DEVELOPMENTS IN DEFENSIVE TACTICS TO TENDER OFFERS: A STUDY OF THE WHITTAKER–BRUNSWICK BID

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1. Introduction

The corporate and securities law issues surrounding takeover contests are frequently discussed and almost as frequently litigated [1]. The validity of specific defensive tactics is a recurring question. In the recent Whittaker–Brunswick contest, three common tactics affecting targets were employed: asset redeployment, lock-ups, and the front-end loaded transaction. In Whittaker Corp. v. Edgar, the court applied a business judgment analysis to the asset redeployment device [2]. Other courts have applied a similar analysis when the target repurchases stock [3]. The Whittaker case also examined whether lock-ups and front-end loaded transactions were manipulative practices within the securities law provisions of the Williams Act [4].

This article will employ the Whittaker–Brunswick contest as a vehicle to examine new developments in tender offer defense. The law in the tender offer area develops almost as quickly as takeover tactics. The Whittaker case may reflect a judicial trend: courts have displayed a reluctance to interfere in the tender offer process. The Whittaker court’s use of the business judgment rule to analyze certain defense maneuvers, as well as its narrow reading of “manipulation” in the Williams Act, represents an attempt to be neutral as between a bidder and target.

2. The business judgment rule

Under the business judgment rule, when the directors of corporations discharge their fiduciary duties in good faith

they enjoy a presumption of sound business judgment, reposed in them as directors, which courts will not disturb if any rational business purpose can be attributed to their decisions.

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In the absence of fraud, bad faith, gross overreaching or abuse of discretion, courts will not interfere with the exercise of business judgment by corporate directors [5].

The rule is based on a general operating assumption that the courts are not equipped to evaluate corporate decisions:

The authority and responsibilities vested in corporate directors both by statute and decisional law proceed on the assumption that inescapably there can be no available objective standard by which the correctness of every corporate decision may be measured, by the courts or otherwise. Even if that were not the case, by definition the responsibility for business judgments must rest with the corporate directors; their individual capabilities and experience peculiarly qualify them for the discharge of that responsibility [6].

The Corporation Law of Delaware, acknowledging the “expertise” of the corporate director, provides that the business and affairs of corporations “… shall be managed by or under the direction of a board of directors” [7].

The business judgment rule presumes that corporate directors have acted in good faith. A plaintiff alleging breach of fiduciary duty must come forward with sufficient evidence that impermissible motives dominated the decision-making process to shift the burden of proof to the directors [8]. In the context of a takeover, an impermissible motive would be to retain control. Under the “primary purpose” test, the plaintiff rebuts the good faith presumption by showing that an impermissible motive was not merely one motive for the decision in question, but either the sole or the primary motive [9]. Essentially, the business judgment rule and the primary purpose test require that the directors act “in good faith and with due care, like reasonable businessmen” [10]. If they act in such a manner, courts will not question their business judgment. In order to rebut the presumption that the directors have acted in good faith, the plaintiff must show that the directors “have engaged in self-dealing or fraud, or… have acted in bad faith” [11].

2.1. The business judgment rule in the context of a hostile takeover

The target board’s initial decision to oppose or support a tender offer [12] falls within the business judgment rule and is presumed to have been made in good faith [13]. The predominant view is that opposition to the bid does not shift the burden of proof to the target company, even where retention of control is “a” motive [14]. “The test, loosely stated, is whether the board [acted] fairly and reasonably [in] exercising its business judgment to protect the corporation and its shareholders against injury likely to befall the corporation should the tender offer prove successful” [15]. Courts have also suggested that incumbent directors have a duty to resist tender offers deemed harmful to the corporation:
Having so decided in good faith, with rational business purposes attributable to their
decision, defendants had not only the right “but the duty to resist by all lawful means
persons whose attempt to win control of the corporation, if successful, would harm the
corporate enterprise” (citations omitted) [16].

As a tactical matter, resistance to an unsolicited takeover bid may be a good
tactic as it may increase the price of the bid, resulting in a better deal for the
shareholders [17].

Some judges believe that the good faith presumption, in the context of
tender offers, has become virtually irrebuttable: “I emphatically disagree that
the business judgment rule should clothe directors, battling blindly to fend off
a threat to their control, with an almost irrebuttable presumption of sound
business judgment, prevailing over everything but the elusive hobgoblins of
fraud, bad faith or abuse of discretion” [18]. In his dissent to Johnson v. Trueblood [19], Circuit Judge Rosenn would not apply the primary purpose test
[20]. In his view, once a conflict of interest on the part of the directors is
shown, the burden shifts to the defendant directors to establish the fairness of
the transaction [21]. These continue to be minority views.

2.2. Defensive tactics and the business judgment rule

The target board’s initial decision to resist a bid or to attempt to raise the
price falls within the business judgment rule. Does the business judgment rule
apply to the various defensive actions taken by directors after the decision is
made to resist the takeover bid? Recent decisions, including Mobil Corp. v.
Marathon Oil Co. [22], Joseph E. Seagram & Sons, Inc. v. Abrams [hereinafter referred to as St. Joe] [23], and Whittaker Corp. v. Edgar [24] indicate
confusion as to the discretion enjoyed by target directors in formulating
defensive tactics. Some courts have held that upon rejecting a bid after a good
faith assessment of its merits, “the company may then take any step not
forbidden by law to counter the attempted capture” [25]. The minority view
insists that a reasonable corporate purpose justify defensive actions.

There are a variety of defensive actions that a target board can take that
may fall under the business judgment rule. Courts have held that acquisitions
which create antitrust difficulties for the bidder [26], or make the target less
attractive to the bidder [27], fall within the business judgment rule. Asset
redeployment [28] and lock-ups [29] may also be valid exercises of target
director’s business judgment.

2.3. Application of the business judgment rule to an unsolicited tender offer: The
Whittaker–Brunswick contest

Whittaker, a California corporation with its principal place of business in
California, was a diversified manufacturer and distributor of products in the
life sciences, metals, technology, marine, and chemical fields. Brunswick, a Delaware corporation with its principal place of business in Illinois, was a diversified manufacturer and distributor of products in the energy, transportation, defense, aerospace, chemical processing, health care (Sherwood medical division) and leisure fields [30].

On January 26, 1982, Whittaker commenced a tender offer to purchase up to 10,400,000 shares of Brunswick common stock for $26.50 per share and up to $30,000,000 of Brunswick's 10% convertible debentures for $1,234.28 per $1,000 principal amount. The bid represented a $312 million offer for 49% of Brunswick stock [31]. Under the terms of the offer, if Whittaker gained control of 49% of the common stock, it intended to propose a merger between its subsidiary, BC Holdings, and Brunswick. Each Brunswick shareholder would receive three-tenths of a share of newly issued Whittaker preferred stock for each share of common stock [32]. The estimated value of the new preferred stock was "more or less than $26.50" [33].

On January 27, employing a common offensive stratagem [34], Whittaker filed suit in the Northern District of Illinois against the Secretary of State of Illinois and Brunswick to enjoin application of the Illinois Business Takeover Act [35]. Operation of the Act would have delayed Whittaker's bid [36].

The same day, at a special meeting, the Brunswick directors determined that the Whittaker offer was "blatantly unfair" [37], and authorized various defensive actions. First, the directors authorized a press release entitled "To All Brunswick Shareholders: The Whittaker Offer Is Worse Than Inadequate; It Demands Rejection!" [38]. Among the reasons given for shareholders to reject the offer were: (1) the dubious worth of Whittaker's preferred stock to be issued in the second step merger; (2) an overload of debt to be incurred by Whittaker under its offer; and (3) the heavy involvement of Whittaker's health-care business in Saudi Arabia and the Middle East [39].

Brunswick hired three investment banking firms to "explore all alternatives to the offer" [40]. The target directors also planned litigation to enjoin Whittaker from proceeding with the offer [41]. Finally, to provide security to its officers, Brunswick awarded shares of restricted stock to top officers and, in addition to existing "golden parachute" employment contracts [42], amended deferred compensation agreements with officers and directors to permit acceleration of benefits.

