CORPORATE TAKEOVERS: DEFENSIVE TECHNIQUES UTILIZED AGAINST RAIDERS

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INTRODUCTION

The takeover mania that has besieged corporate America in recent years is reaching mammoth proportions. An influx of readily available capital allowed Campeau Corporation to complete one of the biggest deals in history in 1988, bidding $6.6 billion for Federated Department Stores.1 By year's end, Kohlberg, Kravis & Robert's successful bid for RJR Nabisco at $25 billion dwarfed any prior transactions.2 However, the size of these latest business combinations brings

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into consideration the effects of takeovers on the economy, shareholders, management, and other constituencies.³

The increased prevalence of takeovers has led to the development of various defensive tactics by target management.⁴ After an introduction to tender offers⁵ and the frequently employed two-tiered tender offer,⁶ this Comment examines competing arguments on the use of defensive techniques.⁷ Traditional legal parameters, such as the business judgment rule, that are utilized in evaluating the propriety of takeover defenses, are then reviewed.⁸ An array of these defensive techniques is next explained, with an emphasis on two popular defenses, the "poison pill" and the "lock-up."⁹ In addition, an examination of the foundational decisions illustrates the development of a modified business judgment rule and the introduction of an "auctioneer" duty—rules judicially designed to address the notion of management entrenchment.¹⁰ To place these judicial theories in context, this Comment presents recent case law involving the use of poison pills and lock-ups.¹¹ An analysis of these decisions reveals particular facts and circumstances which the courts examine when determining the propriety of certain defenses.¹² This Comment concludes that the legal tests developed by these decisions fail to significantly impact the deference to management that prior standards had fostered.

THE TENDER OFFER

To aid in understanding the operation of the various defensive techniques, the tender offer will first be examined.¹³ Although the term tender offer¹⁴ is not specifically defined by federal statute, it has been defined through judicial interpretations of the Securities

3. See infra notes 36-39 and accompanying text.
4. See infra notes 102-70 and accompanying text.
5. See infra notes 14-25 and accompanying text.
6. See infra notes 26-40 and accompanying text.
7. See infra notes 41-67 and accompanying text.
8. See infra notes 68-92 and accompanying text.
9. See infra notes 117-37, 159-70 and accompanying text.
10. See infra notes 171-250 and accompanying text.
11. See infra notes 251-394 and accompanying text.
13. See infra notes 14-40 and accompanying text.
14. See Note, The Developing Meaning of Tender Offer Under the Securities Exchange Act of 1934, 86 HARV. L. REV. 1250 (1973). The term "tender offer" is an anomaly. The entity making the offer does not tender shares, but rather the stockholders of the target corporation are invited to sell. Id. at 1251 n.7. However, most state corporate law statutes indicate what constitutes a tender offer or takeover bid. See, e.g., DEL. CODE ANN. tit. 8, § 203(c)(2) (1983); MASS. GEN. LAWS ANN. ch. 110C, § 1 (West 1958); N.Y. BUS. CORP. LAW § 1601 (McKinney 1986).
and Exchange Act of 1934. In a tender offer, the offeror invites the target corporation's shareholders to sell their shares at a specified price, which is usually set above the market price as an inducement to sell. The offer may be for cash, securities, or a combination thereof.

In contrast to mergers and other change of control techniques that require the collective majority approval of shareholders, directors, or both the tender offer can provide for a shift in control by allowing the offeror to communicate directly with the shareholders on an individual contract basis. After the announcement of the tender offer the shareholders have a certain period of time in which to tender their shares. Generally, the acquiring corporation will subsequently accept the offers to sell from the shareholders, which may result in a change of control. If voting control is acquired, the offeror may thereafter initiate a follow-up merger and acquire the balance of shares not tendered in the original offer.

A tender offer can either be "hostile" or "friendly." A "hostile" tender offer describes the situation when the offeror does not have the support or authorization of the target corporation's board or management. A "friendly" tender offer occurs when both the acquiring and target corporations cooperate to ensure a successful merger. The most frequently used hostile type is the frond-end loaded, two-tiered tender offer. A two-tiered offer is an attempt to acquire all of a target company's securities. In the first tier, the of-


17. See Note, 86 HARV. L. REV. at 1251. The term "cash tender offer" denotes offers in which cash is exchanged for stock of the target company, whereas an "exchange tender offer" utilizes securities for the consideration. Id. at 1251 n.8.


20. Id. at 635.

21. Id.

22. Anderson & Augspurger, 11 J. CORP. L. at 659. From a defensive standpoint, however, the target corporation will always face a hostile tender offer. Id.

23. Id.

24. Id.


26. See generally Comment, Two-Tiered Tender Offers and the Poison Pill: The
feror attempts to secure a controlling portion of the target's securities by paying a high premium over the market price. The second tier consists of a follow-up merger for the remaining securities of the target at a lower value than in the first tier. Therefore, the offeror pays a higher price in the initial stage to acquire control, thereby allowing for the potential elimination of any remaining interests at a lower price. This method emphasizes the element of coercion existing in these types of tender offers.

There are two primary reasons why this tactic benefits the offeror. The first stems from the front-end nature of the offer because the shareholders are faced with the difficult decision of tendering their shares up-front (first tier), or gambling on a potential loss with the less attractive merger (second tier). This uncertainty results in an influx of tendering shareholders. Furthermore, this activity results in subsidizing the higher premiums paid in the first tier because of the lower price paid in the second tier. The second advantage is a lower acquisition cost. The two-tiered offer for total ownership of the corporation is less costly than a partial tender offer with a subsequent decision by the acquiror to obtain the remaining shares outstanding by merger. Once a partial offer is made and completed at a high premium over the market price, the market value of the security will reach a plateau between the offering and initial market prices. Therefore, a subsequent merger to acquire the remaining shares would have to be accomplished at a price higher than the plateau, resulting in a second premium that could be avoided through the use of a two-tiered offer.
DEFENSIVE TECHNIQUES

Although this two-tiered technique is beneficial to the acquiror, its utilization has prompted criticism by commentators. The primary complaint concerning the propriety of the two-tiered offer is its effect of coercing shareholders into selling shares in the initial step before assessing all aspects of the transaction, which prevents other potential acquirors from bidding for the target.

COMPETING ARGUMENTS ON THE USE OF DEFENSIVE TECHNIQUES

There are a number of reasons to allow a target's management to defend against a possible takeover. One reason is that a takeover and subsequent merger may result in a lower market value of the acquiror's stock subsequent to the takeover. Furthermore, a significant percentage of the acquired corporation's employees may be terminated due to an overlap of positions with the acquiror's workforce. Another reason includes the large debt that is undertaken to finance these acquisitions, which drain funds available for long-term capital investment and research, in addition to producing highly leveraged entities.

Martin Lipton justifies the adoption of defensive strategies to tender offers, because he claims that corporations are vital to the sustained health of the economy. Lipton states that strong policy con-

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39. See generally Brudney, Equal Treatment of Shareholders in Corporate Distributions and Reorganizations, 71 CALIF. L. REV. 1072, 1131-33 (1983) (stating that a rule of equal treatment with two-tier offers would be consistent with investor expectations); Mirvis, 39 BUS. LAW. at 496-500 (discussing a bidder's risk of an appraisal proceeding in which the second-tier price and the validity of the second-tier itself is challenged under the "entire fairness" test). But see Bebchuck, The Case for Facilitating Competing Tender Offers, 95 HARV. L. REV. 1028, 1050-56 (1982) (arguing that two-tier offers subject to a rule of auctioneering could stimulate the bidding process).

40. See supra notes 30 and 32.


42. Morrissey, Defensive Tactics in Tender Offers - Does Anything Go?, 53 TENN. L. REV. 103, 113-14 (1985) (arguing that the appropriate response to this employee layoff is an investment in "human" capital to meet the needs of a global economy, rather than allowing corporate managers to insulate themselves from shareholder accountability). See also Edgar v. Mite Corp., 457 U.S. 624 (1981) (Powell, J., concurring in part) (reasoning that the relocation of corporate headquarters due to an acquisition willundeniably have an adverse effect on the prior locale).


44. Lipton, Takeover Bids in the Target's Boardroom, 35 BUS. LAW. 101, 104 (1979).
siderations disfavor jeopardizing the economy, and therefore any development constraining the flexibility of companies to defend against unwanted takeovers is detrimental.\textsuperscript{45} Lipton reinforces his position by noting that the defeat of a tender offer will actually benefit the shareholders of the target, when comparing the post-offer market price to the tender offer price in an “overwhelming majority” of the situations.\textsuperscript{46} Therefore, Lipton believes that legal standards, such as the business judgment rule, that lend deference to management should be applied in takeover situations to protect the interests of the shareholders, the corporations, and the overall economy.\textsuperscript{47} In fact, the majority of case law supports the proposition that the business judgment rule allows directors the power to thwart takeover attempts in various circumstances.\textsuperscript{48}

A view in opposition to the pro-defensive tactic position discussed above is that advanced by Professors Frank Easterbrook and Daniel Fischel.\textsuperscript{49} This view relies on the “efficient capital market theory” and the effects of agency costs in takeover situations.\textsuperscript{50} This theory postulates that the price and value of shares will not greatly diverge due to the arbitrage process\textsuperscript{51} and the dissemination of information in the marketplace.\textsuperscript{52} Therefore, it is not possible for investors to systematically reap abnormal gains by selecting and trading in underpriced or overpriced securities.\textsuperscript{53} Because a tender offer at a higher price will exceed the true value of the stock, it must necessar-

\textsuperscript{45.} Id. at 104-05. Lipton argues that even if empirical evidence supported an idea of shareholder wealth maximization in most takeover situations, the residual risk of adverse macroeconomic consequences would override the interests of shareholders, whom he characterizes as “speculators”. Id.

\textsuperscript{46.} Id. at 108-109. However, the numerical data upon which Lipton bases this argument reveals that in half of the studied cases, the post-offer market price was lower than the tender offer price, disregarding consideration of the time value of money. Id. at 107.

\textsuperscript{47.} Id. at 105. See also Lipton, Takeover Bids in the Target’s Boardroom: A Response to Professors Easterbrook and Fischel, 55 N.Y.U.L. Rev. 1231, 1233 (1980); Lipton, Takeover Bids in the Target’s Boardroom: An Update After One Year, 36 Bus. Law 1017, 1017 (1981).

