure in the tender offer.[5] Corporate raiders preferred to use the quicker cash tender offer and, consequently, the number of cash tender offers increased, soon surpassing the use of exchange offers.[6]

In addition to the absence of a disclosure requirement prior to 1968, the federal securities laws set no minimum time that a corporate raider making a cash tender offer had to hold the offer open.[7] Furthermore, the raider could require that a target shareholder could not withdraw shares once tendered.[8] Finally, the raider could prescribe that if target shareholders tendered more shares than a raider desired to purchase, the raider would buy shares in the order tendered.[9] A shareholder who delayed in tendering shares, therefore, ran the risk that the raider would not purchase any of the shareholder's shares.[10] Corporate raiders, therefore, could proceed quickly and pressure target shareholders into hasty decisions.[11] The coercive nature of cash tender offers and the insufficiency of information for the benefit of target shareholders prompted Congress to enact the Williams Act in 1968 as an amendment to the Securities Exchange Act of 1934 (1934 Act).[12] The Williams Act requires certain disclosures to a target's shareholders,[13] sets a minimum time during which a tender offer must be held open,[14] and provides

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5. LEGISLATIVE ANALYSES, *supra* note 2, at 11; *see also infra* notes 6-9 and accompanying text (terms of tender offers prior to enactment of Williams Act could discourage target shareholders from delaying tender of shares).

6. LEGISLATIVE ANALYSES, *supra* note 2, at 11. The number of cash tender offers began to exceed the number of exchange offers. *See id.* (citing Hayes & Taussig, *Tactics of Cash Takeover Bids,* HARV. BUS. REV., Mar.-Apr. 1967, at 135, 136). In 1960, aggregate cash tender offers had a value of $186 million compared with a $435 million value for exchange offers. *Id.* By 1965, aggregate cash tender offers had a value of $951 million, while exchange offers had a value of $558 million. *Id.*

7. LEGISLATIVE ANALYSES, *supra* note 2, at 11.

8. *Id.*

9. *Id.*

10. *See* W. CARY & M. EISENBERG, *supra* note 2, at 1563 (discussing federal regulation of tender offers prior to enactment of Williams Act).

11. *Id.*

12. 15 U.S.C. §§ 78m(d)-(e), 78n(d)-(f) (1982). Congress amended the Williams Act in 1970 to apply to exchange offers as well as tender offers. *See* LEGISLATIVE ANALYSES, *supra* note 2, at 11.

13. 15 U.S.C. § 78m(d)(1) (1982). The Williams Act requires any person who has directly or indirectly acquired the beneficial ownership of more than five percent of any class of an issuer's equity security to disclose administrative details concerning the beneficial ownership, the source and amount of funds or other consideration used to make the purchases, and the purchaser's plans for the issuer's future operation if the purchaser's purpose in acquiring the equity security is to gain control of the issuer's business. *Id.* § 78m(d)(1)(A-C). The beneficial owner must also disclose the number of shares beneficially owned and whether rights to acquire the beneficially owned shares exist, and information regarding any contracts, arrangements, or understandings with any person involving the issuer's securities. *Id.* § 78m(d)(1)(D-E).

14. General Rules and Regulations, Securities Exchange Act of 1934, 17 C.F.R. § 240.14e-1 (1985). Securities and Exchange Commission regulations now require that a tender offer remain open for at least 20 business days. *Id.*

for equal treatment of all tendered shares.[15] In addition, the Williams Act prohibits misrepresentations of material facts and fraudulent, deceptive, or manipulative acts or practices relating to tender offers and to the solicitation of shareholders' opposition to tender offers.[16]

The Williams Act's prohibition of manipulative acts and practices extends to the actions of a target firm's board of directors during an attempted takeover.[17] Shareholders of a target firm who question the propriety of the target management's use of defensive tactics to frustrate a takeover bid may bring an action under federal law against the target's board of directors, alleging a violation of the Williams Act.[18] Shareholders of a target firm who allege a violation of the Williams Act must show at least misrepresentation or nondisclosure on the part of the target's board of directors with respect to the defensive action taken.[19] If the target's shareholders cannot demonstrate misrepresentation or nondisclosure, the shareholder must seek a remedy under state law by asserting a breach of the target board's fiduciary duty to the firm.[20]

In determining whether a target firm's board of directors breached the board's fiduciary duty to the firm, courts have applied the business judgment rule.[21] The business judgment rule discourages judicial inquiry into the merits of business decisions provided the board of directors acted in accordance with the state law formulation of the business judgment rule.[22] Although

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15. 15 U.S.C. § 78n(d)(6), (7) (1982). Section 78n(d)(6) of the Williams Act provides for pro rata treatment of shares deposited pursuant to a tender offer when the number of tendered shares exceeds the amount the bidder wishes to acquire. *Id.* § 78n(d)(6); *see also supra* notes 1-11 and accompanying text (discussing nature of tender offers prior to enactment of Williams Act). Section 78n(d)(7) provides for a bidder's payment to all of a tender offeree's shareholders of the highest consideration offered to any shareholders. 15 U.S.C. § 78n(d)(7) (1982).

16. *See* 15 U.S.C. § 78n(d) (1982) (prohibiting untrue statement of material fact or omission of fact with respect to tender offer).

17. *See infra* notes 29-47 and accompanying text (discussing structural and financial defensive tactics that target may employ to block hostile tender offer).

18. 15 U.S.C. §§ 78m(d)-(e), 78n(d)-(f) (1982).

19. *See, e.g*, Schreiber v. Burlington N., Inc., 105 S. Ct. 2458, 2463 (1985) (section 14(e) of Securities Exchange Act of 1934 prohibiting manipulative acts requires showing of misrepresentation or nondisclosure). *But see* Mobil Corp. v. Marathon Oil Co., 669 F.2d 366, 377 (6th Cir. 1991) (full disclosure of manipulative act does not assure compliance with section 14(e) of Securities Exchange Act of 1934).

20. *See, e.g*, Santa Fe Indus., Inc. v. Green, 430 U.S. 462, 477 (1977) (language of federal statute weighs heavily against permitting federal cause of action for breach of corporate fiduciary duty); *infra* notes 21-23 and accompanying text (discussing judicial application of business judgment rule to determine breach of fiduciary duty).

21. *See infra* notes 22-23 and accompanying text (demonstrating judicial reluctance to examine substance of business decisions if board of directors acted in good faith and in furtherance of rational business purpose). The judicial reluctance to evaluate business decisions arises from the recognition that circumstances do not qualify or require courts frequently to examine the merits of business judgments. Auerbach v. Bennett, 47 N.Y.2d 619, 630, 393 N.E.2d 994, 1000, 419 N.Y.S.2d 920, 926 (1979).

22. *See generally* Greene & Junewicz, *A Reappraisal of Current Regulation of Mergers and Acquisitions*, 132 U. PA. L. REV. 647, 714-18 (1984) (discussing state regulation of corporate

application of the business judgment rule varies from state to state, courts uniformly decline to overturn purely discretionary business decisions.[23] Commentators, however, have suggested that courts may consider virtually any defensive responses to a takeover bid appropriate simply because the board of directors had relatively little time to implement defensive strategies.[24] The speed with which a tender offer is able to proceed, therefore, is a key element of legislation that addresses hostile tender offers.[25]

Several bills and legislative proposals relating to corporate takeovers and introduced for the purpose of addressing abuses in the takeover process involve extending the period during which a tender offer must be held open or otherwise delaying the takeover process.[26] The outcome of recent litigation concerning defensive tactics suggests that an extension of the period during which an offeror must hold a tender offer open would indeed affect the

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takeovers in connection with business judgment rule); *see also infra* notes 62-67 and accompanying text (discussing various state interpretations of circumstances relevant to application of business judgment rule).

23. *See* Kamin v. American Express Co., 383 N.Y.S.2d 807, 811, *aff'd mem.*, 54 A.D.2d 654, 387 N.Y.S.2d 993-94 (1976) (complaint alleging negligent directorial decision without alleging fraud, dishonesty, or nonfeasance states merely that shareholders disagree with directorial decision, and shareholders fail to make out actionable claim).