On January 28, in response to Whittaker's January 27 filing, Brunswick counterclaimed against Whittaker et al. [43] and moved for a preliminary injunction to block the offer [44]. The two principal allegations were: (1) Whittaker failed to disclose material facts concerning its Saudi Arabian operations in violation of the Williams Act sections 14(d) and 14(e); and (2) the proposed merger of Brunswick and Whittaker would tend to diminish competition in the market for motor-operated aircraft valves in violation of section 7 of the Clayton Act [45].
On February 4, the proration date, Whittaker’s offer was oversubscribed [46]. The withdrawal period was due to expire on February 16 [47]. Brunswick announced that it might sell its Sherwood medical division as an alternative to takeover [48]. On February 8, Judge Flaum of the Northern District of Illinois denied Whittaker’s motion for a Temporary Restraining Order to enjoin Brunswick from disposing of any assets or stock in its Sherwood medical division [49].

On February 10, Whittaker announced a revised tender offer for Brunswick, offering $27 per share for Brunswick’s common stock and $1,257 per $1,000 principal amount for Brunswick’s convertible debentures. In addition, the second step merger would swap new 16% debentures of Whittaker for Brunswick common stock Whittaker did not own, instead of the new preferred Whittaker stock described in the original offer [50]. At a special board meeting that same day, Brunswick considered three alternatives: (1) the revised Whittaker offer, (2) a proposal by American Home Products to acquire the Sherwood division, and (3) an unnamed party’s $450 million cash offer for Sherwood [51].

On February 13, Brunswick and American Home entered into an agreement whereby American Home agreed to commence a tender offer for 14,166,666 shares of Brunswick common stock at $30 per share with Brunswick agreeing to redeem 13,772,000 shares of the stock for Sherwood medical group stock. The total consideration to be paid by American Home for Sherwood was $425 million. The agreement provided that, if American Home was prevented from purchasing Brunswick shares, it held the right to purchase Sherwood for $450 million in cash [52]. The offer commenced on February 16; the withdrawal date for Whittaker’s revised offer was automatically extended to March 2 [53]. In a letter to shareholders, Brunswick recommended that they tender their stock to American Home [54].

On February 23, Whittaker filed a supplemental complaint in the federal district court in Chicago against Brunswick, Brunswick directors, and American Home, seeking a preliminary injunction against the sale of Sherwood. The complaint alleged that: (1) Brunswick had violated section 14(e) of the Williams Act by entering into an unlawful lock-up with American Home and by materially misrepresenting the transaction to its shareholders; (2) Brunswick management breached its fiduciary duties to shareholders in formulating the deal; and (3) the proposed sale required shareholder approval under Delaware corporation law [55].

Judge Flaum denied both the Whittaker and Brunswick motions for preliminary injunction on February 25 [56]. As for Brunswick’s allegations, the court held that neither Whittaker’s Saudi Arabian disclosures nor its description of the second step of its original offer rose to the level of material misrepresentation or omission in violation of section 14(e) of the Williams Act [57]. In addition, the court held that the proposed merger between Brunswick
and Whittaker would not violate section 7 of the Clayton Act. The relevant market (motor-operated aircraft valves) presented low technological and financial barriers to entry as well as the presence of thirteen other competing companies [58]. The court's rulings regarding Whittaker's allegations will be discussed in detail later in this article [59]. Eight days later the Seventh Circuit affirmed Judge Flaum's rulings without an opinion [60].

Having lost its chance to purchase Brunswick with Sherwood, on March 9 Whittaker withdrew its offer [61]. American Home proceeded with the purchase of Brunswick shares tendered and the acquisition of the Sherwood medical division [62].

The next section of this article will evaluate business judgment developments in the context of the Whittaker tender offer. The remainder of the article will address judicial treatment of four specific defensive tactics: redeployment of assets, issuer stock repurchases, lock-up agreements, and front-end loaded transactions.

2.4. Business judgment developments

In its motion for a preliminary injunction before the District Court, Whittaker alleged that the Brunswick board breached its fiduciary duties to Brunswick shareholders [63]. Briefs filed in the Seventh Circuit appealing Judge Flaum's denial of the motion for injunctive relief indicate that the applicability of the business judgment rule remained a major issue of the takeover litigation [64]. The Seventh Circuit, affirning without an opinion, did not disturb the District Court's analysis of the fiduciary duty [65].

The District Court found that Brunswick had established that the proposed transaction with American Home for the sale of Sherwood was within the bounds of valid business purposes [66]. In Judge Flaum's view, transactions with third parties during a takeover contest can be a proper exercise of business judgment:

> When confronted with a threatened change in control, a board of directors of a target company may engage in a corporate transaction with a third party that the board determines in its business judgment to be in the best interests of shareholders. (citations omitted) ... In so doing, the board of directors may enter into various arrangements with the third party to promote consummation of the transactions even though to do so might cause the hostile tender offeror to withdraw [67].

The court clarified what factors it regarded as relevant in applying the rule.

First, the court did not find that the prior existence of a defensive plan was relevant. Whittaker's briefs contended that "sudden turnabouts" in corporate policy, like Brunswick's decision to sell its profitable Sherwood group, prohibited target management from hiding behind the business judgment rule [68]. According to this view, unless the challenged conduct merely accelerated an
existing plan, the burden of proof will shift to target directors to show that retention of control was not their primary purpose [69]. Judge Flaum rejected these arguments: the Whittaker decision attached no significance to whether the target’s third-party transaction was based on pre-existing plans [70].

Second, the court attached weight to whether the target carefully investigated all other alternatives to the tender offer. In determining whether the Brunswick board validly exercised its business judgment, Judge Flaum examined the actions taken by the board in choosing between the Whittaker bid and two other alternatives [71]. Business judgment contemplates a target board carefully considering its alternatives and choosing one deemed to be in the shareholders’ best interests [72]. Flaum invoked a three-part test of good faith, due care, and lack of interest for examining directors’ defensive actions [73]. Although some commentators question whether any director is truly independent [74], courts continue to consider the presence of outside directors as an important factor [75].

In addition, Brunswick’s board relied on experts. Target directors demonstrate “due care” in resisting a bid when they rely on investment bankers for questions of adequacy of price and on independent legal counsel for tax, antitrust, and similar issues [76]. Whittaker alleged that the Brunswick board retained experts, but “consciously avoided eliciting their opinions” [77]. First, there was uncertainty as to the tax-free nature of the Sherwood sale, with legal opinions supporting both sides of the issue [78]. Second, when asked to compare the Whittaker bid and proposed sale of Sherwood as to fairness of price, the investment bankers refused to render a quantitative opinion and left the decision to the “independent business judgment” of the board [79]. The District Court essentially refused to second-guess the Brunswick board in resolving these two questions. Judge Flaum stated that a “court...will not substitute its own notion of what is or is not sound business judgment (citation omitted)” [80]. Furthermore, “[r]eliance upon advice of legal counsel, even if wrong, by a board of directors is not a breach of fiduciary duty (citations omitted)” [81]. The fact that the directors’ decisions resulted in their completing a deal which would keep them in control did not shift the burden of proof to Brunswick [82].

Finally, the court examined the question of whether the price paid for Sherwood was adequate. An investment banker will typically be requested by the target board to render an opinion as to adequacy of the bid price. With the sale of a major division, however, the relevant considerations differ. They might include: (1) comparing the sale price of the division to the bid price [83]; (2) computing the “blended value” of the sale price based on what Brunswick stock might trade for after sale of the division [84]; or (3) adding the sale price of the division to an estimate of the sale price of the remaining assets and comparing this hypothetical price with the bid price. The Whittaker court seemed to view the price determination as speculative, and left the evaluation
of the American Home proposal to the business judgment of Brunswick's "financially sophisticated" directors [85].

3. Redeployment of assets

Restructuring the capitalization of a company through the sale of a division, whole or partial liquidation, spin-off or stock repurchase has become an important aspect of financial planning both within and without the takeover context [86]. In general, asset redeployment (also known as disaggregation) is an effort, on the part of the company, to achieve recognition of values for assets, especially "hard assets" such as natural resources or real estate, greater than the securities market reflects. In the context of a contested takeover, asset redeployment is designed to provide target shareholders with a financial alternative to a bid. Brunswick used this device as a defense against Whittaker when it sold its Sherwood medical division to American Home Products in exchange for Brunswick shares acquired in a tender offer [87].