\textsuperscript{48.} Wenger, 31 Vill. L. Rev. at 1443-44.

\textsuperscript{49.} See infra notes 50-67 and accompanying text.

\textsuperscript{50.} Easterbrook & Fischel, 94 Harv. L. Rev. at 1165-74. For a full discussion on this theory concerning the use of defensive tactics in response to tender offers, see Fischel, Efficient Capital Market Theory, the Market for Corporate Control, and the Regulation of Cash Tender Offers, 57 Tex. L. Rev. 1 (1978); Easterbrook & Fischel, Takeover Bids, Defensive Tactics, and Shareholders’ Welfare, 36 Bus. Law. 1733 (1981).

\textsuperscript{51.} Webster’s Third New International Dictionary 110 (1961). Arbitrage is the “simultaneous purchase and sale of the same or equivalent security, commodity contract, insurance, or foreign exchange on the same or different markets in order to profit from price discrepancies.” Id.

\textsuperscript{52.} Easterbrook & Fischel, 94 Harv. L. Rev. at 1165.

\textsuperscript{53.} Id.
ily benefit the target’s shareholders.54

Easterbrook and Fischel believe the most likely reason for the occurrence of hostile takeovers concerns the presence of agency costs and the monitoring of inefficient management.55 Because much of the benefit produced from the efforts of management inures to shareholders, no manager will exhibit optimal performance in maximizing profits.56 A decrease in concern for profit maximization will lead to agency costs that cause the firm’s shares to trade at a lower price than if agency costs did not exist.57 Because shareholders are generally passive investors who must justify the added time and expense of monitoring performance,58 and a corporation’s internal monitoring devices cannot measure the effectiveness of the management team as a whole, tender offers are the most effective means of reducing agency costs.59 The reduction in agency costs permits bidders, by comparing a company’s potential value with that reflected under current management, to profit although they acquire the firm at a premium.60 Under this scheme, the bidder benefits by the difference between the value of the acquired firm and the amount paid to the former shareholders; the tendering shareholders receive a premium for their tendered shares; and the nontendering shareholders benefit through appreciation in value.61

Based on their conclusion that takeovers are beneficial to both shareholders and society, Easterbrook and Fischel argue that any defensive technique employed to defeat a tender offer reduces shareholder welfare.62 The substantial interests that managers have in retaining their positions exacerbates the reduction in welfare as management becomes more inefficient.63 There is no precise way to determine whether a defensive action is an entrenchment scheme or an

54. Id. at 1167-68.
55. Id. at 1169. The authors note the existence of other explanations for takeovers, such as synergistic gains and tax benefits, but explain that these benefits can also be gained through a friendly merger. Therefore, the authors’ theory is more credible than other explanations for takeovers because it accounts for the substantial cash premiums necessary for takeovers. Id. at 1168-69.
56. Id. at 1170.
57. Id.
58. Id. at 1171. Easterbrook and Fischel note that investor passivity is due to the economic free-rider situations. Shareholders have little interest in discovering the inefficiencies of management, and those who would monitor performance would not be able to capture the resultant gains that accrue to all shareholders. Therefore, each shareholder’s self-interest dictates that the shareholder remain passive and capitalize on the monitoring activities of others. Id.
59. Id. at 1172-73; Easterbrook & Fischel, 36 BUS. LAW. at 1733-36.
60. Easterbrook & Fischel, 94 HARV. L. REV. at 1173.
61. Id. at 1173-74.
62. Id. at 1174-75.
63. Id. at 1175.
honest attempt to conduct an auction for the shareholders’ benefit.\textsuperscript{64} Further, even if a defensive technique leads to a higher bid, the gains are offset by a reduction in value to the bidder’s shareholders, plus the real resources expended on resistance and overcoming the resistance.\textsuperscript{65} Therefore, under the efficient capital market theory advanced by Easterbrook and Fischel, shareholders would ultimately be better off if there were no resistance by the target to a particular offer,\textsuperscript{66} and current legal principles such as the business judgement rule should not give the target’s management the right or the duty to oppose tender offers.\textsuperscript{67}

**BUSINESS JUDGMENT RULE**

In general, the business judgment rule compels the judiciary to defer to the judgment of the management or directors of a corporation unless there is an instance of fraud,\textsuperscript{68} self-dealing,\textsuperscript{69} or bad faith\textsuperscript{70} by these parties.\textsuperscript{71} The Delaware Supreme Court has stated:

A board of directors enjoys a presumption of sound business judgment, and its decisions will not be disturbed if they can be attributed to any rational business purpose. A court under such circumstances will not substitute its own notions of what is or is not sound business judgment.\textsuperscript{72}

When a court is presented with an alleged breach of fiduciary duty, it will not render a decision on the propriety of the transaction when the directors have “no financial interest in the transaction adverse to the corporation and that in reaching the decision the directors fol-

\textsuperscript{64} Id.
\textsuperscript{65} Id.
\textsuperscript{66} Id.
\textsuperscript{67} Id at 1163-64.
\textsuperscript{68} See Panter v. Marshall Field & Co., 646 F.2d 271, 296 (7th Cir.), cert. denied, 454 U.S. 1092 (1981) (holding that the business judgment rule is a presumption that the directors acted in the best interests of the corporation, rebuttable by proof of fraud, bad faith, or self-dealing).
\textsuperscript{69} See Johnson v. Trueblood, 629 F.2d 287, 293 (3d Cir. 1980), cert. denied, 450 U.S. 999 (1981) (stating that a director is protected by the business judgment rule when the motive for defending against a takeover is not solely to retain control); Cheff v. Mathes, 41 Del. Ch. 494, -,-, 199 A.2d 548, 554 (1964) (holding that if the directors’ sole or primary motive is not to retain control, use of corporate funds to defeat a takeover is allowed).
\textsuperscript{70} See Treadway Cos. v. Care Corp., 638 F.2d 357, 382 (2d Cir. 1980) (noting that the plaintiff has the initial burden of proving that the directors acted in bad faith).
\textsuperscript{72} Sinclair Oil Corp. v. Levien, 280 A.2d 717, 720 (Del. 1971). See also Aronson v. Lewis, 473 A.2d 805, 812 (Del. Sup. 1984) (holding that the business judgment rule “is a presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company”).
lowed an appropriately deliberative process.” 73 This deference arises from the responsibilities delegated under state corporate law and a recognition of the courts’ limited competence in business matters. 74

Although many tender offer issues arise under the federal securities laws, the United States Supreme Court has definitively mandated that the formulation and application of the business judgment rule in tender offer situations is a state law consideration. 75 As a state law question, the business judgment rule is related to the directors’ fiduciary duties of due care and loyalty. 76 The duty of due care is similar to the traditional negligence formula in that a director must act as an “ordinarily prudent person” would under like circumstances. 77 Satisfaction of the due care requirement hinges on whether the directors have informed themselves, “prior to making a business decision, of all material information reasonably available to them.” 78

In the tender offer context, the target’s board must make reasonable efforts to obtain and evaluate pertinent information about the offer. 79 Directors who decline to consider alternative methods of addressing the takeover, or fail to procure the advice of attorneys and investment bankers as to the sufficiency of the offer, will breach their duty of due care. 80

The duty of loyalty mandates that directors should act in the best interests of the corporation and shareholders rather than their own. 81 This fiduciary policy is essential to protect the individual in-

74. Id.
75. Kreider, 11 J. CORP. L. at 635.
76. See Norlin Corp. v. Rooney Pace, Inc., 744 F.2d 255, 264 (2d Cir. 1984). The court stated: “A board member's obligation to a corporation and its shareholders has two prongs, generally characterized as the duty of care and the duty of loyalty.”  Id.
77. Gilson, A Structural Approach to Corporations: The Case Against Defensive Tactics in Tender Offers, 33 STAN. L. REV. 819, 821-22 (1981). Professor Gilson argues that the business judgment rule functions more as a technique of judicial restraint, rather than as a standard of managerial conduct or liability. He notes that the rule “is more likely to have survived because it functioned as a quasi-jurisdictional barrier to prevent courts . . . from exercising regulatory powers over the activities of corporate managers.”  Id. at 822 (citations omitted). However, Gilson notes that broader judicial intervention is not necessarily the proper approach because: (1) the court’s intervention at the post-decision stage is of minor assistance; (2) extensive review of directors’ decisions as a method of shareholder protection would address only one of the causes of business failure that can be adequately insured against through shareholder diversification of portfolios; and (3) the potential for personal liability cannot be seen as necessary to insure responsible managerial action when other markets monitor inefficient management at a significantly lesser cost than litigation.  Id. at 823-24.
78. Aronson, 473 A.2d at 812.
80.  Id. at 1448.
vestor's interests because of the concentration of resources under management control inherent in the corporate form. Directors who engage in practices of fraud, self-dealing, or bad faith will breach the duty of loyalty.

Therefore, when the board faces a conflict of interest, the presumption of good faith under the business judgment rule does not apply. Rather, the directors in a conflict situation must prove the "intrinsic fairness" of the transaction challenged:

[Where director action is not protected by the business judgment rule, mere good faith will not preclude a finding of a breach of the duty of loyalty. Rather, in most such instances (which happen to be self-dealing transactions), the transaction can only be sustained if it is objectively or intrinsically fair.]

Thus, when a board has a financial stake in the transaction, a court will evaluate the merits of the board's decision.