24. *See The Shareholder Protection and Elimination of Takeover Abuses Act of 1985: Hearings Before Subcomm. on Monopolies and Commercial Law of the House Comm. on the Judiciary,* 99th Cong., 1st Sess. 13 (1985) (testimony of Martin Lipton, Partner, Wachtell, Lipton, Rosen & Katz, New York, New York) (suggesting judicial leniency toward defensive responses to takeover bids based on limited time period during which board may act) [hereinafter cited as Lipton Testimony]; *see also supra* note 14 and accompanying text (discussing Securities and Exchange Commission regulation establishing minimum time during which bidder must hold tender offer open).

25. *See* Legislative Analyses, *supra* note 2, at 17 (discussing significance of time element in drafting of takeover legislation). The speed with which the acquisition of corporate control is able to proceed determines the advantage that one party to a takeover has over the other party. *See id.* (speed of tender offer is significant factor in relative neutrality of legislation affecting hostile takeover of corporations). To a raider, the speed of the takeover process relates to the element of surprise; to a target firm the speed of the takeover process determines the success of defending against the takeover. *See infra* notes 111-12 and accompanying text (discussing suggestion that extended open tender offer period is necessary for target shareholders and boards to consider unsolicited tender offers carefully); *infra* notes 36-47, 103 and accompanying text (discussing time element in connection with various takeover defensive measures). Congress, in enacting takeover legislation, seeks to minimize the advantages of the parties to a takeover relative to each other. *See Legislative Analyses, supra* note 2, at 17 (Congress enacted Williams Act to make regulation of tender offers neutral as between contending parties.) An example of a bill delaying the corporate takeover process is H.R. 2400, which would place a moratorium on hostile takeovers or acquisitions involving 15% or more of a target's voting stock if low-rated bonds or similar instruments account for 20% or more of the financing. *Id.* at 18. The Shareholder Protection and Elimination of Takeover Abuses Act of 1985 would require the extension of the period during which a tender offer must be held open from the current 20 business days to 60 calendar days. Lipton Testimony, *supra* note 24, at 13, 22, 32-33. The principal purpose of the bills and proposals is to provide the shareholders and board of directors of a target firm adequate time to evaluate a takeover bid. *Id.* at 13.

26. *See infra* notes 108-11 and accompanying text (discussing examples of proposed legislation designed to delay corporate takeover process).

courts' application of the business judgment rule.[27] Courts may become more inclined to examine the justification for takeover defensive tactics if a target firm's board of directors has more time in which to respond to a takeover attempt.[28]

Defensive takeover tactics may be structural or financial in nature.[29] A firm that anticipates becoming the target of a hostile takeover may resort to structural defensive tactics designed to make ratification of a change in corporate control difficult.[30] Structural defensive tactics usually involve amendments, enacted with the approval of the potential target's shareholders, to the corporate charter.[31] Amendments to a corporate charter, known as shark repellant amendments, are appealing to boards of directors because the amendments require shareholder approval and, subsequently, shareholders cannot challenge the amendments as breaches of directors' fiduciary duties.[32] Another structural defense involving a provision in a corporate charter or other agreement is known as a poison pill provision and is triggered by a change in control of the target firm.[33] For example, a target firm may issue a class of securities convertible upon a change in control into the common stock of the raider.[34] The target thus presents a prospective raider with a threat of earnings dilution if the raider's tender offer is successful.[35]

When a firm has not implemented structural defenses before becoming the target of a hostile takeover, the company may resort to financial defensive tactics in response to a tender offer.[36] Target firms design financial defensive

27. *See infra* notes 68-98 and accompanying text (demonstrating likelihood of greater judicial scrutiny of defensive tactics in light of extended open tender offer period that allows boards to take more thoughtful action).

28. *See supra* note 24 and accompanying text (discussing suggestion that limited open tender offer period creates judicial leniency toward defensive responses to takeover bids).

29. *See infra* notes 30-56 and accompanying text (discussing defensive tactics implemented in anticipation of or at time of tender offer).

30. *See generally* Greene & Junewicz, *supra* note 22, at 703-05 (discussing defensive tactics pursued well in advance of commencement of tender offer).

31. *See id.* (discussing shark repellant amendments as usual form of structural defensive tactic).

32. *See infra* note 124 and accompanying text (discussing Securities and Exchange Commission reluctance to preempt state law by prohibiting or further regulating antitakeover charter and by-law amendments). A disadvantage of enacting shark repellant amendments is the possible counterproductive effect of advertising a company as a takeover prospect. *See* LEGISLATIVE ANALYSES, *supra* note 2, at 8 (discussing opinion of Charles C. Cox, Commissioner of Securities and Exchange Commission, concerning possible disadvantage of shark repellant amendments).

33. LEGISLATIVE ANALYSES, *supra* note 2, at 10; *see also* Goldberg, *Regulation of Hostile Tender Offers: A Dissenting View and Recommended Reforms*, 43 MD. L. REV. 225, 239 (1984) (providing definitions of terminology associated with corporate takeover process).

34. Goldberg, *supra* note 33, at 239.

35. *See* Greene & Junewicz, *supra* note 22, at 705 (discussing consequence to raider of poison pill provision in target's corporate charter or other agreement).

36. *See generally id.* at 701-02 (discussing defensive tactics that target board of directors may implement without shareholder approval).

tactics to make the target less attractive to a raider.[37] For example, a target firm may merge with or acquire another firm whose business would create antitrust problems for a particular offeror.[38] The most effective defense against a takeover may be to generate higher prices for the target's shares over which a raider would have to pay a premium to make a tender offer attractive.[39] A target's management, therefore, may elect to initiate an open market purchase program for the firm's own shares at a price above market, which would raise share prices and make a raider's attempt to meet minimum share requirements more difficult.[40]

A target firm's management may have to resort to more drastic financial defenses.[41] For example, management may take last-resort action, known as a scorched earth defense, to discourage a raider by making the target less attractive.[42] In effecting a scorched earth defense, a target's management may sell a valuable subsidiary or property to a party friendly to target management, or white knight,[43] that may subsequently make a favorable tender or merger offer to the target.[44] A target's management also may

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37. *See id.* (discussing operation of financial defensive tactics). A target firm's management, for example, may attempt to destroy an offeror's credibility by engaging in research that might uncover negative information about the offeror. *See* LEGISLATIVE ANALYSES, *supra* note 2, at 8 (discussing defensive tactics that target management may use during tender offers).

38. *See* LEGISLATIVE ANALYSES, *supra* note 2, at 9 (discussing target management's use of less controversial defenses during tender offers). A target firm that has merged with or acquired another firm to create antitrust problems for the raider often employs litigation to highlight the antitrust issue or even possible violations of the securities laws. *Id.* For example, target management may attack the adequacy of the bidder's disclosure of information pursuant to acquisition of five percent of the target's shares. Lerner, *supra* note 2, at 27; *see also supra* note 13 and accompanying text (discussing disclosure requirements under Williams Act). The protracted nature of securities litigation provides a target with the opportunity to prepare alternative defenses. LEGISLATIVE ANALYSES, *supra* note 2, at 9.

39. LEGISLATIVE ANALYSES, *supra* note 2, at 9. A raider may not be willing to pay a price for target shares higher than the market price. *Id.* Target shareholders will be less likely to tender shares to the raider if the raider does not pay a substantial premium over the market price. *Id.*

40. *See* Schilling v. Belcher, 582 F.2d 995, 998 (5th Cir. 1978) (upholding target management's buy-out of three target shareholders at price in excess of market in order to defend against previous management's attempt to regain control).

41. *See infra* notes 41-47 and accompanying text (describing scorched earth defenses that target management may employ).

42. *See* LEGISLATIVE ANALYSES, *supra* note 2, at 10 (explaining nature of scorched earth category of defensive tactics); *see also infra* notes 51-55 and accompanying text (suggesting that financial defenses operate to detriment of target shareholders as well as bidders).

43. *See* Goldberg, *supra* note 33, at 239 (providing definitions of terminology associated with corporate takeover process).