3.1. Desirability of asset redeployment as a defensive tactic

In many cases a hostile bid will be motivated by the bidder's desire to exploit the assets in question either by a third-party sale or leverage. Asset redeployment by a target allows it to increase the market value of its stock and/or provide additional returns for its shareholders by doing what the bidder would do. Benefits to shareholders from the sale of a division or other asset redeployment plans (ARP) include simplification of the company's business structure, making it easier to manage and more understandable to the market. A negotiated ARP also allows the company to carefully plan an advantageous tax picture for its shareholders. Counsel for Brunswick spent a good deal of time attempting to structure the Sherwood sale as a tax-free transaction [88]. Although expert witnesses testified on both sides of the tax issue, Judge Flaum held that the proposed sale of Sherwood was not set at a "manipulative" price, even if it were taxable to Brunswick [89]. Finally, an ARP may create new financing opportunities for a company. Brunswick, for example, recorded a $218.2 million gain on its stock-swap sale of Sherwood and planned to use the gain to reduce debt and finance development of its technical division [90].

3.2. Types of asset redeployment

The most visible form of defensive restructuring has been the sale of a division. Targets that have employed this device include Liggett Group (selling Austin Nichols), St. Joe Minerals (Can Del Oil), and Brunswick (Sherwood medical division).
The term “asset redeployment” includes other transactions such as liquidation, spin-offs, and stock repurchases. Partial or whole liquidation is a form of distribution to shareholders. In a complete liquidation, the board of directors decides that the company is “worth more dead than alive”. This decision to liquidate has been scrutinized under the business judgment rule. Although Judge Pollack expressed outrage at the use of liquidation devices in his St. Joe opinion [91], Judge Weinfeld’s ruling in Conoco appears to represent the recent trend in the law: “This broad, sweeping restraint [against, among other things, liquidation]... would almost sterilize Conoco from the conduct of its affairs in seeking to obtain offers that in the judgment of the directors may be more desirable than that which is presently outstanding” [92]. In the context of a takeover, liquidation – which requires shareholder vote and a proxy statement – may be unrealistic.

Another form of asset redeployment is the spin-off. An asset is spun off when the company creates a new entity (trust, partnership or corporation) which takes ownership of the asset, and the company then distributes interests in the new entity directly to the shareholders. Finally, stock repurchases also redeploy corporate assets [93].

3.3. Legal issues

The general rule followed in Whittaker is that asset redeployment, lock-ups, and defensive acquisitions fall within the business judgment rule in the absence of an impermissible motive [94]. Specifically, asset redeployment constitutes a “corporate transaction with a third party that the board determines in its business judgment to be in the best interests of the shareholders” [95].

Timing of the ARP, although not decisive as to the transaction’s legality, may affect a court’s perception of it under the business judgment rule. Certainly the ARP is less susceptible to judicial criticism if accomplished before a takeover bid is made. Targets will argue, nevertheless, that the business judgment rule should govern no matter when the ARP is effected. This argument is strengthened when an ARP devised during a hostile bid presents shareholders with a “financial package” that is not only superior to the market, but to the bidder’s offer price as well [96]. The careful tax, corporate, and financial planning needed for an ARP, however, is more difficult in the stepped-up time frame of a hostile bid.

The form of an ARP will not affect its legality. Structuring the ARP as a cash or a stock exchange tender offer will, however, affect tax planning and may activate securities regulations. For example, by structuring the ARP transaction as a cash tender offer, American Home and Brunswick shortened, from thirty to fifteen days, the Hart–Scott–Rodino Act waiting period required before closing. In addition, the use of a tender offer required American Home and Brunswick to make Williams Act filings and extended the
withdrawal date for the revised Whittaker offer [97].

Shareholder approval of an ARP may or may not be necessary. Delaware corporation law, as well as most other state codes, requires that a company obtain shareholder approval for a sale of “all or substantially all of its property and its assets” [98]. Courts tend to interpret the language “all or substantially all” narrowly [99]. In Whittaker, Judge Flaum held that the sale of Sherwood, representing “approximately one-third of Brunswick’s after-tax earnings in 1981” [100], did not amount to the sale of “substantially all” of Brunswick’s assets under Delaware’s corporation law [101]. Similarly, in Mobil, Judge Kinneary found that, although the Yates Field was a significant corporate asset, exercise of the Yates Field option would not result in “the transfer of all the effective operating assets of Marathon” [102]. Thus, the option did not activate the Ohio law requiring shareholder approval, as would be true for a total liquidation [103].

When the target structures its ARP as a tender offer, whether by itself or a third party, certain filings under the securities laws are necessary. Target filings include its announcement of position under the Schedule 14D-9 Solicitation/Recommendation Statement. An ARP should be disclosed under Item 7 of Schedule 14D-9 regarding negotiations and transactions by the target. If “no agreement in principle” has obtained, or if disclosure would “jeopardize continuation of such negotiations”, the target need not disclose details of the plan, but only that negotiations are under way [104].

4. Issuer stock repurchases

The stock repurchase has become increasingly frequent [105]. In fact, one commentator suggests that the repurchase strategy has become so common that “corporate investors are amassing stock just for the purpose of selling their holdings back to target companies at a significant profit” [106].

Will corporate directors be liable for a stock repurchase?

Whether directors will be liable for a buy-back of stock at a substantial premium above the market price depends on the directors’ purpose in implementing the deal. Challenges to an issuer repurchase are based on state corporate law principles of directors’ fiduciary duties. Generally, target directors have not been held liable for spending corporate funds in a buy-back if they acted in furtherance of a valid corporate purpose rather than primarily to maintain control [107]. State corporate laws [108], as well as negative covenants in debt instruments which restrict distributions to shareholders, may limit the target’s ability to make stock repurchases.

The target may repurchase a block of its outstanding securities from a
potential bidder or from a person that has accumulated a significant block of stock and is viewed as a threat to the company [109]. The negotiated repurchase may or may not include a standstill agreement which restrains the investor for a period of time from purchasing target stock [110]. Again, the test is whether the repurchase furthers a valid corporate purpose. Valid purposes may include buying out a dissident minority shareholder or a potential bidder whose corporate policies conflict with target policies [111].

The target may attempt to block a potential or pending bid by making purchases on the open market or from a few block holders. The repurchase could involve a self-tender subject to Exchange Act disclosure requirements, a private negotiated purchase from a holder of a block of shares, or various open market purchases. The repurchase response may block a pending bid only if the shareholders accept the company's higher partial offer and do not tender to the original partial bidder or if the repurchases result in a group controlling approximately 50% of the target's shares after the repurchases. Even if it does not block a bid, a self-tender may result in a greater return to the shareholders.

*Crane Co. v. Harsco Corp.* discusses the valid corporate purpose requirement [112]. In that case, the bidder, Crane, moved to enjoin Harsco from repurchasing 132,300 shares of common stock from arbitrageurs. Although the court held that as to its common law claims Crane failed to show the likelihood of irreparable injury necessary for an injunction [113], in what is essentially dicta, the court went on to say that Harsco directors breached their fiduciary duties because the repurchases were intended primarily as a defense maneuver [114]. Directors have an "inherent conflict of interest" when they repurchase stock during a takeover contest [115]. Thus, the burden shifts to the board of directors to show a valid corporate purpose in one of two ways:

> It can either show that some consideration other than the perceived threat to control was the primary reason for the stock purchase; or it can admit that the stock purchase was intended primarily as a defensive maneuver, and show that the directors reasonably determined that a change in control would constitute "a clear threat to the future business or the existing, successful business policy" of the corporation (citations omitted) [116].

A recent court-approved settlement of a derivative action involving the Harsco directors assessed no damages, directed the company to pay $55,000 attorney fees incurred in the derivative action, and set out certain procedures for the company to follow in any subsequent repurchase transactions [117].