To prove that the adoption of anti-takeover devices is a conflict of interest situation, a plaintiff challenging a transaction must show that these tactics were employed for the sole or primary purpose of retaining management in their present positions. This "primary purpose" test applies both to defenses adopted prior to an actual takeover threat and those enacted in response to a specific threat. When the primary purpose is to maintain independence, courts have

82. Id.
85. Id. The author argues, however, that because courts are unqualified to answer complex questions in the takeover context, the "intrinsic fairness" standard is consequently abandoned and the board only must prove that the adoption of the defensive measure was "motivated by a valid business purpose and that the valid purpose was the primary motivation for the board's defensive maneuver." Id. The author notes that the application of this test is indistinguishable from that of the business judgment rule because courts seem satisfied with a demonstration of a rational basis for the decision. Therefore, the author urges the adoption of a middle standard that would require an articulation of a "substantial, unselfish business purpose" for the implementation of a defensive strategy in response to a takeover. Id. at 1970.
86. AC Acquisitions, 519 A.2d at 115.
87. Id. at 111. The court stated that "where a self-interested corporate fiduciary has set the terms of a transaction and caused its effectuation, it will be required to establish the entire fairness of the transaction to a reviewing court's satisfaction." Id.
88. Wenger, 31 VILL. L. REV. at 1449-50; Cheff, 41 Del. Ch. at —, 199 A.2d at 554. Cheff is the initial source of the primary purpose test. In that case, Maremont Automotive attempted to take over Holland Furniture through the purchase of a controlling percentage of the latter's stock. The directors of Holland voted to repurchase the shares at a price exceeding the market value. Id. at —, 199 A.2d at 551-52. The court held that that the directors had proved that the purchase was effected to continue proper business purposes and was not done "solely or primarily" to retain board positions. Id. at —, 199 A.2d at 554-56.
protected directors who have the responsibility to reject offers they deem detrimental to the corporation and its shareholders. Commentators have taken issue with the primary purpose test, noting that the test provides for no greater protection of shareholders than the business judgment rule. Furthermore, it has been argued that once management entrenchment is proven by a plaintiff as a motive in the adoption of a particular defensive technique, then the burden should shift to the defendant directors to prove that the transaction was in the best interests of the corporation.

MODIFIED BUSINESS JUDGMENT RULE

The Delaware courts have recognized that in situations when a board acts to quash a possible change in control of the enterprise, "a more flexible, intermediate form of judicial review is appropriate." A two-pronged standard has developed because the business judgment rule is too deferent to management whereas the intrinsic fairness test is too difficult for management to satisfy. The first element requires the board to articulate that the defensive technique served a proper corporate purpose in responding to a reasonably perceived threat to corporate policy and effectiveness. Second, the defensive measure undertaken "must be found reasonable in relation to the threat posed by the change in control that instigates the action."

The court in Unocal Corp. v. Mesa Petroleum Co. promulgated this modified business judgment rule to determine the propriety of a self-tender offer utilized as a takeover defense. Many other decisions have been rendered in the Delaware courts and elsewhere that have validated or invalidated various other types of techniques under

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92. Block & Miller, The Responsibilities and Obligations of Corporate Directors in Takeover Contests, 11 SEC. REG. L.J. 44, 50 (1983). The authors note the views of two dissenting justices that articulated a recognition of the inherent conflict of interest that pervades a takeover situation. Id. at 49-50. Judge Cudahy in Panter v. Marshall Field & Co., 646 F.2d 271 (7th Cir. 1981), stated that the good faith presumption of the business judgment rule had become essentially irrebuttable, allowing directors to fight any takeover to the point of "fraud, bad faith, or abuse of discretion." Id. at 299. Judge Rosenn in Johnson v. Trueblood, 629 F.2d 287 (3d Cir. 1980), lambasted the primary purpose test and argued for a shift in the burden of proof to the directors once retention of control was found as a motive in the particular decisions. Id.
93. AC Acquisitions, 519 A.2d at 111.
94. Id.
95. Id.
96. Id.
97. 493 A.2d 946 (Del. 1985).
98. See infra notes 184-92 and accompanying text.
this standard. Before a discussion of this case law can be instructive, an overview of the most popular devices utilized in the defensive context is appropriate.

THE TAKEOVER DEFENSES

The increasing number of takeover battles and the myriad of defensive techniques available to a target company’s board of directors have spawned a litany of terms that constitute an entire new language. Terms such as “crown jewels,” “golden parachutes,” “poison pills,” “lock-ups” and “scorched earth” describe specific financial and structural maneuvers taken by a target to protect the enterprise from a future offer (preventative measure) or to thwart a pending bid (remedial measure).

PREVENTATIVE

Preventative defenses are usually undertaken well in advance of any tender offer, and are aimed at making a ratification for change of corporate control more difficult. One of the most common techniques in this category is the use of a staggered board of directors. By amendment to its charter or by-laws the board is divided into separate classes with the term in office of each class concluding at a different interval. Because this method prevents an acquiror from gaining control of the board at any single shareholders’ meeting, the acquiror must spend a greater amount of time to effectively gain control of the target company.

Another precautionary tactic that can be taken in advance of any

100. See infra notes 101-70.
102. Id. at 35-51. The “crown jewel” is the basic incentive for the takeover - an asset of the target corporation that may be a highly profitable division, a revolutionary product, or a large tax-loss carryover. Id. at 36. A “golden parachute” is a large salary bonus or severance payout that upper management of the target will receive upon successful completion of a takeover. Parachutes protect important management personnel from leaving during a takeover battle or from being discharged after the target is acquired. Id. at 40; see also infra notes 117-37, 142-43, 159-70 and accompanying text.
107. Greene & Junewicz, 132 U. PA. L. REV. at 703. For example, a nine-member board may be classified into three separate groups of three members each, thus allowing for the potential removal of a maximum of three directors at any one shareholders’ meeting.
108. Lautzenhiser, N. KY. L. REV. at 486.
particular tender offer is the enactment of a "fair price" amendment. This is an amendment to the potential target's certificate of incorporation which requires any prospective acquiror to provide all shareholders with substantially equal consideration for their shares. Most fair price provisions are triggered when a single entity acquires a specified percentage of the outstanding shares. Because these provisions are usually drafted to require that all shareholders receive an equal premium over the prevailing market price, the operative effect is to hamper two-tiered tender offers and other hostile acquisitions by making the takeover prohibitively expensive for the acquiror. However, most amendments contain exceptions that allow the target board to disregard the provision when the accumulation of stock is condoned either by the present board or a majority of the minority shareholders which excludes the acquiror.

The above defenses may also include the adoption of a super majority voting provision or a "valid cause" removal requirement to make the removal of directors more difficult. The board of directors may also institute a preventative defense by obtaining shareholder authorization to amend the company's charter to increase the number of authorized shares for later distribution to a friendly party or "white knight."

**The Poison Pill**

The most popular and innovative type of preventative takeover

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110. Id.
111. Id. at 296.
112. Id. at 296-97.
113. Id. at 297. Finkelstein argues that the directors' ability to disregard the fair price amendment is justifiable because it encourages acquirors to negotiate with the incumbent board. This reasoning does not correspond with the underlying rationale for fair price provisions, i.e. equal consideration among all shareholders, because the board can ratify two-tiered offers that actually discriminate among shareholders. Nevertheless, the author notes that protection exists because the board's sole incentive in the adoption of this device is to provide equal consideration for all shareholders. Furthermore, the board would be required to inform all shareholders of their right to obtain consideration pro rata in the face of a two-tiered offer. Id.
115. Lautzenhiser, 11 N. KY. L. REV. at 486.
116. A white knight is the "savior in shining armor into whose arms the besieged target company flees." Reiser, supra note 101, at 51. The white knight is persuaded to join the contest for control by entering as a friendly subsequent bidder. Id. See Mobil Corp. v. Marathon Oil Co., 669 F.2d 366, 367-68 (6th Cir. 1981) (involving the issuance of stock and certain options on valuable assets to induce a friendly bid); Treadway Cos. v. Care Corp., 638 F.2d 357, 361-73 (2d Cir. 1980) (upholding under the business judgment rule the issuance of shares to prevent a takeover and facilitate a friendly merger).
defense in recent years has been the “poison pill” rights plan.117 The poison pill was created to increase the ability of the target’s board of directors to negotiate with potential acquirors and provide protection to minority shareholders against inadequate offers.118 In the normal operation of a poison pill plan, the company’s board declares a dividend consisting of one “right” for each outstanding share of common stock.119 The right allows the shareholders to purchase from the company one common share at a price substantially above the current market price; this exercise price allegedly approximates the true value of the company’s stock over the period that the rights are outstanding.120 The right is traded in conjunction with the common stock until a triggering event occurs and activates this right, such as an acquisition by a single entity of, or a tender offer for, a specified percentage.121 The poison pill plan normally allows the company to redeem these rights at an insignificant price until a third party acquisition actually occurs. This plan may allow for redemption for a set period after an acquisition.122

The major detriment of poison pill plans to the acquiror is a potentially severe economic loss from “flip-in” and “flip-over” provisions contained within “rights” and their dilutory financial effects.123 One type of flip-in prevents an acquiror from circumventing the plan by staging a reverse merger with the target as the surviving entity.124 If the acquiror merges with the target, the “flip-in” provision allows each holder of a right, excluding the acquiror, to pay a specified exercise price and typically receive stock in the surviving target company

117. Chittur, Wall Street’s Teddy Bear: The ’Poison Pill’ as a Takeover Defense, 11 J. CORP. L. 25, 25-26 (1985). The technique has been termed a “poison pill” because it only becomes operative and causes detriment to the acquiror after the target company is “swallowed,” that is, when the takeover is successfully consummated. Comment, Escaping the Tender Trap: Defending Against Hostile Takeovers, 30 CORP. J. 3, 7 (1985).
119. Id.
120. Id.
121. Id. The percentage trigger regarding actual acquisition of shares is usually set lower than the percentage requirement applicable to the announcement of a tender offer. For example, a typical plan may set the trigger levels at 20% and 30% respectively. This approach is consistent with the threat posed to the target, because a party with a significant existing ownership interest would be considered the greater threat. However, this scheme allows a potential acquiror to accumulate 19.9% of the outstanding shares and then announce the offer so as to delay activation of the rights.
122. Id.
123. See Chittur, 11 J. CORP. L. at 39-40 (discussing the options under the plan in Moran that allowed for purchase of Household preferred shares or equity of the acquiror). For a discussion of the Moran decision, see infra notes 193-215 and accompanying text.
124. Helman & Junewicz, 42 BUS. LAW. at 773.
with a market value equal to twice the exercise price.\textsuperscript{125} Another version of the flip-in provision gives shareholders the right to purchase shares of the target at half the market value if an acquirer obtains a minimum specified percentage of the outstanding shares.\textsuperscript{126}

With a flip-over provision, each holder of a right can exercise it and obtain a number of shares of the acquiror with a market value twice that of the exercise price when the target is acquired by merger or through a similar type of business combination.\textsuperscript{127} This provision results in a substantial dilution of the acquiror's shareholders interest to the extent the rights are exercised. It can also operate as a significant hurdle for an acquiror staging a second tier merger in an attempt to utilize the cash flow or assets of the target to finance the takeover bid.\textsuperscript{128} Therefore, the typical poison pill can effectively protect target shareholders from the evils of hostile bidders utilizing the prevalent two-tiered tender offer.\textsuperscript{129} Due to the possibility of adverse economic consequences to the acquiror, the poison pill attempts to make the acquiror negotiate the aspects of a potential combination with the target's board of directors.\textsuperscript{130}

There exist both critics and supporters of poison pill plans.\textsuperscript{131} Critics of the poison pill argue that shareholders would never be able to capitalize on the premium prices offered pursuant to a hostile tender offer.\textsuperscript{132} These critics further contend that poison pills, in addition to other defensive measures, are adopted by pressured boards and lead to management entrenchment.\textsuperscript{133}

Supporters of the poison pill contend that the plans allow directors to exert bargaining power which can lead to higher prices paid by the acquiror.\textsuperscript{134} The proponents believe this premium offering price would otherwise be unattainable by the shareholders because shareholders are typically dispersed and unable to collectively

\textsuperscript{125} \textit{Id.} For example, if the exercise price of the right is $50, a holder may pay this price and obtain $100 worth of securities of the combined entity. Because the acquiror is excluded from capitalizing on this provision, its holdings in the entity are diluted to the extent that other shareholders exercise their rights.