44. *See* Mobil Corp. v. Marathon Oil Co., 669 F.2d 366, 367-68 (6th Cir. 1981) (target firm granted white knight option to purchase valuable interest in oil field, exercisable upon failure of white knight's tender offer and third party's control of target). The option described in *Mobil Corp. v. Marathon Oil Co.* is a form of lock-up option in takeover terminology. *See* LEGISLATIVE ANALYSES, *supra* note 2, at 10 (discussing less controversial defenses that target management may use during tender offers). Lock-up options are arrangements that give a white knight a competitive advantage over other bidders and involve either stock or assets of the

decide to liquidate the target in whole or in part,[45] or encourage *en masse* departure of key employees from the target firm, jeopardizing the continuity of the target firm.[46] A target firm may even employ a Pac-Man strategy by launching a counter tender offer for the raider's stock, often incurring substantial debt in order to finance the offer.[47]

Financial defenses serve to frustrate hostile tender offers by changing the financial condition of the target.[48] A target that incurs substantial indebtedness to defend against a tender offer or open market purchase program for the target's own shares or to finance a counter tender offer for the raider's stock becomes less attractive to the raider.[49] Similarly, a firm that sells a valuable subsidiary or other asset becomes a less desirable target.[50] Financial defenses, however, may also serve to frustrate shareholder goals.[51] For example, a target's tender offer or open market purchase program for the target's own shares may have the positive effect of causing the shares to trade at a price above the initial tender price.[52] The open market purchase program, however, may weaken the target's financial condition with debt financing resulting in the market's valuation of the target's shares at a lower price following the takeover battle.[53] The loss of a valuable asset or key

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target firm. *Id.* Stock lock-ups give the white knight the option to acquire the target firm's treasury shares. *Id.* The asset lock-up described in *Mobil Corp.* granted the white knight the option to acquire a major asset of the target firm. *Id.* The United States Court of Appeals for the Sixth Circuit held that the option agreement in *Mobil Corp.* was manipulative under section 14(e) of the Securities Exchange Act of 1934 because the option discouraged competitive bidding for target shares. *Mobil Corp.*, 669 F.2d at 337. The *Mobil Corp.* court, however, declined to disturb the lower court's finding of good faith and loyalty on the part of the target firm's directors. *Id.*

45. *See* Joseph E. Seagram & Sons, Inc. v. Abrams, 510 F. Supp. 860, 861 (S.D.N.Y. 1981) (target firm announcement of plan to sell assets, or alternatively, to destroy charter to circumvent tender offer). In *Joseph E. Seagram & Sons, Inc. v. Abrams,* the United States District Court for the Southern District of New York determined that the tender offeror had demonstrated sufficient evidence of target management's entrenchment motive to warrant the issuance of a temporary restraining order prohibiting further defensive measures. *Seagram,* 510 F.Supp. at 862.

46. LEGISLATIVE ANALYSES, *supra* note 2, at 10.

47. *See* Martin Marietta Corp. v. Bendix Corp., 549 F. Supp. 623, 625 (D. Md. 1982) (target firm's counter tender offer for 50.3% of raider's common stock five days after raider's announcement of tender offer); *see also infra* notes 49 & 53 and accompanying text (discussing consequences of target firm's incurrence of debt to finance defensive measures).

48. Greene & Junewicz, *supra* note 22, at 702-03.

49. *Id.* at 702.

50. *Id.; see generally* Letter from John Shad to Representative Timothy Wirth (Jan. 17, 1986) (discussing Securities and Exchange Commission review of issues related to corporate takeovers) [hereinafter cited as Letter from John Shad].

51. *See infra* notes 53-55 and accompanying text (suggesting that financial defenses operate to detriment of target shareholders as well as bidders).

52. *See supra* notes 39-40 and accompanying text (discussing significance of share price to successful defense against hostile takeover bid).

53. *See* Remarks of Representative Timothy E. Wirth, Brookings Institution's Center for Public Policy Education, Forum on Corporate Takeovers: Impact on the Economy (Dec. 11,

employees may also result in a lower market valuation of the target's shares.[54] Successful financial defenses, therefore, often serve to perpetuate target management's control at the expense of target shareholder interests.[55] The detrimental nature of financial defensive tactics may lead to increased judicial scrutiny of the merits of management resistance to takeover threats.[56]

The regulation of management action during the takeover process is most relevant to the financial defenses that directors authorize without shareholder approval because firm managements may implement structural defenses only with shareholder approval.[57] In *Santa Fe Industries, Inc. v. Green*,[58] the United States Supreme Court distinguished the circumstances under which shareholders have a federal cause of action against a corporation's board of directors from those circumstances that state law controls.[59] The *Santa Fe* decision indicated that shareholders who merely question the authorization of defensive action are asserting a breach of the board's fiduciary duty to the corporation, traditionally an area of state law concern.[60]

Under state law, the determination whether a breach of fiduciary duty has occurred involves application of the business judgment rule.[61] The most

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1985 (noting contribution of takeover wave to high levels of debt in American economy) [hereinafter cited as Remarks of Representative Wirth]. Representative Wirth noted the comment of Gerald Corrigan, President of the New York Federal Reserve, concerning the net reduction in corporate equities resulting from takeovers, leveraged buy-outs, and stock repurchases. *Id.* Corrigan predicted a combined net reduction in corporate equities of $150 billion for 1984 and 1985. *Id.; see also* J. FREELAND, S. LIND & R. STEPHENS, CASES AND MATERIALS ON FUNDAMENTALS OF FEDERAL INCOME TAXATION 524 (5th ed. 1985) (discussing wide corporate use of bonds and debentures to acquire stock or assets of other corporations). Congress, to discourage the use of debt financing in corporate acquisitions, enacted section 279 of the Internal Revenue Code (IRC) in 1969. FREELAND, LIND & STEPHENS, *supra*, at 524. Section 279 of the IRC imposes limitations on the deductibility of interest on corporate indebtedness incurred to acquire stock or assets of another corporation. I.R.C. § 279 (1985).

54. *See supra* notes 43-46 and accompanying text (discussing effect of scorched earth defenses on continuity of target firm).

55. *See generally* LEGISLATIVE ANALYSES, *supra* note 2, at 3-4 (discussing divergence of target management and target shareholder interests inherent in corporate takeover process).

56. *See infra* notes 68-98 and accompanying text (demonstrating increasing judicial willingness to examine substance of business decisions).

57. *See supra* note 32 and accompanying text (discussing requirement of shareholder approval in implementing structural or financial defensive tactics).

58. 430 U.S. 462 (1977).

59. Santa Fe Indus., Inc. v. Green, 430 U.S. 462, 477 (1977). In *Santa Fe Indus., Inc. v. Green*, the United States Supreme Court maintained that the language of section 10(b) of the Securities Exchange Act of 1934 weighs heavily against permitting a federal cause of action for the breach of corporate fiduciary duty. *Id.* The *Santa Fe* Court noted that Congress had not intended the manipulation requirement of section 10(b) to apply to instances of corporate mismanagement in which a fiduciary treated shareholders unfairly. *Id.* The *Santa Fe* Court further noted that state regulation traditionally addressed corporate mismanagement involving fiduciary relationships. *Id.* at 478.

60. *See* Santa Fe Indus., Inc. v. Green, 430 U.S. 462, 478 (1977) (state law traditionally controls instances of corporate mismanagement involving fiduciary relationships).

61. *See generally* Greene & Junewicz, *supra* note 22, at 714-18 (discussing business judgment rule in connection with state regulation of corporate takeovers).

common application of the business judgment rule provides that courts will uphold directorial action taken in good faith and in pursuit of a rational business purpose.[62] The rule presumes directors' good faith until a complaining shareholder offers evidence that self-interest motivated the directors' action.[63] The burden of proof then shifts to the directors to show that directors acted in furtherance of a rational business purpose.[64] Courts, however, interpret rational business purposes broadly and are likely to accept as sufficient any justification that the directors might offer.[65] Another application of the business judgment rule recognizes that self-interest is an inherent motivation for any directorial action, particularly actions taken in connection with corporate takeovers that involve potential changes in corporate control.[66] Under this application of the rule, when a change in

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62. *See id.* at 714, 717 (discussing traditional circumstances under which courts apply business judgment rule). *But see* Gearhart Indus., Inc. v. Smith Int'l, Inc., 741 F.2d 707, 723-24 (5th Cir. 1984) (business judgment rule in Texas provides that courts should not interfere with business judgment of directors unless transaction is fraudulent or ultra vires act).