Higher standards apply when ERISA trustees repurchase stock. In *Donovan v. Bierwirth*, the Secretary of Labor moved to enjoin three trustees of the Grumman Corporation Pension Plan from using Plan assets to purchase Grumman stock on the open market [118]. The trustees, who were also directors of Grumman, planned to purchase stock at a premium over market in an effort to defend against an unsolicited bid by LTV Corporation. The court held that the plaintiff was likely to succeed on his claim that the trustees
violated their fiduciary duties under the Employee Retirement Income Security Act of 1974 [119]. Although the court rejected a *per se* rule under ERISA that trustee-directors who buy company stock during a takeover have dual loyalties, so that they may not make an investment decision to repurchase company stock [120], it held that in this case defendants violated the heightened fiduciary obligations of ERISA [121]. The court tested the trustees' fiduciary conduct by reviewing their independent investigation in deciding to purchase Grumman shares for the plan. The trustees breached their duty of inquiry when they failed to consider possible alternatives to acquiring Grumman stock. Alternatives included: (1) tendering presently held Grumman stock to LTV at a substantial profit to the trust beneficiaries; and (2) negotiating with LTV to obtain protection of pension plan benefits in the event of takeover [122].

The trustees failed to justify the short-term losses which would result from successful completion of their repurchase plan. Careful scrutiny of the trustees' actions convinced the court that they "failed to discharge their duty of prudence either diligently or in good faith" [123].

The conduct of the trustees reflects a silent agreement among them (1) to "see, hear, and speak" nothing positive about the LTV tender offer and avoid any inquiries which might have uncovered facts to the contrary and (2) to isolate themselves from legal advice which might have precluded the Pension Plan from participating in the well-orchestrated plan to kill the LTV takeover [124].

The language of the court indicates that in a different fact situation, for example if the trustees more carefully investigated the repurchase of target stock by a target beneficiary plan, the court might find no breach of duty. *Bierwith* does not rely on the usual business judgment-corporate purpose analysis. Rather, it applies a special higher duty of care and loyalty on director-trustees under ERISA. [125].

5. Lock-up agreements

The lock-up, broadly defined as "an arrangement, made in connection with the proposed acquisition of a publicly held business, that gives the proposed acquiror an advantage in acquiring the target over other bidders" [126], is an arrangement employed extensively as a takeover defense as well as in acquisition planning [127]. Three recent cases provide a framework to analyze the lock-up technique [128]. These cases indicate that the structure of a lock-up may determine whether or not it will be upheld by the courts [129].

5.1. Some lock-ups are "manipulative"

In *Mobil*, the Court of Appeals for the Sixth Circuit held that Mobil, a bidder for Marathon Oil, had demonstrated a substantial likelihood that it
would succeed on its claim that two lock-up options granted by Marathon to U.S. Steel, a white knight making a competing bid for Marathon, were "manipulative acts or practices, in connection with [a] tender offer" in violation of section 14(e) of the Exchange Act [130]. The options, both individually and in combination, "had the effect of creating an artificial price ceiling in the tender offer market for Marathon common shares" [131]. Thus, they deterred Mobil and any other potential tender offerors from competing with U.S. Steel for Marathon shares. In holding the options to be "manipulative," Judge Engel said:

In our view, it is difficult to conceive of a more effective and manipulative device than the "lock-up" options employed here, options which not only artificially affect, but for all practical purposes completely block, normal healthy market activity and, in fact, could be construed as expressly designed solely for that purpose [132].

The Mobil court acknowledged the novelty of its ruling that the options were "manipulative," but countered with the general notion that the term "must remain flexible in the face of new techniques which artificially affect securities markets" [133]. According to one commentator, the Sixth Circuit's ruling "surprised the corporate and securities bar" [134].

The court found the options "manipulative" both individually and in combination [135]. The stock option gave U.S. Steel a presently exercisable right to purchase ten million authorized but unissued Marathon shares for $90 per share. In addition, U.S. Steel obtained an option to purchase Marathon's 48% interest in Yates oil field for $2.8 billion. It was exercisable only if U.S. Steel's tender offer for $125 per share did not succeed and a third party gained control of Marathon. Because the option presented a threat that any other bidder gaining control of Marathon would lose the oil field, the court held that its only effect could be to deter bidders from competing with U.S. Steel in an auction for control of Marathon [136].

The options found objectionable by the court seemed to have gone too far. The size of the stock option was an offensive factor cited by the court [137]. U.S. Steel could purchase ten million newly issued shares at any time during the takeover contest. Marathon had 58,685,906 common shares outstanding. U.S. Steel would then control approximately 17% of Marathon's stock by exercising the stock option.

The court also objected to the discount price given to U.S. Steel. The stock option gave U.S. Steel the right to purchase 10,000,000 shares at $90 per share. U.S. Steel's tender offer was for thirty million shares at $125 per share, to be followed by a merger in which U.S. Steel notes with a face amount of $100 would be issued. These notes had an estimated market value of approximately $86. The court calculated that because of the option it would cost Mobil $47 million for every dollar raise in the bid, but would cost U.S. Steel only $30 million [138]. Moreover, averaging U.S. Steel's front-end offer price ($125)
with its back-end price ($86) reveals that the discount spread between the $90 option and the $106 average offer price amounts to a $160 million discount for the option shares [139].

With respect to the Yates Field option, perhaps the decisive factor in the Mobil case was the value of the “crown jewel”. The richness of the Yates oil field, according to the Sixth Circuit, was well known [140]. Although the District Court had held that the U.S. Steel option price of $2.8 billion was fair, the Sixth Circuit held that only the open market contemplated by the Williams Act could adequately measure the field’s value [141]. The court received evidence that the field’s value ranged from $2.539 to $3.639 billion [142].

The Sixth Circuit concluded with two caveats in Mobil [143]. First, the court refused to disturb the District Court’s ruling that Marathon directors did not breach their fiduciary duty to shareholders by granting the options [144]. The language of the opinion may indicate disapproval of U.S. Steel’s tactics in “demanding and obtaining” the options [145]. Since section 14(e) “protects target shareholders regardless of who did the manipulating” [146], it was the white knight, U.S. Steel, that violated the Act in obtaining the options [147].

Second, Mobil was not to be a rule of decision for all claims of manipulation under the Williams Act. The court indicated that some options which “‘lock up’ takeover battles or otherwise discourage competing tender offers” [148], may not violate section 14(e) of the Williams Act. In essence, the court acknowledged that the term “lock-up” may subsume many forms of defensive action by a target, some of which are not offensive [149].

5.2. Sale of a division is not a lock-up

In the Whittaker case, Judge Flaum held that the proposed sale of Sherwood to American Home Products (AHP) was not a manipulative act violating section 14(e) [150]. In so holding, the court distinguished the lock-up device in Mobil from the defensive action taken by Brunswick. Brunswick did not actually grant an option to American Home Products at all; rather, it sold an asset and received Brunswick shares as consideration. The court stated:

Brunswick has not granted any lock-up option to American Home, nor did Whittaker revise its offer for Brunswick in an attempt to compete with the proposed sale of Sherwood as Mobil did in the Mobil case. Thus, the sale of Sherwood has not created an artificial price ceiling in the tender offer market for Brunswick common shares which would have been a manipulative act in violation of the Williams Act (italics added) [151].

In a February 13, 1982 agreement, AHP agreed to make a tender offer for over fourteen million Brunswick shares at $30 per share. Brunswick agreed to distribute Sherwood stock to AHP in redemption of its shares acquired by AHP in the tender offer [152]. The aspect of this agreement which arguably represented a “lock-up” was the provision whereby AHP gained the right to
purchase Sherwood for $450 million in cash even if the Whittaker bid succeeded. Whittaker indicated on several occasions that it considered Sherwood the major attraction in its bid for Brunswick [153].

Whittaker argued that the agreement between Brunswick and AHP had the same deterrent effect on competitive bidding as the U.S. Steel options. Brunswick's agreement, Whittaker argued, combined the unfair advantages of both of the U.S. Steel options: it gave AHP a price advantage in any bidding auction as well as the right to obtain Sherwood under any circumstances [154]. The Seventh Circuit, however, affirmed without an opinion Judge Flaum's ruling that the Brunswick "lock-up" device is distinguishable from the option in Mobil [155].

Essentially, the court viewed the Brunswick–AHP deal as a sale, not a lock-up. Brunswick granted AHP a contract right to buy an asset, not an option to purchase if another bidder gained control of the target. In Mobil, the option to buy became exercisable only if Mobil or another competing bidder gained control of Marathon. The Whittaker court held that a contractual right to buy was distinguishable from an option even if the parties contemplated that the purchaser would be making a tender offer for the seller's stock [156].