\textsuperscript{126} \textit{Id.} at 772.

\textsuperscript{127} \textit{Id.} at 774. For example, if an acquiror triggers the flip-over right by accumulation of 20% of the target's stock, each rightholder could exercise at a price of $50 and obtain $100 worth of the acquiror's equity securities.

\textsuperscript{128} \textit{Id.} at 773.


\textsuperscript{130} \textit{Id.} at 773.

\textsuperscript{131} Id. at 1086-87.

\textsuperscript{132} Anderson & Augspurger, 11 CORP. L. at 663.

\textsuperscript{133} Crowder, 31 ST. LOUIS L.J. at 1086-87.

Supporters also argue that the poison pill allows shareholders to retain the long-term investment contemplated when the stock was originally purchased. As poison pill takeover defenses are the most popular techniques in corporate control struggles, their validity under recent case law will be further examined below.

**REMEDIAL DEFENSES**

Takeover defenses also arise after a tender offer is actually commenced. These defenses are remedial in nature and consist primarily of financial defenses that involve either the purchase or sale of stock or assets by the target corporation which may make the company less financially attractive to the acquiror. One such defense consists of full or partial liquidation of the target company, referred to as the "scorched-earth" defense. This defense is premised on the assumption that the company's individual assets or subsidiaries have liquidation values superior to the acquiror's tender offer price.

Another defense involves the sale of a target's "crown jewel" to a friendly third party. The company's crown jewel is its most valuable asset or subsidiary, the sale of which is designed to rid the acquiror of its primary motivation for the attempted takeover. Rather than a crown jewel sale, the target's board may authorize a

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135. See Lowenstein, Priming Deadwood in Hostile Takeovers: A Proposal for Legislation, 83 Colum. L. Rev. 249, 267 (1983) (noting that the tender offer context is much different than that involving a sale of assets, for example when shareholders have equivalent opportunities to receive benefits of the transaction, regardless of how they voted, provided a collective majority approves).

136. Anderson & Augspurger, 11 Corp. L. at 663 (analogizing this assertion with the Lipton argument that defensive tactics aid in the promotion of future corporate planning which has benefits accruing to the shareholders).

137. See infra notes 332-94 and accompanying text.


139. Id.

140. Id.


143. Block & Miller, 11 Sec. L.J. at 61.

144. See Mobil Corp. v. Marathon Oil Co., 669 F.2d 366, 367-69 (6th Cir. 1981) (involving Marathon's ownership of Yates Field, a large oil field in the Peruvian basin province of West Texas); Whittaker Corp. v. Edgar, 535 F. Supp. 933, 937-44 (N.D. Ill. 1982) (involving a sale by Brunswick Corp. of its medical instruments subsidiary to a white knight, thus inspiring Whittaker to cancel its tender offer).

merger with, or sale of a block of securities to a white knight. The white knight merger involves a business combination between the target and a friendly corporation, undertaken before a hostile acquiror can accomplish the takeover.

A target may defend against a takeover by purchasing its own shares on the open market pursuant to an effort to become a privately held corporation. The target may also initiate a tender offer for its own shares to make it more difficult for the acquiror to obtain the needed number of shares to attain control. A target's tender offer at a premium price may also inflate the stock price, making a successful takeover prohibitively expensive for the acquiror. A similar technique, most recently referred to as a "street sweep," describes a swift accumulation by the target of a substantial amount of the target's stock through open market purchases and negotiated private transactions or both.

Other defensive techniques that can be utilized once a tender offer is commenced relate to the target's acquisition of other corporations. The target can acquire another competitor and create potential antitrust problems. The antitrust violation can thereafter be utilized by target management in litigation to overcome the takeover. A related defense is the acquisition of a "safe harbor,"

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146. See D. Hertzberg, 'White Squires' Becoming Popular Ploy Against Takeovers, But Tactic is Risky, Wall St. J., Oct. 18, 1985, at 6, col. 1. The sale of securities is referred to as the "white squire" defense, whereby the target locates a friendly investor to purchase a large block of its stock, thus reducing the number of shares obtainable by the acquiror. This defense differs from the white knight merger in that the friendly third party does not acquire the target corporation.


149. Greene & Juniewicz, 132 U. PA. L. REV. at 701-02. For a complete discussion on the validation of a self-tender used in Unocal, see infra notes 171-92 and accompanying text.

150. Block & Miller, 11 SEC. L.J. at 62. The authors note, however, that this approach may backfire in certain instances. Because most state corporate laws treat repurchased shares as treasury stock, a self-tender may actually increase percentage ownership of the acquiror and make the possibility of a successful takeover greater. Id.


152. See infra notes 153-58.


154. Id. For example, in Panter v. Marshall Field & Co., 646 F.2d 271 (7th Cir. 1981), Marshall Field ("Field") faced a takeover attempt by another merchandise retailer, Carter Hawley Hale ("CHH"). Id. at 279. Field announced that it would expand into the Galleria Mall in Houston, where CHH already maintained a store. Id. at 280. This move, combined with the proximity of other stores, allowed Field's to allege antitrust violations and defeat the proposed takeover. Id. at 280-81.
which occurs when the target acquires a company that operates in a heavily regulated industry such as trucking or network television.\textsuperscript{155} The acquisition of a safe harbor makes the target company less attractive and at the very least forces the bidder to obtain approval for consummation of the merger by a governmental agency.\textsuperscript{156} Another acquisition defense the target can utilize is the "Pac-Man" defense.\textsuperscript{157} This defense, named after the popular video game, describes an equally hostile tender offer by the target in an attempt to takeover the original acquiror.\textsuperscript{158}

The Lock-up

A defensive measure that may result in a transfer of interests from the target to a third party is the "lock-up" option.\textsuperscript{159} The lock-up is a technique that enables one potential acquiror to gain an advantage over other bidders in its attempt to take over the target corporation.\textsuperscript{160} This technique may involve the granting of options to friendly third parties that allow for the purchase of significant amounts of stock.\textsuperscript{161} However, the target usually grants the option to purchase certain valuable assets, or crown-jewels to a white knight, exercisable at the time the hostile bidder acquires a specified amount of the target's outstanding shares.\textsuperscript{162}

Although it is generally agreed that lock-ups are not per se illegal,\textsuperscript{163} courts have noted that the potential for maximizing shareholder wealth can be stifled since lock-ups can dampen, rather than enhance, bidding for a target corporation.\textsuperscript{164} Because the option is usually granted at a bargain price, a sizable option will effectively

\textsuperscript{155} Prentice, 8 J. CORP. L. at 341.
\textsuperscript{156} Id.
\textsuperscript{157} Reiser, supra note 101, at 48. For an illustration of how this unique reverse takeover operates, see Martin Marietta Corp. v. Bendix Corp., 549 F. Supp. 623 (D. Md. 1982).
\textsuperscript{158} Reiser, supra note 101 at 48.
\textsuperscript{159} Prentice, 8 J. CORP. L. at 342.
\textsuperscript{160} Id.
\textsuperscript{161} Kreider, 11 J. CORP. L. at 643.
\textsuperscript{162} Wenger, 31 VILL. L. REV. at 1442. See also Block & Miller, 11 SEC. L.J. at 56 (describing a lock-up in conjunction with divestiture as forms of "asset redeployment"). For an examination of a lock-up utilized in a well documented case, see Hanson Trust PLC v. ML SCM Acquisition, Inc., 781 F.2d 264, 267 (2d Cir. 1985) (invalidating the target's arrangement, upon completion of a successful hostile tender offer, to sell two profitable divisions to a white knight).
\textsuperscript{163} Hanson Trust, 781 F.2d at 273-74; Whittaker, 535 F. Supp at 951; Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 183 (Del. 1985).
\textsuperscript{164} See Mobil Corp., 669 F.2d at 374 (stating that the lock-up options employed in those circumstances "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").
end the bidding because the recipient may exercise the option even though the hostile acquirer eventually gains control.\textsuperscript{165} If the acquirer is deterred from further bidding, a lock-up will preclude the shareholders from receiving a premium price that a competitive atmosphere would have encouraged.\textsuperscript{166}

Although it appears that lock-ups operate to exclude bidders and bring the auction to an abrupt halt, reasonable use of lock-ups can be advantageous to the target’s shareholders.\textsuperscript{167} The primary value of a lock-up is its ability to lure an otherwise uncooperative bidder into the fight, thereby upping the ante in the contest for control of the target.\textsuperscript{168} Because a white knight undertakes a diversity of risks by entering the bidding contest, including litigation costs, the tenacity of the acquirer, and the prospect of itself becoming a takeover victim, the lock-up option allows it to compete on even footing.\textsuperscript{169} When the lock-up induces an otherwise nonexistent third party into the takeover fracas to enhance bidding, the ultimate beneficiaries become the shareholders of the target corporation.\textsuperscript{170}