63. *See* Norlin Corp. v. Rooney Pace, Inc., 744 F.2d 255, 265 (2d Cir. 1984) (business judgment rule governs only when directors did not have self-interest in transaction at issue) (quoting Treadway Cos., Inc. v. Care Corp., 638 F.2d 357, 382 (2d Cir. 1980)). In *Norlin Corp. v. Rooney Pace, Inc.*, Rooney Pace, Incorporated, together with Piezo Electric Products, Incorporated (Piezo), began purchasing large blocks of Norlin Corporation (Norlin) shares. 744 F.2d at 258. Norlin's board of directors subsequently issued new common and voting preferred stock to a wholly-owned subsidiary and to a newly-created employee stock option plan. *Id.* The new stock issues were an attempt to hinder any takeover advances against Norlin by concentrating greater voting control in the hands of Norlin's board of directors. *Id.* Piezo sought a preliminary injunction preventing the Norlin board from voting the new shares. *Id.* The United States District Court for the Southern District of New York noted that a possible consequence of the new stock issues, because the issues had not received shareholder approval, was delisting from the New York Stock Exchange that would cause irreparable injury to Norlin shareholders. *Id.* The district court therefore granted the preliminary injunction. The United States Court of Appeals for the Second Circuit affirmed the grant of the preliminary injunction. *Norlin Corp.*, 744 F.2d at 269.

64. *See Norlin Corp.*, 744 F.2d at 265 (once plaintiff demonstrates directors' self-dealing or bad faith, burden shifts to directors to prove that transaction was fair and reasonable to corporation) (quoting Treadway Cos., Inc. v. Care Corp., 638 F.2d 357, 382 (2d Cir. 1980)).

65. *See, e.g,* Panter v. Marshall Field & Co., 646 F.2d 271, 296 (7th Cir. 1981) (decision to build value of company from within, rather than through merger or takeover, may be rational exercise of business judgment); Cheff v. Mathes, 41 Del. Ch. 494, 199 A.2d 548, 556 (1964) (directorial authorization of target firm's purchase of target shares at inflated prices held to be legitimate response to threat against continued existence of target firm).

66. *See* Johnson v. Trueblood, 629 F.2d 287, 292 (3d Cir. 1980) (self-interest is inherent element of directorial position). In *Johnson v. Trueblood*, the United States Court of Appeals for the Third Circuit examined the lower court's jury charge on the burden of overcoming the business judgment rule. *Id.* The jury charge included a statement that a showing that a director's sole or primary purpose for adopting a course of action or for refusing to adopt another course of action is to retain control serves to rebut the business judgment rule. *Id.* The appellants argued that the standard of proof was simply to show that a desire to retain control was one motivation for directorial action. *Id.* The Third Circuit noted that the retention of control is inevitably one motivation for a director's action and therefore, plaintiffs could always assert that the desire to retain control motivated directorial action. *Id.* The Third Circuit maintained that the standard of proof that the appellants advanced was inconsistent with Delaware law and

corporate control is involved, a plaintiff may not show merely that self-interest motivated directorial action, but the plaintiff must show that self-interest was the primary purpose of the directors' action.[67]

More recent applications of the business judgment rule have added new elements to the rule in the takeover context.[68] For example, in *Unocal Corp. v. Mesa Petroleum Co.*,[69] the Supreme Court of Delaware upheld Unocal Corporation's (Unocal) selective self-tender offer made in response to a minority shareholder's hostile takeover bid.[70] At an initial meeting of the Unocal board of directors, eight independent directors, constituting a majority of the Unocal board, unanimously agreed to recommend that the board reject the takeover bid as inadequate.[71] The independent directors also

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would undercut the purpose of the business judgment rule. *Id.* at 292-93. The *Johnson* court therefore found that the lower court properly charged the jury on the burden of overcoming the business judgment rule. *Id.* at 293.

67. *See* Treco, Inc. v. Land of Lincoln Sav. and Loan, 749 F.2d 374, 378-79 (7th Cir. 1984) (business judgment rule continues to insulate directors' actions in challenge-to-control contexts despite directors' apparent self-interest, unless self-interest was sole or primary purpose for directors' resistance) (quoting Panter v. Marshall Field Co., 646 F.2d 271, 292 (7th Cir. 1981) and adopting quoted formulation of business judgment rule as Illinois' likely version); Johnson v. Trueblood, 629 F.2d 287, 292 (3d Cir. 1980) (unless plaintiff can offer evidence to show that defendant's sole or primary motive was to retain control, presumption of exercise of sound business judgment stands).

68. *See infra* notes 69-98 and accompanying text (discussing recent decisions that have considered new circumstances in applying business judgment rule); *supra* notes 62-65 and accompanying text (discussing traditional circumstances under which courts apply business judgment rule).

69. 493 A.2d 946 (Del. 1985).

70. *Id.* at 958. In *Unocal Corp. v. Mesa Petroleum Corp.*, the Supreme Court of Delaware held that the Unocal Corporation (Unocal) board of directors acted within the board's power in opposing a minority shareholder's tender offer and implementing a selective exchange of Unocal debt securities for Unocal stock made in good faith after reasonable investigation. *Id.* Furthermore, the *Unocal* court found that the use of the selective exchange was reasonable in relation to the terms of the takeover, which the Unocal board believed to be inadequate and coercive. *Id.*

71. *Unocal*, 493 A.2d at 950. At the initial meeting to consider the takeover bid, the entire Unocal board of directors heard detailed presentations of legal counsel concerning the board's position under Delaware corporate law and the federal securities laws. *Id.* The entire board also heard a presentation of investment bankers concerning the basis of the opinion that the takeover bid was inadequate and outlining various defensive strategies. *Id.* The eight independent Unocal directors then met separately with the legal counsel and the financial advisors prior to making a recommendation to the entire board. *Id.*

Mesa Petroleum Company and related entities (Mesa) had made an offer of $54 per share in cash for approximately 37% of Unocal's outstanding shares. *Id.* at 949. The investment bankers had advised the Unocal board that the sale or orderly liquidation of 100% of Unocal's stock would generate a minimum cash value of $60 per share. *Id.* at 950. In addition, the securities, allegedly worth $54 per share, which Mesa offered to exchange for the balance of Unocal's publicly held shares were subordinated to existing Mesa debt and were worth less than $54 per share. *Id.* at 949, 956. The Unocal court noted that a "two-tiered" offer such as Mesa's is a classic coercive takeover device designed to pressure target shareholders into tendering shares at the first stage of the offer to avoid the less desirable terms of the offer's second stage. *Id.* at 956.

recommended that the board undertake a self-tender offer in order to provide Unocal shareholders with an alternative to the takeover bid.[72] At a subsequent meeting, the Unocal board determined to make an offer to all the Unocal shareholders except the raiding shareholder to exchange debt securities having an aggregate par value of seventy-two dollars per share for Unocal shares.[73] The *Unocal* court noted that a board of directors, to invoke the protection of the business judgment rule, must not have acted solely out of a desire to remain in control, but out of a good faith concern for corporate and shareholder welfare.[74] In addition, the *Unocal* court recognized a new element in the application of the business judgment rule by requiring that a defensive measure must be reasonable in relation to the takeover threat.[75] The determination of a defensive measure's reasonable relation to the takeover threat involves target director assessment of the takeover bid and the bid's effect on the target.[76] Relevant considerations include the adequacy of the offered price, the timing of the offer, the possibility of illegality, the impact on target creditors, customers, employees and the community, the risk of noncompletion of the takeover transaction, and the quality of securities offered in the exchange.[77] Another factor that the target board of directors may consider reasonably is the basic shareholder interest of receiving maximum value for shares held.[78] The *Unocal* court concluded that the selective exchange offer was a reasonable measure to protect Unocal shareholders from an inadequate and coercive tender offer.[79]

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72. *Id.* at 950. At the initial meeting of the Unocal board of directors, investment bankers discussed Unocal's ability to finance a self-tender offer. *Id.* The investment bankers noted that reductions in exploratory oil drilling would be necessary but would not impair the continuity of Unocal operations. *Id.*

73. *Id.* at 951.