The sale did not block an auction. Unlike U.S. Steel, AHP was not competing for control of the target. The agreement merely provided for a sale in the face of a hostile bid. Thus, the auction for Brunswick could continue, although the bid would now be for Brunswick without the Sherwood division. The sale could not be "construed as expressly designed solely for the purpose of completely blocking normal, healthy market activity as did the Yates Field lock-up" [157]. The sale was not at a discounted price, nor did the court find evidence that the market valuation of Sherwood was artificially low. The Whittaker court held that selling an asset may be a part of healthy market activity. Judge Flaum stated: "[the] sale of a substantial asset by a corporation in the face of a hostile tender offer standing alone is not a violation of section 14(e)" [158].

5.3. Some lock-ups are inoffensive

In Marshall Field & Co. v. Icahn, District Judge Leval denied preliminary relief and held that the bidder, the Icahn group (which had accumulated a substantial position in Marshall Field), failed to show irreparable harm or a likelihood of success on the merits based on its allegation that certain agreements between Marshall Field and Batus, a white knight for Fields, violated section 14(e) [159]. The court then expressed its view that the Mobil decision represents a "questionable legal theory" [160].

In my view the reasoning of that decision could unduly interfere with the right of company management to combat a takeover attempt that it believes in good faith to be harmful to its
shareholders. In my view the securities laws do not bar management from taking action in the best interests of its shareholders even if this will make more difficult the success of a disfavored offeror. The rule might be otherwise on a showing that management is acting for its own interests in violation of its fiduciary duty to its shareholders. No such showing has been made here [161].

Judge Leval held that, even if Mobil were good law, the agreements between Marshall Field and Batus were distinguishable because they were contracts with conditions, not options, and were not set at a bargain price [162].

Field made two agreements with Batus which implemented a form of lock-up on the Chicago properties held by the target [163]. In its stock purchase agreement, Batus agreed to purchase two million shares of Field’s treasury stock at $25.50 per share - the initial tender offer price. Under the contract, at its election, Batus was relieved of this obligation if a third party gained 51% of Field stock or if its tender offer for the same price remained open until April 1, 1983. In its second agreement, Field granted Batus a right of first refusal for the Chicago properties if they should be sold within one year of the termination of the Batus–Field merger agreement. Batus could pay with Field stock valued at Batus’ cost of $25.50 per share. A clarification agreement, executed at the court’s request, provided that any exercise by Batus of this right would reopen the bidding for the Chicago division [164].

Judge Leval distinguished the Batus–Field agreements from the options in Mobil. First, the court found that the “lock-up” devices were not options, but defeasible contracts [165]. The stock purchase agreement did contain one provision that looked like an option: Batus could terminate its tender offer for Field’s shares and tender into another offer if certain events occurred. Basically, if outbid, it need not buy. The second agreement was a limited right of first refusal. Batus could not purchase the Chicago properties in the face of a successful takeover bid by Icahn. It only obtained the right to match the bid for the properties if they were sold within one year of the termination of the Batus–Field merger agreement [166]. Judge Leval also stated that exercise of the agreement was highly unlikely:

The first refusal comes into play only if Field (including any new management after a takeover) seeks to sell the Chicago properties within a year of the termination of the Field–Batus merger. A new management need only wait one year to sell those assets to defeat Batus’ rights. These contracts seem most unlikely to dissuade competitors (if any exist) from tendering for control of Field [167].

According to the court, the agreements did not give Batus a discount price. Even though Batus raised its tender offer to $30 per share, the stock purchase agreement set at $25.50 per share was not a discount at the time it was entered into [168].
5.4. Future of manipulation claims under section 14(e)

A recent case, Cities Service Co. v. Mesa Petroleum Co. [169], indicates that courts may be reluctant to label other takeover tactics as manipulative. In that case, Cities made a tender offer for 51% of Mesa shares. Mesa responded with the so-called “PacMan defense” [170] when it made a hostile offer for 15% of the much larger Cities at $45 per share. Mesa also made a friendly offer for 46% of Cities at $50 per share. In its motion for a preliminary injunction restraining Mesa’s 15% offer, Cities alleged that Mesa violated section 14(e) of the Williams Act in its two offers and in a repealed by-law amendment [171]. Cities alleged that Mesa’s offers were a “tender now–finance later” scheme designed to attract financing by coercing Cities shareholders to tender. Cities also alleged that Mesa’s representations created an illusion in the marketplace that Mesa had the financing needed to purchase control of Cities [172]. The court held that Cities lacked a likelihood of success on the merits of its claim that Mesa manipulated the market. Judge Stapleton held that Mesa could make a 15% offer in hopes of attracting sufficient shares to gain control, provided that Mesa did not mislead the market about its financing possibilities. The court refused to “[intrude] into the processes of the market”, even though Mesa’s 15% offer was used as a weapon in takeover battle [173].

6. The front-end loaded transaction

A major development for bidders has been the emergence of the so-called “front-end loaded” two-step transaction [174]. The Whittaker offer of January 26, as well as its revised offer of February 10, are examples, although not forceful ones. The offer involved an initial partial tender offer of $26.50 in cash (raised to $27) for 49% of Brunswick’s common shares including convertible debentures. The second step, pursuant to the merger, would entail the exchange of newly created Whittaker preferred securities (revised to new subordinated debentures) for the remaining Brunswick common stock. Whittaker valued its second step at “more or less than $26.50 (raised to $27)” [175]. Brunswick, however, alleged in communications to shareholders, to the press, and in its January 28 counterclaim, that the “more or less than $26.50” characterization of the second step was false and misleading because Whittaker’s investment banker set the value at $25, while Brunswick’s bankers set it between $19.50 and $21.

Brunswick also alleged that the two-step structure illegally coerced Brunswick shareholders into tendering their shares in violation of state corporate law and the Williams Act [176]. A more forceful front-end loaded transaction would involve a greater disparity in price between the front-end and back-end. For example, U.S. Steel’s deal with Marathon involved a $25 per share cash...
offer for 51% of Marathon, with a back-end merger proposal of notes having a value in the neighborhood of $86 [177].

As is characteristic of the front-end loaded transaction, the effect of Whittaker's split offer was to cause a shareholder "stampede" to tender. As of the first proration date, February 4, the Whittaker offer was oversubscribed [178]. By tendering stock into the bidder's proration pool in the first ten calendar days, the shareholder could receive cash promptly and avoid, to the extent possible, relegation to the lower-priced second step, which might not occur for some time period. Under the Williams Act, only stock tendered within ten calendar days from the initiation of a partial bid must be accepted on a pro-rata basis [179]. Moreover, that stock forms a discrete pool which continues to obtain priority if the bidder raises its price.

Brunswick did not litigate the corporate or securities law issues surrounding Whittaker's two-step offer: Judge Flaum's refusal to enjoin the Sherwood sale mooted the issue because Whittaker withdrew its offer [180]. This issue was analyzed in Radol v. Thomas [181], a decision concerning the two-step structure of U.S. Steel's friendly bid for Marathon. In addition to the federal law questions discussed in Radol, various as yet unresolved state law questions must also be addressed: Must the second step satisfy the "entire fairness" or similar test? What is the impact of appraisal statutes; and are the results different for negotiated and non-negotiated transactions [182]?

6.1. Do front-end loaded transactions violate the Williams Act?

In Radol, Judge Rubin denied injunctive relief to plaintiff minority shareholders of Marathon Oil on their claims that the second step merger of U.S. Steel and Marathon violated the Williams Act [183]. The tender offer and merger were part of an agreement negotiated between U.S. Steel and Marathon. The court addressed several securities law issues including the question of whether the two-step structure of U.S. Steel's tender offer and merger was coercive and manipulative in violation of sections 14(e) or 10(b) of the Exchange Act [184]. U.S. Steel made a friendly offer in step one for 51% of Marathon shares at $125 per share, while in step two, pursuant to the merger, it offered U.S. Steel debentures valued at approximately $86 in exchange for the remaining Marathon shares [185]. A February proxy statement to shareholders revealed that an internal report valued Marathon stock at $276 to $323 per share, while First Boston gave the company an asset valuation of $189 to $226 [186].