FOUNDATIONAL DECISIONS

\textbf{UNOCAL CORP. v. MESA PETROLEUM CO.}

A collection of decisions from the Delaware Supreme Court provides a framework for an analysis of recent case law regarding defensive techniques.\textsuperscript{171} The most cited case is \textit{Unocal Corp. v. Mesa Petroleum Co.},\textsuperscript{172} which adopted the modified business judgment rule. In \textit{Unocal}, Mesa Petroleum (“Mesa”), which owned 13% of Unocal’s outstanding common stock, made a two-tiered tender offer for approximately 37% of the publicly held shares of Unocal at $54 per share.\textsuperscript{173} The first tier offer was for cash, while the “back-end” (second tier) provided for an exchange of highly leveraged debt securities supposedly also worth $54 per share, to eliminate the remainder of the publicly held shares.\textsuperscript{174}

\begin{itemize}
\item \textsuperscript{165} Kreider, 11 J. CORP. L. at 645.
\item \textsuperscript{167} Note, 96 HARV. L. REV. at 1078.
\item \textsuperscript{168} \textit{Id.}
\item \textsuperscript{169} \textit{Id.}
\item \textsuperscript{170} \textit{Id.}
\item \textsuperscript{171} See \textit{infra} notes 172-250 and accompanying text.
\item \textsuperscript{172} 493 A.2d 946 (Del. 1985).
\item \textsuperscript{173} \textit{Id.} at 948.
\item \textsuperscript{174} \textit{Id.}
\end{itemize}
Unocal's board met to consider the Mesa proposal and various alternative strategies. The board, which was comprised of eight outside and six inside directors, received detailed presentations by the company's investment advisor and concluded that the Mesa offer was inadequate, which led it to consider the adoption of defensive measures. Among the various defensive strategies presented was a self-tender offer by Unocal in the $70-75 price range. After a separate meeting of the outside directors with their financial advisors and attorneys, the entire board unanimously rejected the Mesa offer and approved a self-tender offer for Unocal stock at $72 per share. After commencement of the self-tender offer, Mesa filed suit in the Delaware Court of Chancery. After the trial court granted Mesa a preliminary injunction to halt Unocal's offer, Unocal appealed to the Supreme Court of Delaware.

Mesa contended that the discriminatory nature of the self-tender offer violated Unocal's fiduciary duties. Unocal's defense was that the board of directors, in good faith and through the exercise of due care, reached a reasonable, informed conclusion that Mesa's two-tiered tender offer at $54 was both coercive and inadequate. Given the board's power to undertake certain defensive measures, the Delaware Supreme Court noted the business judgment rule and the standards of conduct thereunder apply in a takeover situation. However, the court stated that when a pending takeover bid is involved, the business judgment rule does not automatically apply due to the inherent possibility of board self-interest. Therefore, the court concluded, "there is an enhanced duty which calls for judicial examination at the threshold before the protections of the business judgment rule may be conferred." First, the board must have reasonable grounds for a belief that danger to corporate policy exists, which can be satisfied by showing good faith and reasonable investigation. A board's action can further be proven reasonable when

175. Id. at 950.
176. Id.
177. Id.
178. Id. at 951.
179. Id.
180. Id. at 949.
181. Id. at 953.
182. Id.
183. Id. at 954.
184. Id.
185. Id.
186. Id. at 955. The court cited Cheff v. Mathes, 199 A.2d 548 (Del. 1964), wherein it was determined that a board of directors, after a reasonable investigation, was justified in believing that a reasonable threat to the continued existence of the company was present. Thus, the board was afforded the protection of the business judgment
the board is composed of a majority of outside directors.\textsuperscript{187}

Second, an element of balance must be taken by a board in responding to a takeover battle: "If a defensive measure is to come within the ambit of the business judgment rule, it must be reasonable in relation to the threat posed."\textsuperscript{188} The court found that the perceived threat was seen as a coercive two-tiered tender offer at an inadequate offering price, compounded by the possibility of greenmail.\textsuperscript{189} More specifically, the board found the $54 per share cash price of the first tier did not reflect Unocal's true value, and the "junk bonds" offered in the second tier had a fair market value substantially lower than $54.\textsuperscript{190} Moreover, the inadequate offer was made by a well-known corporate raider with a history of greenmail tactics.\textsuperscript{191} Because the board's articulated purposes (to defeat the tender offer or, alternatively, to provide $72 worth of higher quality, senior debt securities) could not be accomplished if Mesa participated in Unocal's self-tender offer, the court concluded that "the [self tender] offer is reasonably related to the threats posed."\textsuperscript{192}

**MORAN V. HOUSEHOLD INTERNATIONAL, INC.**

Later in the same year, the Delaware Supreme Court had the opportunity to apply the recently promulgated modified business judgment rule of *Unocal* in *Moran v. Household International, Inc.*\textsuperscript{193} In *Moran*, the court approved the actions of Household International's ("Household") board in implementing a poison pill rights plan as a defensive mechanism.\textsuperscript{194} The rights plan entitled each shareholder to obtain one right per common share upon the occurrence of either

\textsuperscript{187.} *Unocal*, 493 A.2d at 955 (citations omitted).
\textsuperscript{188.} Id. The factors used in determining the severity of the threat posed include "inadequacy of the price offered, nature and timing of the offer, questions of illegality, the impact on 'constituencies' other than shareholders, . . . risk of nonconsummation, and the quality of securities being offered in the exchange." Id.
\textsuperscript{190.} Id. at 956. "Junk bonds" are corporate bonds issued at higher than normal market rates. Originally used to finance smaller companies that could not obtain conventional bank financing, junk bonds are now utilized to finance the premium bids in hostile takeovers and leveraged buyouts.
\textsuperscript{191.} Id.
\textsuperscript{192.} Id.
\textsuperscript{193.} 500 A.2d 1346 (Del. 1985).
\textsuperscript{194.} Id. at 1357. The court noted that the rights plan was the newest "in the arsenal of corporate takeover weaponry" and that questions regarding the propriety of its use had "attracted national attention." Amicus briefs were submitted by the Securities and Exchange Commission, the Investment Company Institute, and others. Id. at 1348.
of two events: (1) the announcement of a tender offer for at least 30% of Household’s outstanding common shares; or (2) the accumulation by any single party of at least 20% of Household’s stock.\footnote{195} Under either scenario the holder of a right would be entitled to purchase 1/100th of a share of new Household preferred stock for $100.\footnote{196} If the right was not exercised and a change of control occurred, the rightholder could purchase $200 of the tender offeror’s stock for $100.\footnote{197} The validity of this latter element, the “flip-over” provision, constituted the basis of the pending litigation.\footnote{198}

Household emphasized that the rights plan was not adopted as a defensive mechanism to thwart the efforts of a particular raider, but rather as a protective measure to deter future hostile take-over attempts.\footnote{199} Its investment advisor noted that the formulation of the plan was in response to the board’s concerns about the prevalence of the takeovers in the financial services industry, the general use of “bust-up” takeovers, and the negative effect of an attempted takeover on employees and other constituents that had an interest in the stability and viability of the company as a continuing entity.\footnote{200} After board approval of this plan, one of the two dissenting board members filed suit.\footnote{201} Prior to the lawsuit, the plaintiff had discussed the possibility of a leveraged buyout by his own company, Dyson-Kissner-Moran Corporation, the largest single holder of Household stock.\footnote{202} A trial court ruling in favor of Household prompted an appeal to the Delaware Supreme Court.\footnote{203}

The Delaware Supreme Court noted that the basic issue involved the applicability of the business judgment rule to the directors’ ac-

\footnote{195}{Id.}
\footnote{196}{Id. at 1349.}
\footnote{197}{Id. at 1348. The two situations differed, however, in one major respect; under the 30% trigger, the rights were redeemable by the board at $.50 per right, whereas under the 20% trigger the rights were nonredeemable. \textit{Id. at 1349}. The ability to redeem in the prior instance seems consistent with the idea that although a tender offer is made, it may (1) never stimulate the amount of tendered shares needed, or else (2) a friendly merger may occur which would obviate the need for the rights. On the other hand, 20% of the stock firmly in another’s hands constitutes an immediate threat that can be protected by exercising the rights, or in the alternative, utilizing the flip-over provision to dilute the offerer’s financial ability to consummate the merger.}
\footnote{198}{Id.}
\footnote{199}{Id.}
\footnote{200}{Id. The court noted that a “bust-up” takeover involves divesting certain divisions or subsidiaries of the target company to raise funds in financing the acquisition. \textit{Id. at 1349 n.2.}}
\footnote{201}{Id. As the court indicated, Mr. Moran, one of the six insider directors, had previously proposed a leveraged buy-out by his own company, D-K-M, Household’s largest single shareholder. \textit{Id.}}
\footnote{202}{See supra note 201.}
\footnote{203}{\textit{Moran}, 500 A.2d at 1350.}
DEFENSIVE TECHNIQUES

The court stated that the present case was distinguishable from prior takeover defense decisions in that it involved a mechanism adopted to deter future takeovers rather than a response to a current threat. This disparity increased the probability of meeting the business judgment rule because "pre-planning for the contingency of a hostile takeover might reduce the risk that, under the pressure of a takeover bid, management will fail to exercise reasonable judgment." The court then analyzed Moran’s contention that an alteration of corporate structure constituted a usurpation of the stockholders’ rights to consider tender offers. The court responded by noting the various methods that could be taken to circumvent the tender offer and that “the [r]ights [p]lan is not absolute.” It found that the existence of the rights plan could not lead to an arbitrary rejection of a tender offer because the board’s actions would be examined under the same fiduciary standards applicable when the decision to adopt the defensive measure was made.

The court further focused attention on the propriety of the board’s action under the business judgment rule. The court noted that although normally the business judgment rule provides a presumption that a board’s actions were proper, the adoption of a defensive tactic places the initial burden on the directors to satisfy the Unocal modified business judgment rule. The court stated that upon satisfaction of this dual inquiry, the burden of ultimate persuasion rests upon the plaintiff, who must then prove a breach of the board’s fiduciary duties.