74. *Id.* at 955.

75. *Id.; see supra* notes 62-65 and accompanying text (discussing traditional circumstances under which courts apply business judgment rule).

76. *Unocal,* 493 A.2d at 955.

77. *Id.* (citing Lipton & Brownstein, *Takeover Responses and Directors' Responsibilities: An Update,* A.B.A. NAT'L INST. ON THE DYNAMICS OF CORP. CONTROL 7 (1983)).

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

79. *Id.* at 958. The Unocal directors considered the raider's national reputation as a greenmailer. *Id.* at 956. A greenmail arrangement occurs when a target firm purchases the shares of the target held by a potential tender offeror who already has acquired a significant amount of the target's shares. LEGISLATIVE ANALYSES, *supra* note 2, at 9. The target firm and potential tender offeror subsequently enter into an agreement that provides that the potential offeror will not acquire other shares of the target firm for a specified time. *Id.; see also* Moran v. Household Int'l, Inc., 500 A.2d 1346, 1356-57 (Del. 1985) (directors must show that defensive mechanism was reasonable in relation to threat posed). In *Moran v. Household Int'l, Inc.,* the board of directors of Household International Incorporated (Household) adopted a Preferred Share Purchase Rights Plan (Rights Plan) to discourage potential takeover attempts. 500 A.2d at 1348-49. Under the Rights Plan, the announcement of a tender for 30% of Household shares would cause Household to issue Rights immediately exercisable to purchase 1/100 share of new preferred stock for $100, which the Household board could redeem for $.50 per Right. *Id.* at 1349. If any person were to acquire 20% of Household shares, Household would issue the Rights, which would be immediately exercisable but nonredeemable. *Id.* In addition, if a Rights

A subsequent decision has applied the reasonable relation element of the business judgment rule and has reached a decision contrary to the *Unocal* court's holding.[80] In *MacAndrews & Forbes Holdings, Inc. v. Revlon, Inc.*,[81] a subsidiary of Pantry Pride, Incorporated (Pantry Pride) made a series of cash tender offers for Revlon, Incorporated (Revlon) shares in an effort to acquire or merge with Revlon.[82] The Revlon board of directors opposed each offer and responded with various measures designed to discourage Pantry Pride's further bidding.[83] Pantry Pride

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holder did not exercise a Right and a merger or consolidation subsequently occurred, the Rights holder could exercise each Right to purchase for $100 common shares of the tender offeror worth $200. *Id.; see supra* note 34 and accompanying text (in enacting poison pill provision in corporate charter or other agreement, target firm may provide for issuance of class of securities convertible upon change in control into common stock of raider). Certain Household shareholders brought an action to invalidate the Rights Plan. Moran v. Household Int'l, Inc., 490 A.2d 1059, 1063 (Del. Ch. 1985). The Court of Chancery of Delaware held that the adoption of the Rights Plan was an appropriate exercise of business judgment. *Id.* at 1083.

In affirming the decision of the lower court, the Supreme Court of Delaware found that under the Delaware Corporation Law, the Household board had the authority to adopt the Rights Plan. Moran v. Household Int'l, Inc., 500 A.2d 1346, 1353 (Del. 1985). In applying the business judgment rule to the Household board's adoption of the Rights Plan, the *Moran* court noted that the complaining shareholders had not alleged bad faith or an entrenchment motive by the Household directors. *Id.* at 1356. The *Moran* court found that the Household board had made an informed business judgment; the directors had received information on the Rights Plan and the current takeover environment, had engaged in extended discussion with legal and financial counsel, and were familiar with the arguments of a director opposing the Rights Plan. *Id.* The *Moran* court also found that the Rights Plan was a reasonable defensive mechanism in light of the Household board's concern with coercive acquisition techniques. *Id.* at 1357.

80. *See supra* note 75 and accompanying text (Supreme Court of Delaware noted that defensive measure's reasonable relation to takeover threat was circumstance significant to application of business judgment rule).

81. 1985 FED. SEC. L. REP. (CCH) ¶ 92,333 (Oct. 23, 1985), *aff'd sub nom. Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 1985 FED. SEC. L. REP. (CCH) ¶ 92,357 (Nov. 1, 1985).

82. *See infra* note 83 and accompanying text (describing individual tender offers and target responses).

83. 1985 FED. SEC. L. REP. at ¶ 92,333, 92,217-19. In *MacAndrews & Forbes Holdings, Inc. v. Revlon, Inc.*, Pantry Pride, Incorporated's (Pantry Pride) first offer to Revlon, Incorporated (Revlon) was to pay $42 or $43 in a negotiated acquisition or to pay $45 per share in a hostile takeover attempt. *Id.* at 92,217. Revlon's Chairman of the Board and Chief Executive Officer declined to consider the Pantry Pride offer, and the Revlon board decided at a special meeting that the offered price was inadequate. *Id.* At the same meeting, Revlon's investment banker advised the board that the separate sales of Revlon divisions, if timed properly, could generate between $60 and $70 per share, but somewhat less if Revlon sold as a single entity. *Id.* Also at the same meeting, special counsel for Revlon recommended that the Revlon board unanimously adopt a Note Purchase Rights Plan (Rights Plan). *Id.* at 92,217-18. The Rights Plan provided that each Revlon shareholder receive as a dividend one Note Purchase Right entitling the shareholder to exchange one share of common stock for Revlon notes of a $65 principal amount. *Id.* Revlon's special counsel, together with Revlon's management and investment banker, developed the Rights Plan to discourage tender offers of less than $65 per share and to encourage prospective bidders to negotiate with the Revlon board. *Id.* Revlon shareholders could exercise the rights when anyone acquired beneficial ownership of 20% or more of Revlon shares unless the acquiror announced and effected a transaction to purchase for cash Revlon shares for at least $65 per share. *Id.* at 92,218.

sought an injunction to invalidate Revlon's use of a particular defensive measure.[84]

The Delaware Court of Chancery, in ruling on the applicability of the business judgment rule to the takeover defense, noted the position of the Delaware Supreme Court in *Unocal Corp. v. Mesa Petroleum Co.* that a board of directors has the power to employ defensive measures that are reasonable responses to the takeover threat.[85] The *Revlon* court further noted that once the liquidation of Revlon became imminent, the function of the Revlon board was to act as auctioneer, attempting to obtain maximum prices for Revlon divisions.[86] The *Revlon* court found that the Revlon board, rather than maintaining an impartial position with

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Pantry Pride subsequently commenced a tender offer for any and all shares of Revlon common stock at $47.50 per share. *Id.* The Revlon board met to consider the offer, determined that it was unacceptable, and recommended that shareholders reject the offer. *Id.* In addition, the Revlon management offered to exchange senior subordinated notes with a $47.50 principal amount together with one tenth of a share of preferred stock worth $100 per share for each share of common stock for up to 10 million shares. *Id.* The notes contained covenants, intended to discourage tender offers, placing severe restrictions on Revlon's ability to incur additional debt, sell assets, or pay dividends. *Id.*

Pantry Pride terminated the initial tender offer and commenced a new offer for at least 90% of Revlon shares at $42 per share. *Id.* The Revlon board again rejected the Pantry Pride offer and already had begun negotiating with third parties to arrange a leveraged buy-out of Revlon. *Id.* Pantry Pride offered $50 per share and later raised the offer to $53 per share for a merger agreement with Revlon. *Id.* The Revlon board met and unanimously approved the plan to enter into an agreement for a leveraged buy-out under which Revlon shareholders would receive $56 per share and Revlon management would have the opportunity to acquire an equity interest in the surviving corporation. *Id.* at 92,219. As part of the agreement, however, Revlon would lift the note covenants, and as a consequence, the value of the senior subordinated notes began to drop following Revlon's announcement of the buy-out proposal. *Id.* Pantry Pride raised its tender offer from $42 to $56.25 per share. *Id.*