The court in Radol refused to evaluate the fairness of the price for Marathon shares, reserving the issue for a hearing on the merits [187]. Rather, it held that the average $106 price of the offer ($125 for 51% of their shares and $86 for 49% of their shares) was comparable in value to both steps of Mobil's first offer ($85 at both ends) and offered a premium over market.
Assuming a less than unanimous acceptance of U.S. Steel's offer, those shareholders that tendered would receive higher overall consideration. Thus, the two-step structure would be more attractive to early tenderers than an equal $106/$106 offer [188]. The court concluded that the U.S. Steel offer was not coercive:

... the overwhelming response to U.S. Steel's tender offer was due, not to the coerciveness alleged to be inherent in a two-tier pricing structure, but because of the relatively attractive price offered at both ends of the transaction, giving those that tendered the opportunity to receive at a minimum approximately $106 per share [189].

Nor was the pricing structure manipulative of the market by inhibiting alternative bids, because Mobil responded with a higher $126/$90 bid [190]. In the view of Judge Rubin, the U.S. Steel two-step offer was neither coercive nor manipulative in violation of sections 10(b) or 14(e) [191]. Despite the inherent risks to shareholders attendant to any tender offer, the court found that “both the case law as well as pertinent SEC Rules and Regulations appear to contemplate such pricing arrangements” [192]. Judge Rubin did not directly address the question whether the front-end loaded transaction, with its “whipsaw” effect on shareholders, violates the intent of the federal securities laws to allow shareholders the opportunity to make investment decisions in an unhurried manner [193]. The two-step price structure may be in part a product of the new 1980 tender offer rules, 14d-1 to 14d-9, 14e-1 and 14e-2, which added new withdrawal provisions and extended the time period for bids [194]. By structuring a tender offer as a partial bid with two steps, the bidder can pressure a shareholder to tender early (within the ten calendar days) and not withdraw shares already tendered in order to lower his risk of proration. The bidder can offer a higher price on the front end without raising the overall cost of the bid. Thus, the purpose of the Williams Act – to slow down the ten-day “Saturday Night Special” tender offer – can arguably be subverted by the stampede to tender within the ten-day proration period [195].

The Williams Act intent issue may be solved in three ways. First, as is often stated, the paramount federal interest in the Williams Act is disclosure and not regulation of the substantive fairness of tender offers [196]. According to this laissez-faire view, any tender offer forces the non-tendering minority to risk freeze-out in a subsequent merger or impairment of the marketability of his shares [197]. Despite this inherent coerciveness, Congress has chosen to regulate disclosure of tender offers, not outlaw them [198]. Moreover, Rule 13e-3 contemplates front-end loaded transactions: failure to comply with the “equal consideration” exemption for a “going private” transaction requires compliance with the rule [199]. Nor has the SEC issued interpretative guidelines for two-step pricing.

The argument that the average price paid to shareholders was fair convinced
the court in Radol that the two-tier price was not manipulative or coercive [200]. Such an approach treats the partial bid as "unitary acquisitions in which part of the shares are acquired at the tender offer price and part on the terms of the second-step merger" [201].

Adopting the SEC's proposed Rule 14d-8 [202] would solve the problems inherent in prorating and the front-end loaded transaction. Under this rule, pro rata treatment would be afforded all shares tendered during the offer period, including an extension of the offer. Such a rule, in the view of the SEC, would better serve the goal of equal treatment of shareholders. The SEC based its proposed rule on:

... [the] assessment that, in light of current tender offer practices, extension of proration rights to the term of the tender offer is necessary to assure security holders the time to consider the merits of a tender offer ... and to obtain sufficient information upon which to base their investment decisions [203].

6.2. Should the second step be analyzed under the "entire fairness" doctrine?

The Radol court specifically declined to determine whether Marathon shareholders received a fair price on the first or second steps [204]. No case specifically addresses whether, in the context of the contemporary front-end loaded transaction, it is proper to "freeze out" the minority at the lower price or whether the second step must provide "entire fairness" to non-tendering shareholders [205]. This question may be more pertinent with a second step after a non-negotiated bid. In the negotiated transaction, when both prices are negotiated at the same time and the parties are clearly at arm's length, the unitary nature of this transaction is more apparent. Even in this context, however, how are appraisal rights affected?

Delaware cases apply the "entire fairness" doctrine in acquisition transactions where a company is being acquired by a controlling person [206]. The doctrine requires careful scrutiny of so-called freeze-out mergers on a case-by-case basis [207]. In determining whether the entire fairness test has been satisfied, the courts review various factors, both substantive and procedural, including: (1) the "business purpose" of the transaction, including whether it was done solely to freeze out the minority; (2) the fairness of the consideration offered the minority; (3) whether the transaction was approved by a majority of the minority; (4) the obtaining of a fairness opinion from an independent financial advisor; and (5) whether the transaction was negotiated with, and approved by, independent directors of the company [208]. The nature and extent of the required procedural fairness will, it appears, depend upon all the facts involved. Factors to assess whether the squeeze-out price was fair include going concern value, book value, net asset value and market value [209]. No case has expressly ruled that the second-step price must be equal to the tender
offer price. One case found that, even where the second-step merger was preceded by a tender offer at a premium price, non-tendering shareholders are not necessarily entitled to the premium price [210].

As seen above, Delaware corporation law contemplates analysis of many different valuation methods. Moreover, the specific weight assigned to each value will vary with the individual corporation. Other states which apply the “entire fairness” doctrine may apply only the less stringent market value test [211]. One commentator would view two-step acquisitions on a unitary basis:

One way is to treat the partial bid as an acquisition of the entire company at two price levels: the number of shares to be purchased in the tender offer at the tender offer price; and the remaining shares at either the market price before announcement of the partial bid or at the bankers' estimate of the price at which the target company's shares will sell after completion of the tender offer. The fairness of the financial terms of the acquisition would be judged on the basis of the weighted average price that is produced by this method. If a partial bid is within the range of fairness, even after dilution by the shares that are not purchased in the tender offer, the partial bid would be considered fair from a financial point of view [212].

7. Conclusion

The defensive tactics examined in this article are among the most highly litigated issues in tender offers today. On balance, absent a substantive violation, such as antitrust, courts do not seem inclined to interfere with the tactics of either bidder or target. At this time, the judicial view follows what many commentators perceive as a legislative policy behind the Williams Act – a neutral stance between bidder and target [213]. The attitude of courts might aptly be summarized as “let the bid proceed”.

Notes


[13] Northwest Industries, Inc. v. B.F. Goodrich, Co., 301 F. Supp. 706, 712 (N.D. Ill. 1969). Recent cases have allowed limited judicial inquiry to determine whether a decision to terminate a shareholders' derivative action falls within the business judgment rule and is appropriate. See Auerbach v. Bennett, 47 N.Y.2d 619, 419 N.Y.S.2d 920, 393 N.E.2d 994 (1979). See also Zapata Corp. v. Maldonado, 430 A.2d 779 (Del. 1981); Payson, Goldman. & Inskip, After Maldonado – The Role of Special Litigation Committee in the Investigation and Dismissal of Derivative Suits, 37 Bus. Law. 1199 (1982). This doctrine of judicial inquiry has not been extended to the review of directors' conduct in a takeover.

Certain commentators have suggested that hostile takeover contests create an unavoidable conflict of interest for directors, and therefore their decisions should not be analyzed under the business judgment rule. See, e.g., Easterbrook & Fischel, The Proper Role of a Target's Management in Responding to a Tender Offer, 94 Harv. L. Rev. 1161 (1981); Gelfand & Sebastian, Reevaluating the Duties of Target Management in the Hostile Tender Offer, 60 B.U.L. Rev. 403 (1980); Gilson, A Structural Approach to Corporations: The Case Against Tactics in Tender Offers, 33 Stan. L. Rev. 819 (1981).


[17] See generally Fleischer, supra note 9, at 79–82.

[18] Panter, 646 F. 2d at 299 (Cudahy, J., dissenting).


[20] Id. at 300-301.