The court found that Moran made no claims of bad faith or entrenchment motives with respect to adopting the plan, and although the Household directors received no opinion from counsel on the flip-over aspect of the plan, this lack of information did not rise to the level of gross negligence. Furthermore, because the board was

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204. Id. 205. Id. 206. Id. 207. Id. at 1353-54. 208. Id. at 1354. These methods included conditioning the tender offer on redemption of the rights, soliciting consents to remove the board and the rights, acquiring 50% of the outstanding stock to force a self-tender for the rights, or accumulating 19.9% of the stock and then forming a group to solicit proxies to achieve the desired outcome. Id. 209. Id. 210. Id. at 1355. 211. Id. at 1356. 212. Id. 213. Id. The court cited Smith v. Van Gorkom, 488 A.2d 858 (1985), wherein it was determined that “the concept of gross negligence is also the proper standard for deter-
concerned with the increasing frequency of "bust-up" takeovers in the financial services industry, the likelihood of a two-tiered tender offer, and the plaintiffs' proposed leveraged buyout ("LBO"), the adoption of the rights plan was considered a reasonable response to these perceived threats. Although the trial court decision was affirmed, the court expressed one caveat in that the board's actions would be subsequently reexamined when the rights plan was implemented in response to an actual takeover threat.

REVLON, INC. v. MCANDREWS & FORBES HOLDINGS, INC.

The Delaware Supreme Court examined the use of a defensive tactic implemented in response to an actual threat in Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc. In Revlon, the tender offeror sought to enjoin the granting of a lock-up provision to a third party white knight. The controversy was preceded by failed negotiations between Pantry Pride and Revlon concerning the possibility of a friendly merger, or, in the alternative, a hostile takeover by Pantry Pride at $45 per Revlon share.

After the Revlon board adopted a repurchase and "poison pill" rights plans, Pantry Pride made a cash tender offer for any and all shares at $47.50 per common share conditioned upon sufficient financing and an abandonment of the rights plan. After a recommendation to the shareholders to reject the plan, Revlon announced its own offer for up to 10 million common shares, in exchange for one $47.50 face value note and one-tenth share of convertible preferred stock per common share. As all ten million shares were subsequently tendered on a pro rata basis, certain note covenants limiting the payment of dividends, sale of assets, or additional debt became effective, further hindering Pantry Pride's takeover attempt.

In response to the Revlon proposal, Pantry Pride announced a new offer at $42 per common share, conditioned upon a tender of at

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214. Van Gorkom, 488 A.2d at 873.
215. Moran, 500 A.2d at 1357.
216. Id.
217. Id. at 175-76.
218. Id. at 176. The named plaintiff, MacAndrews and Forbes Holdings, Inc., was the majority stockholder of Pantry Pride. The court referred to them collectively as Pantry Pride because their respective stakes in the litigation were basically inseparable. Id. at 175 n.1.
219. Id. at 177.
220. Id. The notes earned an 11.75% rate of interest and were due in 1995, whereas the new cumulative, convertible preferred stock was valued at $100 with a $9.00 dividend. Id.
221. Id.
least 90% of the outstanding stock. This offer was rejected by the Revlon board, which further authorized the management to communicate with third parties about alternative solutions. One such party was Forstmann Little & Co. ("Forstmann"), with whom the Revlon board negotiated a leveraged buyout. The terms of this proposal provided for a $56 cash payment per common share, a redemption of the rights, cancellation of the note covenants and an assumption of $475 million in debt. Therefore, the shareholders had the opportunity to approve the proposed leveraged buyout, accept the Pantry Pride offer, or reject both transactions.

Pantry Pride responded to the leveraged buyout by raising its tender offer price to $56.25 per share, and noted its determination to acquire Revlon through fractional bidding to top any Forstmann offer. Forstmann made a final offer of $57.25 per share, conditioned, upon a lock-up that provided an option to purchase two Revlon divisions for $525 million, an amount $100 to 175 million below their fair market value, if another offeror acquired 40% of Revlon’s shares. The Revlon board unanimously accepted the Forstmann offer pursuant to Forstmann’s demand to immediately consummate the transaction. One of the primary reasons for approval of the offer was Forstmann’s agreement to uphold the par value of the previously issued notes because the decline in the value of the notes prompted threats of litigation by their holders.

Pantry Pride filed an amended complaint with the Court of Chancery to challenge the new provisions of the Forstmann agreement, and thereafter raised its own offer to $58 per share conditioned on an injunction of the Forstmann lock-up and an abandonment of the rights and note covenants. The court enjoined the lock-up, concluding that the Revlon board had breached its duty of loyalty to the shareholders by dealing preferentially with Forstmann, rather than accepting Pantry Pride’s offer.

222. Id. Pantry Pride also indicated its willingness to buy less than 90% of the stock at an even higher price, conditioned upon removal of the note purchase rights. Furthermore, the present $42 per share offer was considered by Revlon’s investment banker as comparable in value to the higher prior offer of $47.50 per share, due to the consummated Revlon offer and the adverse effects of both the rights and vote covenants. Id.
223. Id.
224. Id. at 178.
225. Id.
226. Id. Pantry Pride’s offering price had been previously raised to $50 per share as of September 27, 1985 and $53 per share on October 3, which was the prevailing price at the time the Forstmann buyout was approved. Id. at 177.
227. Id. at 178.
228. Id. at 179.
229. Id. at 178-79.
230. Id. at 179.
than attempting to obtain the best possible price for the Revlon shares.\textsuperscript{231}

On appeal, the Delaware Supreme Court affirmed the Court of Chancery's holding and stated that the fiduciary duties of loyalty and due care owed by a board of directors to the corporation and its shareholders "are the bedrock of our law regarding corporate takeover issues."\textsuperscript{232} Due to these considerations and the constant possibility of board self-interest, the court held that the various defensive techniques adopted in the present case would be evaluated under the \textit{Unocal} standard before the presumption of the business judgment rule would operate.\textsuperscript{233} That is, the board had to prove: (1) "that they had reasonable grounds for believing there was a danger to corporate policy and effectiveness;" and (2) "that the responsive action taken is reasonable in relation to the threat posed."\textsuperscript{234}

Before the court embarked upon an analysis of the lock-up provision, it noted that the developing situation enhanced the responsibility of the Revlon board.\textsuperscript{235} The court found that Pantry Pride's incremental bidding and the board's decision to allow negotiations with third parties was "a recognition that the company was for sale."\textsuperscript{236} Therefore, the board had a duty to maximize the value received by the shareholders rather than to preserve the corporation's existence, and the use of defensive techniques to ward off takeover threats at an inadequate price was no longer appropriate.\textsuperscript{237} In essence, "[t]he directors' role changed from defenders of the corporate bastion to auctioneers charged with getting the best price for the stockholders at a sale of the company."\textsuperscript{238}

The court then turned to an examination of the lock-up provision, finding that a primary reason for its implementation was Forstmann's agreement to support the market value of the notes, thus reducing the exposure of the board to litigation.\textsuperscript{239} As the initial threat of divestiture of the company had become an inescapable fact, the court held that selective dealing to thwart the efforts of a particular acquiror was impermissible in light of the board's sole duty to

\begin{thebibliography}{99}
\bibitem{231} Id. A "no shop" agreement prevents the target from considering bids from parties other than the acquiror. The cancellation fee is another term for the "goodbye" or termination fee, defined at \textit{infra} note 298.
\bibitem{232} Id. at 179.
\bibitem{233} Id. at 180.
\bibitem{234} Id.
\bibitem{235} Id. at 182.
\bibitem{236} Id.
\bibitem{237} Id.
\bibitem{238} Id. \textit{See infra} notes 463-66 and accompanying text.
\bibitem{239} Revlon, 506 A.2d at 182.
\end{thebibliography}
maximize value for the common shareholders. Therefore, the board could not meet the required standard of good faith by preferring the interests of the noteholders over those of the stockholders. Such preference to the detriment of the shareholders constituted a breach of the board's duty of loyalty.

The court further reasoned that the use of a lock-up had been previously approved in Delaware, and that lock-ups can enhance bidding and compensate white knights who otherwise may be unwilling to enter the takeover contest. However, these same devices can be detrimental to shareholders when they stifle further bidding and effectively end an auction. Noting that the Forstmann lock-up in fact destroyed the bidding process, the court found that the financing and price of the competing offers were of nominal difference. The court stated that the “principal object, contrary to the board’s duty of care, appears to have been the protection of the noteholders over the shareholders’ interests.” Therefore, because the board foreclosed the bidding for inadequate reasons, and the effects included an insulation from personal liability arising from the prior adoption of other defensive tactics, the enhanced standard of Unocal was not met.

In conclusion, the court found that the initial defensive measures were proper under Unocal, as they benefitted the shareholders and enhanced the bidding process. However, the lock-up and subsequent measures, enacted for improper reasons, ended the auction for Revlon to the detriment of the corporation’s shareholders. Therefore, these measures constituted a breach of the fundamental duty of care, the modified business judgment rule was not met, and the decision of the Court of Chancery was appropriately affirmed.

240. Id.
241. Id. The court noted that the noteholders’ rights were established by contract and allowed them no additional protection. Id.
242. Id. The court further disposed of two related arguments for the noteholders. It distinguished Unocal, which involved the permission to consider other constituencies, by noting that such considerations must be rationally related to stockholder benefit. Furthermore, the court found that contractual and good faith obligations to noteholders, as set forth in Gilbert v. El Paso Co., 490 A.2d 1050 (Del. Ch. 1984), were inapplicable when improper actions had been undertaken to satisfy these obligations. Id.
243. Revlon, 506 A.2d at 183.
244. Id.
245. Id. at 183-84. The court found that although Forstmann’s $57.25 offer was $1 more than Pantry Pride’s, the latter was immediate whereas the former had to be discounted for the time value of money due to the delay in approving and implementing the subsequent merger. Id. at 178 n.6.
246. Id. at 184.
247. Id.
248. Id.
249. Id.
250. Id.
RECENT CASE LAW

BLACK & DECKER CORP. v. AMERICAN STANDARD, INC.

The United States District Court for the District of Delaware applied the Revlon auctioneer rule to a lock-up and related defensive measures in Black & Decker Corp. v. American Standard, Inc. After repeated attempts by Black & Decker to consummate a business combination with American Standard, American Standard stated that it was not interested in any type of merger. Thereafter, Black & Decker announced an all cash tender offer for American Standard at $56 per share.

American Standard retained investment advisors and legal counsel, and considered various responses to the tender offer, including a recapitalization plan. The investment bankers stated that Black & Decker's offer was inadequate due to substantial interest in the company by Black & Decker and other parties, and a restructuring would provide immediate wealth in excess of the tender offer price. In reliance on this opinion, the board unanimously rejected the Black & Decker offer as inadequate.