84. *Id.* ¶ 92,333, at 92,129. In *Revlon*, the Revlon board granted the option to the white knight in connection with a proposal to raise the per share value of the leveraged buy-out to $57.25 per share. *Id.* The option involved the purchase of the Vision Care and National Health Laboratories divisions of Revlon for $525 million. *Id.; see also supra* note 44 and accompanying text (discussing lock-up options characterized either as asset or as stock lock-ups). The amended buy-out proposal included an offer to exchange new senior subordinated notes for the notes given in the Revlon exchange in an effort to increase the value of the Revlon notes. *Revlon*, 1985 FED. SEC. L. REP. ¶ 92,333, at 92,219. The Revlon board considered the tender offer and the buy-out proposal and concluded that the buy-out was more favorable to Revlon shareholders. *Id.*

Although Pantry Pride's request for a preliminary injunction focused on the grant of the option, Pantry Pride also sought to invalidate the Rights Plan. *Id.; see also supra* note 83 and accompanying text (discussing adoption of Note Purchase Rights Plan). Within three hours of the conclusion of oral argument on the request for injunctive relief, Pantry Pride increased the latest tender offer to $58 per share and announced the intention to provide the same support for the Revlon notes as the buy-out proposal. 1985 FED. SEC. L. REP. ¶ 92,333, at 92,219.

85. *See Revlon*, 1985 FED. SEC. L. REP. ¶ 92,333, at 92,220 (in face of hostile acquisition, directors have right, even duty, to adopt defensive measures, but element of balance is required to insure that measure adopted is reasonably designed to meet posed threat) (citing Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 955 (Del. 1985)).

86. *Revlon*, 1985 FED. SEC. L. REP. ¶ 92,333, at 92,221.

respect to each bidder, favored a white knight throughout the bidding.[87] The *Revlon* court also found that self-interest motivated the Revlon board's favoritism.[88] After reviewing Revlon's responses to developments in the attempted takeover, the *Revlon* court held that the Revlon board violated the board's fiduciary duty to shareholders, and that the business judgment rule did not extend to the board's use of the takeover defenses.[89]

The United States District Court for the Southern District of New York in *Hanson Trust PLC v. SCM Corp.*[90] demonstrated a similar willingness to examine the circumstances of a defensive takeover measure in applying the business judgment rule.[91] The *Hanson Trust* court, however, focused on different circumstances than the *Revlon* court in examining the reasonableness of defensive measures.[92] In *Hanson Trust,* the target firm, SCM Corporation (SCM), granted a white knight options to purchase SCM's pigments and consumer foods businesses.[93] In ruling on the validity of the purchase

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87. *Id.* at 92,222.

88. *Id.* The *Revlon* court noted that the drop in value of the Revlon senior subordinated notes following the waiver of covenants had resulted in litigation on behalf of the noteholders against the Revlon board of directors. *Id.* The *Revlon* court further noted that in spite of the unfavorable consequences to the noteholders, participation in the exchange offer involving the notes had been voluntary, and the Revlon board's primary responsibility, even after the exchange offer, was to protect the rights of the remaining equity holders. *Id.* The Revlon board neglected a primary responsibility by continuing to focus on restoring value to the noteholders. *Id.* The *Revlon* court deduced that the Revlon board had acted to protect board members from the consequences of litigation and had therefore acted out of self-interest. *Id.; see supra* note 83 and accompanying text (describing individual tender offers and target responses).

89. *Revlon,* 1985 FED. SEC. L. REP. ¶ 92,333, at 92,222-23. Noting that a lock-up arrangement may be a valid defensive measure when used to advance the bidding process, the *Revlon* court found that the asset lock-up excluded the bidding of Pantry Pride to the detriment of Revlon shareholders. *Id.* at 92,222.

90. 1985 FED. SEC. L. REP. (CCH) ¶ 92,376 (Nov. 26, 1985).

91. *See supra* notes 69-89 and accompanying text (demonstrating willingness of *Unocal* and *Revlon* courts to examine details of attempted takeover in applying business judgment rule).

92. *See infra* notes 94-98 and accompanying text (discussing Southern District of New York's focus on directorial power in applying business judgment rule).

93. *Hanson Trust,* 1985 FED. SEC. L. REP. ¶ 92,376, at 92,359. In *Hanson Trust PLC v. SCM Corp.,* SCM Corporation (SCM) granted a white knight asset lock-ups in connection with a leveraged buy-out agreement. *Id.; see also supra* note 44 and accompanying text (discussing lock-up options characterized either as asset or as stock lock-ups). The white knight would commence a cash tender offer at $74 per share for up to 80% of SCM's common stock. *Hanson Trust,* 1985 Fed. Sec. L. Rep. ¶ 92,376, at 92,359. A merger would follow the tender offer, in which the white knight would exchange a high risk, high yield bond valued at $74 for each remaining SCM common share. *Id.*

The options enabled the white knight to purchase the SCM businesses when a person or group other than the white knight acquired more than one third of SCM's common shares. *Id.* The asset lock-ups permitted the white knight to purchase SCM's pigments business for $350,000,000 and SCM's Durkee Famous Foods business for $80,000,000. *Id.* Together, the pigments and consumer foods businesses had accounted for up to 50% of SCM earnings. *Id.* at 92,361.

The tender offer was contingent on the white knight obtaining 66 2/3 percent of SCM common shares. *Id.* at 92,359. In addition, the leveraged buy-out agreement provided for SCM management participation in the surviving company with the possibility of current SCM management owning up to 15% of the surviving company. *Id.*

option, the *Hanson Trust* court first observed that under the application of the business judgment rule in the United States Court of Appeals for the Second Circuit, directors have broad power to resist takeover bids, provided the resistance is the result of careful analysis and not self-interest.[94] Furthermore, the *Hanson Trust* court noted that the SCM board had retained both legal and financial advisors on whose advice the nine independent directors were correct in relying.[95] The *Hanson Trust* court noted that the three management directors on the SCM board abstained from voting on the lock-ups and had not influenced unduly the independent directors.[96] The *Hanson Trust* court found that the nine independent directors had granted the lock-up options to ensure that the SCM shareholders received maximum value for their shares rather than to secure the independent directors' positions on the SCM board or to perpetuate current SCM management.[97] Based on the circumstances of granting the asset lock-ups, the *Hanson Trust* court declined to grant a preliminary injunction to prevent SCM's use of the options.[98]

While the *Unocal, Revlon,* and *Hanson Trust* decisions reach different conclusions regarding the defensive measures involved, the reasoning behind the decisions suggests an increasing willingness to inquire into the merits of

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94. *See Hanson Trust,* 1985 FED. SEC. L. REP. ¶ 92,376, at 92,363 (business judgment rule gives directors wide latitude to resist unfriendly advances and applies unless directors have acted out of self-interest in some manner).

95. *Id.*

96. *Id.* The *Hanson Trust* court emphasized that the nine independent directors were truly independent; the directors held no management positions in SCM, owned no significant amount of SCM stock, received no significant compensation from SCM, and had no other business contact with SCM. *Id.*

97. *Id.* The *Hanson Trust* court found that the SCM Corporation (SCM) directors granted the lock-up option to obtain a higher cash tender offer in connection with the leveraged buy-out. *Id.* The party with whom the SCM board had been negotiating would not have made a higher offer without the option. *Id.* The *Hanson Trust* court further noted that the SCM board previously had refused to grant lock-up options in connection with a leveraged buy-out agreement. *Id.; see supra* note 93 and accompanying text (describing circumstances leading to SCM board's granting of lock-up option).

98. *Hanson Trust,* 1985 FED. SEC. L. REP. ¶ 92,376, at 92,365. The *Hanson Trust* court specifically distinguished the positions of the SCM Corporation (SCM) board of directors from the Revlon, Incorporated (Revlon) board of directors. *Id.* The Revlon board was not disinterested; six of the fourteen members held prominent positions in Revlon management, two of the members held significant blocks of Revlon stock, and most of the remaining members had an association with entities that did business with Revlon. *Id.* In addition, the Revlon board of directors had acted to protect the interests of parties other than Revlon shareholders. *Id.; see supra* note 88 and accompanying text (discussing motivation of Revlon board of directors in employing defensive measure).