[21] Id. at 301.

not constitute a breach of fiduciary duty by Marathon directors. \textit{Id.} at 92,285. First, the court held that Mobil had met its threshold burden of showing self-interest on the part of Marathon directors. \textit{Id.} at 92,284. Although the fact that directors will continue in office after a successful defense is not enough to shift the burden, see \textit{Crouse-Hinds Co.}, 634 F.2d at 702–703, in Judge Kinneary's view, a defensive business combination perpetuating incumbent control that is proposed \textit{after} a hostile tender offer will shift the burden to directors. \textit{Mobil}, [1981–1982 Transfer Binder] Fed. Sec. L. Rep. §§98,375, at 92,284–85 n. 55. The court went on to find, however, that the Marathon directors had succeeded in carrying their burden of showing "fairness, corporate purpose and good faith", because the options were "a necessary step in furtherance of what the directors perceived to be the shareholders' best interests". \textit{Id.} at 92,285. When the Sixth Circuit reversed the district court in \textit{Mobil} and found the lock-up options "manipulative" under section 14(e) of the Williams Act, it did not disturb the lower court's finding of good faith and loyalty on the part of Marathon directors. In the view of the Sixth Circuit, given the "non-negotiable package proposal" by U.S. Steel, the directors did not breach their fiduciary duty in accepting what seemed to be a better deal for the shareholders. \textit{Mobil Corp. v. Marathon Oil Co.}, 669 F.2d 336, 377 (6th Cir. 1981).

[23] 510 F. Supp. 860 (S.D.N.Y. 1981). In the \textit{St. Joe} case, which seems contrary to \textit{Whittaker}, Judge Pollack expressed outrage at the target's tactics: "It is inconceivable that an alleged flourishing enterprise has authorized its board to subject the assets and charter of the company to a scorched earth policy to be accomplished in the name of an exercise of business judgment ..." \textit{Id.} at 861. Pollack's opinion suggested that it was not just the sale of a division (Can Del), but the sale coupled with a threat to liquidate the business that concerned the court. The liquidation threat, according to the court, evidenced the directors' intent:

to keep control of the company entrenched within the present board of directors regardless of the company's real best interests or else to dismember it piece by piece, even to the point of liquidation of the enterprise, regardless of the proclaimed profitability and in the absence of all evidence whatsoever that the actual owners of the enterprise want its demise. \textit{Id.} at 862.

Is there a legal distinction, however, between the sale of a division and a piece-by-piece liquidation? Courts have generally not been responsive to \textit{St. Joe} type motions, and have refused to restrain, in advance, a target from carrying out any transactions that could be viewed as "defensive". See, e.g., \textit{Conoco, Inc. v. The Seagram Company, Ltd.}, No. 81-4029 (S.D.N.Y. July 3, 1981) (Judge Weinfeld denied Seagram's motion for a TRO enjoining Conoco directors from selling all or some of the company's assets).


[32] Offer to Purchase, supra note 26, at 18–21 (purpose of the offer). See also Whittaker, 535 F. Supp. at 938.


[34] Pitt, Hostile Tender Offers Now Omnipresent Fact of Life, Legal Times of Wash., July 19, 1982, at 16, col. 1 [hereinafter cited as Pitt]. Mr. Pitt cites the pre-emptive strikes in which federal court litigation is commenced in order to invalidate state takeover laws as a common bidder tactic.


[38] Brunswick Corp., Press Release (Jan. 27, 1982) (available in authors' files).

[39] Id. Not specifically discussed here are literary and political defenses to takeover. Brunswick's allegations of Mideast involvement combine both types of strategy. See generally Fleischer, supra note 9, at 99–105, 113–19.


[42] Brief for Plaintiffs–Appellants at 8–9, Whittaker Corp. v. Edgar, Nos. 82-1305 & 82-1307 (7th Cir. 1982) [hereinafter cited as Whittaker Brief]. See also Metz, Brunswick Acted Before Whittaker Offer to Protect Top Officers in Any Takeover, Wall St. J., Feb. 1, 1982, at 14, col. 2. Employee compensation agreements are not anti-takeover devices: they do not prevent a company from being taken over. See Grinstead, The Treatment of Employee Benefit Plans in Mergers and Non-Negotiated Acquisitions, 13th Annual Institute on Securities Regulation 13 (P.L.I. 1981). As compared to the amounts involved in most tender offers, an obligation to make severance payments or to accelerate benefit plans upon a change of control will generally not make the target less attractive to a hostile bidder in a material financial sense. Rather, in the judgment of directors, the agreements are designed to supply financial and job security against risks, like the unsolicited takeover, over which management has no control. Moreover, these contract provisions may help attract, and retain, high level employees, and may lend greater objectivity to decisions made during consideration of a hostile tender offer. Although employment agreements were not an issue in the...
Whittaker litigation, Whittaker did attempt to argue that the provisions were evidence of management's intent to entrench itself in control. Brunswick countered that the contracts were irrelevant to the issue of an impermissible motive because they became effective only if the hostile tender offer succeeded. The court did not rule upon, nor did the parties argue, the issue of whether the agreements constituted a waste of corporate assets. No court has ruled on the validity of golden parachutes, although two judges criticized them. See Conoco, Inc. v. The Seagram Company, Ltd., No. 81-4029, slip op. at 20-21 (S.D.N.Y. July 3, 1981); Joseph E. Seagram & Sons v. Abrams, No. 81-1419, slip op. at 74-77 (S.D.N.Y. Mar. 24, 1981).

[43] B.C. Holdings, named in the motion for a preliminary injunction, was a wholly-owned subsidiary of Whittaker incorporated immediately prior to the bid for Brunswick shares. Whittaker, 535 F. Supp. at 937.

[44] Id. at 943.

[45] Id. at 943-44.


[47] Offer to Purchase, supra note 31, at 6 (withdrawal rights).


[55] Id. at 946-47.

[56] Id. at 937, 944-52. See also Brunswick Corp., Whittaker Each Win a Round in Court, Wall St. J., Feb. 26, 1982, at 18, col. 3.


[58] Id. at 949-50. For a discussion of antitrust litigation as a "show-stopper", see Fleischer, supra note 9, at 120-29. For a negative view of antitrust litigation in this context, see Easterbrook & Fischel, Antitrust Suits by Targets of Tender Offers, 80 Mich. L. Rev. 1155 (1982).

[59] See notes 63-85, 122-65 infra & accompanying text.


[64] See Whittaker Brief, supra note 42, at 41-49; Brief for Defendant-Appellee American Home Products Corp. at 16-24, Whittaker Corp. v. Edgar, Nos. 82-1305 & 82-1307 (7th Cir. Mar. 5, 1982) [hereinafter cited as AHP Brief]; Brief for Defendant-Appellee Brunswick Corp. at 17-32, Whittaker Corp. v. Edgar, Nos. 82-1305 & 82-1307 (7th Cir. Mar. 5, 1982) [hereinafter cited as Brunswick Brief].
Whittaker, 535 F. Supp. at 950 (citations omitted).

See, e.g., Panter, 646 F.2d at 300-301 (Cudahy J., dissenting) (naive to view nonmanagement directors as truly independent). See note 13 supra.

See, e.g., Panter, 646 F.2d at 294. ("The presumption of good faith the business judgment rule affords is heightened when the majority of the board consists of independent outside directors" (citations omitted)). Former SEC chairman, Harold Williams has commented. "I would expect to find an increasing number of instances in which a corporation's board delegates to a special committee of independent directors the investigation of an offer and the recommendation to the full board of an appropriate response." Williams, Tender Offers and the Corporate Director, 1979-1980 Transfer Binder Fed. Sec. L. Rep. (CCH) ¶82,445, at 82,880 (Jan. 17, 1980).

See Fleischer, supra note 9, at 88-40.

Whittaker Brief, supra note 42, at 49. A similar charge of failing to follow expert advice was found to show lack of due care in Chicago Stadium Corp. v. Scallen, 530 F.2d 204 (8th Cir. 1976). See Fleischer, supra note 9, at 88-43.


Id. at 941.

Id. at 950.

Id. at 951.

Id. In addition, the court held that even if the facts were sufficient to shift the burden of proof to Brunswick to show that the sale of Sherwood was within the bounds of valid business purposes, Brunswick had so established. Id.

See Brunswick Brief, supra note 64, at 9-13; AHP Brief, supra note 64. at 33-34.