Another board meeting two weeks later led to the adoption of defensive measures including: (1) amendments to the American Standard retirement and savings plans; (2) creation of a severance plan; and (3) the proposed recapitalization. The above compensation plans were designed to accelerate payments to particular salaried employees in the case of a "potential change of control." Because the recapitalization plan was exempted from the "change of control" definition, the approximately $130 million dollar cash outflow would only apply to changes of control instigated by outside parties.

Alleging the invalidity of the recapitalization, Black & Decker argued that it transferred to management 55% of American Standard's common stock, and thus the board had facilitated the sale of control of the company. Because the amended retirement plan

252. Id. at 774.
253. Id.
254. Id.
255. Id. at 775-76.
256. Id. at 776.
257. Id.
258. Id.
259. Id.
260. Id. at 778. Black & Decker buttressed this argument with various facts, namely a prior news release which stated that management and the ESOP combined would have 55% control of the company. When the plan was introduced, Goldman Sachs touted the fact that management, through the ESOP, would control a majority interest. Id.
dedicated any surplus from the retirement plans upon a change of control to the insurance and medical plans, Black & Decker contended that the recapitalization plan constituted a lock-up of $80 million in favor of the management.\textsuperscript{261} It charged that any lock-up must be undertaken to maximize shareholder wealth rather than impede or halt bidding in view of \textit{Revlon}.\textsuperscript{262} Finally, Black & Decker argued that the active bidding of an auction process was under way in that Black & Decker increased its bid on three occasions while the recapitalization plan was adjusted twice.\textsuperscript{263}

American Standard countered, claiming that \textit{Revlon} did not apply for several reasons.\textsuperscript{264} First, management would not gain control through the recapitalization plan as it would only control 24\% of the new common, and because the savings plan and employee stock ownership plan would be governed by a trustee with pass-through voting.\textsuperscript{265} Second, management claimed that its intentions and actions to remain independent foreclosed an application of \textit{Revlon}.\textsuperscript{266} Furthermore, American Standard argued that the recapitalization plan was not a lock-up condemned under \textit{Revlon} because the plan would become effective only upon a shareholder vote.\textsuperscript{267} Finally, American Standard alleged that it had no duty, contrary to Black & Decker's position, to negotiate with the latter or any acquiror.\textsuperscript{268}

The court reasoned that Black & Decker's allegations were premised upon a finding that the \textit{Revlon} principles were applicable to the present facts.\textsuperscript{269} It stated that for the auctioneer duty of \textit{Revlon} to apply, it would have to reach the determination that the company was for sale.\textsuperscript{270} Although the court noted that the chairman of American Standard's board testified regarding its intentions to remain independent, the court stated that "the record before this Court reveals the probability that the actions taken by the [board], while at the same time mouthing cliches about a desire to remain independ-
ent, paint a picture of deliberate actions calculated to culminate in a sale of the corporation. 271 This determination, the court noted, could only be reached if a transaction which results in a change of control can be deemed a "sale" under Revlon. 272

The court held that a change of control could constitute a sale under Revlon. 273 It then examined the recapitalization plan, recognizing that the common shareholders' stake could decrease from 92.6% to 45.5% of the outstanding common stock. 274 Although the court entertained American Standard's argument that the public would actually control 55% of the company, it found that scenario ignored the effects of various stock options that made the transfer of control a present threat. 275 Furthermore, unlike an acquisition by a third party, American Standard was being acquired by management through the sale of stock and options. 276 The court concluded that the company was for sale, and that a bidding contest had been effected by the incremental increases in the parties' respective offers. 277

The court proceeded to determine the second issue presented, "whether the adoption of the severance plan and amendments to the retirement and savings plans were actions consonant with the [b]oard's duty of an auctioneer." 278 It outlined the several factors that must be examined in evaluating the board's conduct during the bidding contest, including the timing of the auction and an analysis of the competing bids. 279 Furthermore, although a board may consider

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271. Id.
272. Id. at 780-81. The court stated that although none of the litigants provided supporting authority to determine whether the recapitalization would trigger the Revlon auctioneer duty, the court would nevertheless have to examine Revlon and subsequent case law to determine the probable outcome as if the case had been decided by the Delaware Supreme Court. Id. at 781 n.3.
273. Id. at 781. In Freidman v. Restaurant Associates, [1987-1988 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 93,502, at 97,214 (Del. Ch. October 16, 1987), the court held that the target's board had a duty to maximize shareholder wealth once it was obvious that the "corporation is to be subject to a change in control." Furthermore, this conclusion was consistent with the factual situation in Edelman v. Fruehauf Corp., 798 F.2d 882 (6th Cir. 1986). In Edelman, a leveraged buyout was proposed through a two-tier transaction, the first tier consisting of a tender offer for 77% of the company's shares. The Sixth Circuit found that the directors knew an auction had begun, and that the company was for sale even though management was acquiring less than 100% of the outstanding shares. Id. at 885-87.
274. Black & Decker, 682 F. Supp. at 782. These percentages are calculated on a fully diluted basis, that is, all options available to the ESOP and other plans would be exercised to purchase stock. Id. at 782 nn.7-8.
275. Id. at 782. The discrepancy between the 45.5% and the 55.5% figures is due to treatment of the options on fully diluted and nondiluted bases.
276. Id. at 783.
277. Id.
278. Id. at 784.
279. Id. at 784-85. The court noted that in Revlon, the lock-up given Forstmann,
other interested parties when taking action, there must be "rationally related benefits accruing to the stockholders." However, when an active auction is underway, such considerations must be disregarded in an attempt to sell the company to the highest bidder.

The court, pursuant to the above reasoning, proceeded to analyze the propriety of the retirement and severance plans. The court found that the plans operated to treat the competing bidders unequally; if Black & Decker completed a takeover, the acceleration of payments under the retirement plan upon a change of control would result in an $80 million loss to the stockholders. Additionally, the severance plan would cost an acquiror $50 million under the change of control provision, while the recapitalization plan was exempt from these costs. The court found this combined $130 million potential advantage in favor of management treated Black & Decker unfairly in its bid for American Standard.

The court then analyzed the competing bids themselves and found them to be "substantially similar." It noted that the recapitalization plan had a per share value of $74 to 75, while the Black & Decker bid was worth $73 per share. The court reasoned that at this level, the $59 cash component of the recapitalization plan required $1.7 million to cover these payments and therefore would not necessarily be considered an obviously superior offer. Furthermore, because Black & Decker's offer was open to all shareholders, the alleged discrepancies in methods of financing the bids were of "little or no significance."

Finally, the court found little support for the proposition that the actions taken by the board benefitted the shareholders. Because concern for other interested parties is not allowed in the context of an active contest for control, the court found it probable that the board breached this duty to the shareholders by providing for which had already entered the bidding, foreclosed further offers and was therefore invalid. Citing Revlon, the court noted that the discrepancies in financing were insufficient to grant a lock-up, especially when the outstanding offers were cash bids for all outstanding shares. (citing Revlon, 506 A.2d at 183-48).

280. Id. at 785.
281. Id.
282. Id. at 785-87.
283. Id. at 786.
284. Id.
285. Id.
286. Id. at 786-87.
287. Id. at 786.
288. Id. In fact, the court stated that it "may not have been a viable offer." Id. (emphasis supplied).
289. Id. (quoting Revlon, 506 A.2d at 184).
290. Id. at 786-87.
employees, rather than selling the company to the highest bidder. As the plans were utilized to stifle the bidding process, the court enjoined the proposed recapitalization.

COTTLE v. STORER COMMUNICATION, INC.

Subsequent to the Delaware federal district court's decision in Black & Decker, the United States Court of Appeals for the Eleventh Circuit validated a lock-up in Cottle v. Storer Communication, Inc. Cottle involved a shareholder derivative action challenging a variety of takeover defensive techniques, including a lock-up option granted by the Storer Communication ("Storer") board to a white knight, Kholberg, Kravis, Roberts & Company ("KKR").

Certain dissident shareholders comprising the Coniston Group sought a solicitation of proxies for board membership which would enable them to implement a planned liquidation. The Storer directors employed Dillon Read & Company, an investment banker, to investigate alternative courses of action, and subsequently determined that the Coniston Group's proposal would not be beneficial to the Storer shareholders. A search for potential purchasers by Dillon Read led to offers by KKR and Comcast Corporation ("Comcast"). KKR's initial offer was for $75 and one share of preferred stock with a $25 liquidation preference for each share of Storer common stock, including requests for a $3 million "hello fee" and an $18 million "goodbye fee." Furthermore, the offer called for management to remain with the new enterprise.

The Storer board rejected KKR's bid as inadequate and proposed a repurchase plan for up to six million shares. On July 16, 1985, Comcast made a merger proposal to the board for $82 cash, 1.2 shares

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291. Id. The court, however, noted that similar lock-up plans could serve legitimate corporate purposes of rewarding employees, and in fact had been validated pursuant to the business judgment rule. Id. at 787 (citation omitted).
292. Id. at 787-788.
293. 849 F.2d 570 (11th Cir. 1988).
294. Id. at 572.
295. Id.
296. Id.
297. Id. at 572-73.
298. Id. at 572. A "hello" fee allows an acquiror to retain some profit for its efforts in pursuing a transaction, rather than becoming a "stalking horse" in a contest between the target corporation and a second bidder. Id. at 572 n.1. A "goodbye" or termination fee may be requested by the acquiror, and is payable if the companies fail to complete a merger for reasons other than the acquiror's inability to obtain financing. Id. at 572. This fee allows the acquiror to recoup expenses for research analysis, legal and investment banker fees, and other related expenditures connected with the takeover bid.
299. Id.
300. Id.
of preferred with a $25 liquidation preference, and 1.2 warrants for the purchase of stock in the new company for each share of Storer common. The offer provided that Storer would remain independent, and would also contain stock lock-up and "no-shop" provisions. Following extensive negotiations, the Storer board informed both Comcast and KKR that it would consider all present and revised offers at the next board meeting.

At the subsequent meeting, both bidders introduced revised offers; Comcast's offer was increased to a per share price of $83.50 cash, .353 shares of preferred stock, and a $35 principal amount twelve year zero coupon note. Comcast eliminated the stock lock-up but included an $18 million goodbye fee, and stated that it would keep the offer open until 5:00 p.m. the following day. KKR's bid was increased to $90 cash plus one warrant, but added an asset lock-up option to purchase either three of Storer's television stations for $535 million, or its cable stations for $835 million; this offer was slated to expire at 5:00 p.m. that day.