The *Hanson Trust* court also addressed an allegation that the SCM board was hasty in giving away the two optioned assets. *Hanson Trust,* 1985 FED. SEC. L. REP. ¶ 92,376, at 92,364; *see supra* note 93 and accompanying text (describing transaction in which SCM board granted to white knight options to purchase two SCM businesses). The *Hanson Trust* court noted that the SCM board did not have the luxury of unlimited time in which to respond to the various alternatives before the board. *Hanson Trust,* 1985 Fed. Sec. L. Rep. ¶ 92,376, at 92,364; *see supra* note 24 and accompanying text (suggesting connection between duration of open tender offer period and rigor of judicial application of business judgment rule).

takeover defensive tactics, including the details of the tender offer and the directorial response.[99] The judicial willingness to examine the substance of defensive responses might increase further with enactment of legislation designed to delay a tender offer from proceeding.[100] If the legislative proposals to extend the duration of tender offers encourage courts to examine the merits of defensive tactics, plaintiffs asserting a breach of a target board's fiduciary duty may have a greater chance of success than in the past.[101] For example, a plaintiff may assert that under the extended open offer period, a particular defensive measure was not reasonably related to the takeover threat involved.[102] Because raiders will not be able to use the time element to pressure either the target shareholders or board of directors into hasty action, boards of directors will have the inherent defense of passing time that will permit market forces to discourage shareholders from tendering securities.[103] Alternatively, a plaintiff may assert the reasonable relation to the takeover threat of a less drastic defensive response.[104] For example, a plaintiff may allege that the target's management had time to develop an auction in which other bidders could enter bids.[105] The auction process would enable shareholders to obtain a better price for their shares.[106]

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99. *See supra* notes 69-98 and accompanying text (demonstrating willingness of *Unocal, Revlon,* and *Hanson Trust* courts to examine details of attempted takeover in applying business judgment rule); *supra* note 21 and accompanying text (discussing basis of judicial reluctance to examine merits of business decisions).

100. *See infra* notes 108-11 and accompanying text (discussing examples of proposed legislation designed to delay corporate takeover process).

101. *See supra* note 24 and accompanying text (suggesting connection between duration of open tender offer period and rigor of judicial application of business judgment rule).

102. *See* Unocal Corp. v. Mesa Petroleum Co, 493 A.2d 946, 958 (Del. 1985) (selective stock repurchase plan reasonably related to takeover threat).

103. *See* Lipton Testimony, *supra* note 24, at 13 (twenty-day offer period subjects target board to intense pressure that leaves board no choice but to act hastily).

104. *See* Wilner & Landy, *The Tender Trap: State Takeover Statutes and Their Constitutionality,* 45 FORDHAM L. REV. 1, 10 (1976) (discussing most effective defense against tender offer). Following the public announcement of a tender offer, present shareholders and speculators often make open-market purchases of target stock. *Id.* The price of target stock rises due to active trading, and the economic desirability of tendering target stock fades as market price approaches the tender offer price. *Id.* As the economic incentive fades, target management more readily may convince the shareholders not to tender stock. *Id.*

105. *See* Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 958 (Del. 1985) (selective stock repurchase plan reasonably related to takeover threat).

106. *See* LEGISLATIVE ANALYSES, *supra* note 2, at 34-35 (discussing effect of delay of takeover process). Proponents of delaying the takeover process claim that an auction protects the target's small shareholders while accelerated action favors arbitraguers and professional investors. *Id.* at 35. Proponents of delay also claim that an auction provides a greater chance that the offeror bidding the highest is also the firm that can use the target's assets more efficiently. *Id.* Legislation serving to extend the open tender offer period, however, might favor a target's board of directors. *See supra* note 101 and accompanying text (suggesting that plaintiff asserting breach of fiduciary duty may have greater chance of success under extended open tender offer period). Under extended time conditions, the courts might presume that a target board's decision to employ a particular defensive tactic was an informed decision. *See* Unocal

Current federal legislation requires any person making a tender offer to hold the offer open for twenty business days.[107] Several bills before Congress that are concerned with correcting abuses in the takeover process deal in whole or in part with delaying the takeover process.[108] For example, H.R. 1480 requires that a tender offer remain open for sixty days.[109] In April of 1985, attorney Martin Lipton appeared before the Subcommittee on Monopolies and Commercial Law of the House Committee on the Judiciary and proposed the Shareholder Protection and Elimination of Takeover Abuses Act of 1985.[110] Among Lipton's proposed amendments to the Securities Exchange Act of 1934 was a provision extending the open tender offer period to sixty calendar days.[111] Lipton maintained that the time extensions would provide shareholders and boards of directors needed time to consider unsolicited tender offers carefully.[112] In addition, Lipton suggested that the time extensions would result in a more rigorous judicial application of the business judgment rule.[113]

The recent decisions of the Delaware courts and the United States Court of Appeals for the Second Circuit have demonstrated increased rigor in applying the business judgment rule in a takeover context.[114] In addition, the application of the business judgment rule in the Delaware courts and the Second Circuit is consistent with the evolving concepts and needs of corporate law.[115] The Delaware courts retained the good faith element of the common

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Corp. v. Mesa Petroleum Co., 493 A.2d 946, 958 (Del. 1985) (directorial power existed to oppose hostile tender offer and to undertake selective stock exchange made in good faith and upon reasonable investigation); Hanson Trust PLC v. SCM Corp., 1985 FED. SEC. L. REP. (CCH) ¶ 92,376 (Nov. 26, 1985) (business judgment rule protected decision of nine independent directors made in reliance upon independent legal and financial counsel).

107. 17 C.F.R. § 240.14e-1 (1985).

108. *See generally* LEGISLATIVE ANALYSES, *supra* note 2, at 17-18 (discussing bills designed both to accelerate and to delay takeover process).

109. *Id.*

110. *See supra* notes 24 & 26 and accompanying text (discussing proposed provision to extend duration of open tender offer period and potential effect on judicial application of business judgment rule). The firm of which Mr. Lipton is a partner has represented parties to takeover litigation on numerous occasions. *See, e.g.,* Joseph E. Seagram & Sons, Inc. v. Abrams, 510 F. Supp. 860 (S.D.N.Y. 1981) (Wachtell, Lipton, Rosen & Katz of New York, New York representing target firm); Moran v. Household Int'l, Inc., 500 A.2d 1346 (Del. 1985) (representing target corporation); MacAndrews & Forbes Holdings, Inc. v. Revlon, Inc., 1985 FED. SEC. L. REP. (CCH) 92,333 (OCT. 23, 1985), *aff'd sub nom.* Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 1985 Fed. Sec. L. Rep. (CCH) ¶ 92,357 (Nov. 1, 1985).

111. Lipton Testimony, *supra* note 24, at 13, 22, 32-33.

112. *Id.*

113. *See id.* (stating that many actions that are justifiable in pressured context of 20-day offer period may be inappropriate in context of 60-day offer period).

114. *See supra* notes 69-98 and accompanying text (demonstrating willingness of *Unocal, Revlon,* and *Hanson Trust* courts to examine details of attempted takeover in applying business judgment rule); *supra* note 21 and accompanying text (discussing basis of judicial reluctance to examine merits of business decisions).

115. *See supra* note 66 and accompanying text (traditional application of business judgment rule is inappropriate in change-of-control cases).

application of the business judgment rule.[116] The Delaware application, however, expanded the concept of rational business purpose to require that a defensive measure, to be an appropriate means of thwarting an undesired takeover attempt, must be reasonable in relation to the takeover threat.[117] The Second Circuit's application of the business judgment rule focuses on the target firm's board of directors, examining board members' relation to the target as well as board actions in connection with a defensive measure.[118] The willingness of the courts to examine the substance and circumstances of board decisions in which directorial self-interest is inherent enabled the courts to grant business judgment protection in the takeover context without simply rubber-stamping any decision a board makes.[119]

Commentators have suggested that an extended open tender offer period will lead to increased judicial scrutiny of target board actions in response to takeover attempts.[120] The future, however, of any legislation serving to delay the takeover process is uncertain at present.[121] The Executive and Legislative branches of the federal government have taken opposing views on the desirability of regulating corporate takeover activity.[122] The Securities and Exchange Commission (SEC), during a recent review of issues related to corporate takeovers, considered several defensive takeover tactics.[123] The five-member Commission concluded unanimously that the marketplace and the state and federal courts are adequately addressing defensive tactics.[124]

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116. *See* Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 958 (Del. 1985) (business judgment rule protected directors' decision to employ defensive measure made in good faith, upon reasonable investigation, and that was reasonable in relation to threat of takeover).