See Whittaker Brief, supra note 42, at 12-13.

Whittaker, 535 F. Supp. at 941, 951.

See generally Fogelson & Wenig, Disaggregation as a Takeover Defense, Buying & Selling Subsidiaries & Divisions 325 (1982) [hereinafter cited as Fogelson & Wenig].

See notes 52-54 supra & accompanying text.

See Whittaker, 535 F. Supp. at 941-43; Whittaker Brief, supra note 42, at 15-17. The type of redemption scheme which Brunswick argued would qualify under old section 311(d) (2) (B) as an exception to gain the recognition rule in section 311(d) (1) is no longer possible under the new 1982 tax law. Tax Equity and Fiscal Responsibility Act of 1982, §222(a) (1), Pub. L. No. 97-248 (codified at I.R.C. §311(d) (2) (1982)).
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[89] Id. at 949. For a consideration of tax and other strategic considerations of an ARP, see Herzel, Sherck, & Colling, Sales and Acquisitions of Divisions, 5 Corp. L. Rev. (1982).

[90] See Brunswick Corp. Says Sale of Major Unit to Foil Whittaker Hasn't Crippled It., Wall St. J., Mar. 11, 1982, at 34.

[91] See note 23 supra.


[94] See notes 26–29 supra.


[101] Id. at 951–52.


[104] 17 C.F.R. §240.14d-101 (1981). The target should also describe any board resolution relating to the need for confidentiality regarding the negotiations. Id. Item 7(b).

[105] See Fleischer, supra note 9, at 149–53.


[111] See, e.g., Cheff, 199 A.2d 548.


[113] Id. at 306.

[114] Id. at 305–306.

[115] Id. at 305 (citing Bennett v. Propp, 41 Del. Ch. 14, 22, 187 A.2d 405, 409 (1962)).

[116] Id. at 305.


[119] Id. at 476.

[120] Id. at 467–70.

[121] Id. at 470–75. See also Withers v. Teachers' Retirement Sys. of New York, 447 F. Supp. 1248 (S.D.N.Y. 1978) (good faith belief held by trustees of Teachers' Retirement System did not insulate them from charges that they acted imprudently) (discussed in Bierwirth, 538 F. Supp. at 470–71).


[123] Id. at 475.

[124] Id.

[125] In addition, neither case found that an issuer repurchase from third parties constituted a tender offer. The Crane court held that Harsco's repurchases of 132,300 shares of its own stock...
from arbitrageurs did not constitute a self-tender requiring disclosure under Rule 13e-4. Crane, 511 F. Supp. at 302–303. Judge Mishler, in a later case in which LTV sought a preliminary injunction against Grumman's stock repurchases, held that Grumman's purchasing program in the open market of up to 1,275,000 of its own shares did not constitute a tender offer. LTV Corp. v. Grumman Corp., No. 81-3322 (E.D.N.Y. Oct. 16, 1981).


[130] Mobil, 669 F.2d at 369.

[131] Id. at 375.

[132] Id. at 374.

[133] Id.

[134] Bialkin, supra note 129.

[135] Mobil, 669 F.2d at 374.

[136] Id. at 375.

[137] Id. at 376.

[138] Id. at 375.


[141] Id. at 375.


[143] Id. at 377.

[144] Id. See also id. at 374 (“[w]e offer no opinion regarding the merits of the fiduciary duty claim ...”).

[145] See id. at 374–75. See also id. at 377 (“non-negotiable package proposal from USS”).

[146] Id. at 377.

[147] For a similar view, see Bialkin, supra note 129.


[149] For a description of types of lock-ups, see Fraidin & Franco, supra note 126.


[151] Id.

[152] Id. at 941–42. See also American Home Products Corp., Offer to Purchase Shares of Brunswick Corp. (Feb. 16, 1982).


[157] Id.

[158] Id. The Whittaker court also held that Brunswick did not violate the section 14(e) prohibition against material misrepresentation or omissions. Id. at 946–47. Using a quite liberal disclosure standard (or a strict requirement of materiality), the court found the following:
1. **Tax Aspects:** Although Brunswick did not make a full disclosure of all of the tax ramifications of the proposed sale in the AHP offer or its letter to shareholders and the court disapproved of Brunswick statements to the press that the sale was tax-free, those disclosures did not violate section 14(e) since Brunswick adequately disclosed the possible tax consequences of the sale. *Id.* at 946.

2. **Bold-Face Type:** Brunswick's use of bold-face type in a letter to shareholders, although perhaps inappropriate, was not material. *Id.*

3. **Costs of Sale:** Failure to provide specific costs figures in the AHP offer and the Brunswick letter to shareholders was not a material omission within section 14(e). *Id.* at 947.

[160] *Id.* at 93,061.
[161] *Id.*
[162] *Id.*
[165] *Id.* at 93,061.

[166] The target, Marshall Field, professed fear that Icahn would loot the company by selling off its valuable Chicago division for a profit as soon as acquired. *See, e.g., Marshall Field Sues to Bar Icahn Group From Raising Stake,* Wall St. J., Feb. 9, 1982, at 3, col. 2. (Field calls Mr. Icahn a "notorious corporate opportunist", known for acquiring large blocks of stock and then selling them back to their issuers.) The right of first refusal protected Field from this eventuality for one year.

[168] *Id.* at 93,060.
[170] *See Masters*, *Aborted Takeover Bid Adds New Tactics, Terms to Legal Lexicon,* Legal Times of Wash., July 5, 1982, at 1. The Pac-Man defense fights off a takeover attempt by seeking to take over the bidder. *Id.* The bid might also be called a "bootstrap" because Mesa sought to attract financing to bid for control of Cities. *Id.*

[171] *Cities Service,* 541 F. Supp. at 1221-22. The by-law amendment provided that special meetings of Mesa stockholders could be called upon request of one-third of the voting shareholders. *Id.* at 1222. Mesa rescinded its amendment deleting the provision.

[172] *Id.* at 1222-23.


[177] For a description of the offer, *see* notes 134-35 *supra*.
[178] *See* note 46 *supra*.
[180] *See* note 59 *supra*.
In light of the emergence of these two-step transactions, potential targets might consider the adoption of a charter amendment which would require that the consideration offered in the back end of a two-step deal equal the consideration in the front end. For a discussion of similar fair price provisions, see Hochman & Fulger, *Deflecting Takeovers: Charter and By-law Techniques*, 34 Bus. Law. 537, 553-55 (1979) (requirement that a specified percentage over market be paid to all non-tendering shareholders). These so-called “shark repellants” provisions would generally require shareholder approval. *See generally Fleischer, supra* note 9, at 22-24-4. For another viewpoint, see Friedenberg, *Jaws III: The Impropriety of Shark Repellent Amendments as a Takeover Defense*, 7 Del. J. Comp. Corp. L. 32 (1982).

*Radol*, 534 F. Supp. at 1318.

*Id.* at 1311-13.

*Id.* at 1305 & n.2.


*Radol*, 534 F. Supp. at 1318.

*Id.* at 1312-13 & n.15. See also *Fleischer, supra* note 174.

*Radol*, 534 F. Supp. at 1313.

*Id.*


*Id.* at 1312.


*Id.* at 818 n.28. *See also Symposium on Takeovers; Mechanisms for Regulating Takeovers: Hearings Before the House Comm. on the Judiciary, 97th Cong. 2d Sess.* (June 10, 1982) (testimony of Arthur Fleischer, Jr.).

*See, e.g.*, Great Western United Corp. v. Kidwell, 577 F. 2d 1256, 1276 (5th Cir. 1978) (‘‘let the investor decide for himself’’).


*Id.*

*Id.* at 1311-13.


*See, e.g.*, Tanzer v. Internat’l General Indus., Inc., 402 A.2d 382, 387 (Del. Ch. 1979).

*See Dorman Memo, supra* note 178; Dorman Memo, *supra* note 197, at 3-6.

*See, e.g.*, Sterling v. Mayflower Hotel Corp., 33 Del. Ch. 20, 28, 89 A.2d 862, 867 (Del. Ch. 1952) *aff’d* 33 Del. Ch. 293, 96 A.2d 107 (Del. 1952).

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[212] Chazen, supra note 201, at 1462–63.


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