117. *Id.* Other jurisdictions are likely to follow Delaware's example because Delaware is the state in which most businesses choose to incorporate. *See* CARY & EISENBERG, *supra* note 2, at 24 (noting Delaware as principal place for incorporation); Dwyer, Glaberson & Norman, *Delaware's Grand Masters of the Merger Game*, BUS. WK., Feb. 3, 1986, at 90 (more than half of companies listed on New York Stock Exchange incorporated in Delaware).

118. *See supra* notes 94-98 and accompanying text (discussing *Hanson Trust* court's focus on directorial power in applying business judgment rule).

119. *See supra* note 66 and accompanying text (traditional application of business judgment rule is inappropriate in change-of-control cases).

120. *See supra* note 24 and accompanying text (suggesting connection between duration of open tender offer period and rigor of judicial application of business judgment rule).

121. *See infra* notes 123-29 and accompanying text (discussing opposing views on desirability of increased regulation of corporate takeovers).

122. *See infra* notes 123-29 and accompanying text (discussing position of Securities and Exchange Commission, Reagan Administration, and House Subcommittee on Telecommunications, Consumer Protection and Finance on regulation of corporate takeovers).

123. *See generally* Letter from John Shad, *supra* note 50 (setting forth conclusions and proposals resulting from recent Securities and Exchange Commission review of corporate takeover activity).

124. *Id.* at 3. The Securities and Exchange Commission (SEC) determined specifically not to take or recommend actions to prevent a target company from taking defensive action pending target shareholder approval of a takeover bid. *Id.* The proposed prevention of defensive action related to a provision requiring a bidder to submit a tender offer to the target's board of directors prior to commencement of the offer. *Id.* If a majority of the target's independent directors did not approve the offer, the offer would proceed to the target shareholders for

The SEC has opposed earlier proposals to extend the tender offer period, contending that the twenty-day period is sufficient to permit informed investor decisions.[125] The SEC has approved a legislative proposal that actually would serve to expedite the takeover process.[126] At a recent forum on corporate takeovers, Representative Timothy E. Wirth expressed the opposing view of the House Subcommittee on Telecommunications, Consumer Protection and Finance (House Subcommittee).[127] Representative Wirth questioned the existence of a truly free market for corporate control.[128] Noting the necessity of the federal securities, tax, and antitrust laws and the state corporation and takeover laws, Wirth argued that because the market does not function free from regulation, legislators should not rely on the marketplace alone to correct perceived abuses in the corporate takeover process.[129]

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approval. *Id.* The SEC, however, concluded that the provision was not necessary for target shareholder protection and also concluded that insufficient reason existed to preempt state law. *Id.*

The SEC also determined not to take action to prohibit or further regulate antitakeover charter and by-law-amendments or to prohibit target company use of lock-ups. *See supra* notes 31-32 and accompanying text (discussing shark repellant amendments); *supra* note 44 and accompanying text (discussing lock-up options). With regard to antitakeover charter and by-law amendments, the SEC concluded that full disclosure and shareholder approval adequately protect shareholder interests, and that no reason exists to preempt state law. Letter from John Shad, *supra* note 50, at 4. Concerning lock-ups, the SEC noted the recent decisions in *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.* and *Hanson Trust PLC v. SCM Corp.* and concluded that the courts can address lock-ups adequately on a case-by-case basis. *Id.; see supra* notes 80-89 and accompanying text (discussing *Revlon* decision); *supra* notes 90-98 and accompanying text (discussing *Hanson Trust* decision).

The Reagan Administration's position on regulation of corporate takeovers reflects the position of the SEC. Remarks of Representative Wirth, *supra* note 53, at 3. The Administration has indicated to the House Subcommittee on Telecommunications, Consumer Protection and Finance that Congress should not interfere with the operation of the free market forces. *Id.*

125. Legislative Analyses, *supra* note 2, at 35.

126. Letter from John Shad, *supra* note 50, at 1. The Legislative proposal that the Securities and Exchange Commission (SEC) approved would reduce to two calendar days the current ten calendar day period for the filing of a Schedule 13D with the target firm, with each exchange where target shares trade, and with the SEC. *Id.* Schedule 13D is a beneficial ownership report that any person who acquires five percent or more of any class of shares must file pursuant to section 13(d) of the Securities Act of 1934. Lerner, *supra* note 2, at 27. While the purpose of reducing the required filing period is to enhance prompt disclosure of rapid securities accumulations, the change in the timing of filing would also decrease delay in the takeover process by eight calendar days. Letter from John Shad, *supra* note 50, at 1; *see also* Legislative Analyses, *supra* note 2, at 17 (some bills' effect in timing of completion of tender offers is incidental to other purposes).

127. *See generally* Remarks of Representative Wirth, *supra* note 53 (commenting on current corporate takeover environment).

128. *Id.* at 4; *see supra* note 124 and accompanying text (discussing position of Reagan Administration that Congress should not interfere with operation of free market forces).

129. *See* Remarks of Representative Wirth, *supra* note 53, at 4 (legislators should carefully consider revising laws governing marketplace). In addition to calling for increased policing of corporate takeovers, Representative Wirth also indicated the need for a new approach to

The future enactment of legislation that would delay the corporate takeover process is unlikely.[130] While the House Subcommittee does support increased regulation of takeover activity, the Subcommittee favors intensified SEC scrutiny of takeover activity over the enactment of additional legislation.[131] The SEC in turn recently determined not to take action to directly or indirectly control a variety of defensive takeover tactics.[132] Unless legislators adopt an approach to takeover legislation that would enable proponents of an extended open tender offer period to argue for enhanced investor protection, the proposed extension will find no place in the regulatory scheme.[133] As an indirect means of curbing takeover defensive tactics through judicial application of the business judgment rule, the possible effect of an extended open tender offer period is intriguing but entirely too speculative to justify the enactment of legislation.[134]

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takeover legislation that would measure the effect of takeover activity on key public policy goals, including long-term economic growth, preservation of the integrity of capital markets, and protection of investors. *Id.* at 3-4 & 6. Representative Wirth noted the tendency of both the Securities and Exchange Commission (SEC) and the House Subcommittee on Telecommunications, Consumer Protection and Finance to focus on takeover tactics in recommending and drafting takeover legislation. *Id.* at 2-3. Representative Wirth analogized the limited focus on takeover tactics to repairing potholes in a road while ignoring the road's destination. *Id.* at 3. Representative Wirth suggested that legislators must be willing to consider carefully revising the takeover laws, and also called on the SEC to take a strong, aggressive position with regard to takeover activity and to monitor the market for corporate control more closely during periods of increased takeover activity. *Id.* at 4 & 6.

130. *See infra* notes 131-33 and accompanying text (suggesting that enactment of legislation extending duration of open tender offer period is not imminent).

131. *See supra* notes 127-29 and accompanying text (discussing comments of Representative Wirth concerning regulation of corporate takeover activity).

132. *See supra* note 124 and accompanying text (discussing consequences of Securities and Exchange Commission conclusion that marketplace and state and federal courts are adequately addressing defensive tactics).

133. *See supra* note 129 and accompanying text (discussing Representative Wirth's impressions of alternative approaches to regulation of corporate takeover activity).

134. *See supra* note 24 and accompanying text (suggesting connection between duration of open tender offer period and rigor of judicial application of business judgment rule); *supra* note 111 and accompanying text (discussing provision to extend open tender offer period from 20 business days to 60 calendar days); *supra* notes 130-33 and accompanying text (suggesting that enactment of legislation extending duration of open tender offer period is not imminent).