The Storer board found that the KKR proposal was superior. It then met with KKR, which increased its cash price one dollar to $91 and increased the lock-up option price on the television stations by $100 million to $635 million. The board reconvened, and voted unanimously to accept the KKR bid. A special shareholders' meeting was called to vote on the KKR-Storer merger proposal which the shareholders adopted by a significant margin.

As the prior negotiations were underway, Michael Cottle filed the present action after the Storer board's refusal to investigate cer-
tain "entrenchment conduct" of Storer officers and directors.\textsuperscript{311} The district court granted summary judgment for the Storer directors, and the central issue on appeal to the Eleventh Circuit concerned the district court’s application of the business judgment rule to the present situation.\textsuperscript{312} The court stated that for Cottle to fulfill his burden of proof he "must allege specific facts that show a genuine issue of material fact concerning fraud, bad faith or abuse of discretion on the part of the Storer directors."\textsuperscript{313}

The first allegation advanced by Cottle concerned the asset lock-up granted to KKR, which allegedly prevented Comcast from evaluating the remaining assets and thereby ended the bidding contest.\textsuperscript{314} The court noted the general rule that lock-ups designed to invite new bidders into the contest are acceptable, but those that deter new bidders or exclude hostile acquirors are not permitted.\textsuperscript{315} However, the court found that this rule is not always determinative of the outcome in a particular situation as all lock-ups encourage the recipient and deter other bidders.\textsuperscript{316} Because all auctions must eventually end, the court noted that the issue was not whether the lock-up ended the bidding contest, but "whether Storer had conducted a fair auction, and whether KKR made the best offer."\textsuperscript{317}

The court further stated that a lock-up must be analyzed in light of the entire transaction.\textsuperscript{318} In this situation, the court found that Storer's board had searched for some time for possible bidders, yet only KKR and Comcast expressed interest.\textsuperscript{319} Furthermore, instead of hastily granting a lock-up upon Comcast's initial request, Storer "negotiated extensively and deliberately with both parties," granting KKR a lock-up only after full presentations by both companies.\textsuperscript{320} The action could not constitute an abuse of discretion as the competing offers were nearing expiration, Storer's efforts to find an investor were winding down, and as the court stated, "[i]t was time to end the auction."\textsuperscript{321}

The court then examined the financial aspects of the competing bids and found that in exchange for the lock-up, the cash price

\begin{itemize}
  \item \textsuperscript{311} \textsuperscript{Id.}
  \item \textsuperscript{312} \textsuperscript{Id.}
  \item \textsuperscript{313} \textsuperscript{Id. at 575.}
  \item \textsuperscript{314} \textsuperscript{Id.}
  \item \textsuperscript{315} \textsuperscript{Id. at 575-76.}
  \item \textsuperscript{316} \textsuperscript{Id. at 576 (quoting Nachbar, Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc. - The Requirement of a Level Playing Field in Contested Mergers, and its Effect on Lock-ups and Other Bidding Deterrents, 12 DEL. J. CORP. L. 473, 488 (1987)).}
  \item \textsuperscript{317} \textsuperscript{Id. (citing Nachbar, 12 DEL. J. CORP. L. at 493; Edelman, 798 F.2d at 886).}
  \item \textsuperscript{318} \textsuperscript{Id. at 576-77.}
  \item \textsuperscript{319} \textsuperscript{Id. at 576.}
  \item \textsuperscript{320} \textsuperscript{Id.}
  \item \textsuperscript{321} \textsuperscript{Id.}
\end{itemize}
DEFENSIVE TECHNIQUES

quoted by KKR was $16 higher than its previous bid and $7.50 per share higher than Comcast's. This disparity in bids, in the court's view, distinguished Hanson Trust PLC v. ML SCM Acquisition, Inc., where the higher bid was "at best one dollar and change" different, and Revlon, where there was "very little improvement" from the previous offer. The court further distinguished these cases on the premise that the prices for the assets under lock-up in the present situation were reasonable. Given these factors, the court found no abuse of discretion in the board's granting the lock-up and deferred to the protection of the business judgment rule.

Cottle further contended the directors' decisions to embrace the KKR bid without attempting to further bargain with Comcast constituted an abuse of discretion. As Dillon Read had valued Comcast's offer at $2 per share greater than KKR's, Cottle argued an acceptance of the latter bid without further negotiation was an abuse of discretion not protected by the business judgment rule. The court noted, however, that Cottle's allegation raised no factual question of fraud, but that the basis was the mere inadequacy of price. To overcome the presumption of the business judgment rule, the court reasoned the allegation must be "based on a gross inadequacy of price." Because no such allegations existed, the court concluded the directors were entitled to the presumption that they acted properly in their contacts with the bidders and shareholders, and affirmed summary judgment for the defendants.

CRTF CORP. v. FEDERATED DEPARTMENT STORES, INC.

A greater percentage of recent case law in the takeover area continues to wrestle with the validity of poison pill plans; the overwhelming majority of these decisions hold that the poison pill is a valid defensive technique. One recent decision that discusses both the poison pill and a variety of other defensive measures is CRTF

322. Id. at 576-77.
323. 781 F.2d 264 (2d Cir. 1986).
324. Cottle, 849 F.2d at 576. It is important to note, however, that the disparity was not as great as the court would have one believe. Including the minimum $5.25 per share right, the Comcast offer was $88.75 per share, only $2.25 less than KKR's. The court relegated this distinction to a footnote discussion. Id. at 576 n.8.
325. Id. at 577.
326. Id.
327. Id.
328. Id.
329. Id. (citing Gimbel v. Signal Cos. Inc., 316 A.2d 599, 609-10 (Del. Ch.), aff'd, 316 A.2d 619 (Del. 1974)).
330. Cottle, 849 F.2d at 577.
331. Id. at 579.
Corp. v. Federated Department Stores, Inc.\textsuperscript{333}

CRTF commenced a cash tender offer at $47 per share for all shares of Federated Department Stores ("Federated"), the defendant.\textsuperscript{334} Concurrent with the filing of the tender offer, CRTF filed suit against Federated in the Federal District Court for the Southern District of New York, claiming a breach of fiduciary duty in connection with the poison pill rights plan adopted by the Federated board.\textsuperscript{335}

The previously adopted poison pill plan provided that the distributed rights would be exercisable: (1) ten days after a person acquired 20\% or more of Federated's outstanding shares; (2) ten days after a person announced a tender offer for 30\% or more of Federated's shares; or (3) ten days after the board determined that a 15\% stockholder constituted an "adverse person" under the plan.\textsuperscript{336} The plan also contained the typical "flip-in" and flip-over" provisions which provided for the purchase of stock at an exercise price equal to one-half the market value.\textsuperscript{337}

The Federated board rejected the initial offer as "grossly inadequate" and expressed concern regarding CRTF's ability to acquire financing.\textsuperscript{338} Although CRTF raised its bid several times to the mid $60 per share range and expressed a desire to consummate a friendly merger, the Federated board continually rejected the offers due to the questionable financing.\textsuperscript{339} Thereafter, Federated sought to implement alternative solutions to CRTF's bids, including a restructuring or the solicitation of competing bids.\textsuperscript{340} Although Federated and CRTF came close to a final agreement on a negotiated transaction at $68 per share, Federated issued a press release exposing the existence of an alternative, comparable offer.\textsuperscript{341} The new bidder was R.H. Macy & Co. ("Macy's"), which proposed a tender offer for 80\% of Federated's shares at $73.80 per share, and a second step merger in which the remaining shareholders would receive 40\% equity in the new combined entity.\textsuperscript{342} The two companies announced that an agreement had been signed and approved by their respective boards.
of directors.\textsuperscript{343} CRTF thereafter announced a new offer at $75 per share for 80% of Federated's shares and a subsequent merger at $44 per share for the remaining 20%.\textsuperscript{344} Macy's responded by raising the initial stage cash price to $77.35 per share and lowering the merger percentage from 40% to 36% of the combined entity's securities.\textsuperscript{345} However, even assuming that Macy's had not made its final offer, CRTF was determined to acquire Federated.\textsuperscript{346} Counsel for Federated stated he was "'quite confident from having seen the determination of the businessmen and their advisors that they intend to press and press to get this company.'"\textsuperscript{347} CRTF contended that several aspects of the agreement between Federated and Macy's were implemented to discourage competing bids, but decided to forego action on these provisions and sought relief from the most troublesome defense, the poison pill.\textsuperscript{348} The court articulated the enhanced two-stage inquiry developed in \textit{Unocal}, and noted that a defensive measure approved by a majority of outside directors "materially enhances" the premise that the board has adopted a mechanism that is reasonable in relation to the threat posed.\textsuperscript{349} The court also recognized the "auctioneer" duty required by \textit{Revlon}, which is the duty to sell the corporation at the highest price available to maximize shareholder welfare once it is determined that sale of the company is inevitable.\textsuperscript{350} Furthermore, as the plan was adopted in advance of any specific threat, the court stated when a plan is adopted to discourage future takeover threats rather than a pending bid, "it seems even more appropriate to apply the business judgment rule."\textsuperscript{351}

CRTF further alleged that two amendments to the plan also constituted a breach of the directors' fiduciary duties.\textsuperscript{352} The first amendment, lowering the flip-in trigger from 50% to 30%, was a recognition by the board that effective control could occur with an ac-

\begin{footnotes}
\item[343] Id.
\item[344] Id. at 435. A dispute existed over whether this offer constituted a "new" or "amended" offer, the relevance of which mandated the length of time the offer was to be kept open under S.E.C. regulations. Id.
\item[345] Id.
\item[346] Id.
\item[347] Id. (quoting March 14 Transcript at 37, \textit{Federated}).
\item[348] Id. CRTF also requested the court to require that Federated discharge Paine Webber from an agreement in which the latter agreed not to provide financing for any CRTF offer unless authorized by Federated. Id.
\item[349] Id. at 436-47.
\item[350] Id. at 437.
\item[351] Id. at 438 (quoting Moran v. Household International, 500 A.2d 1346, 1350 (Del. 1985)).
\item[352] Id.
\end{footnotes}
quisition of 30% or more of the outstanding shares. The second amendment, the 15% trigger for an "adverse person," was adopted in response to the concern that Donald J. Trump intended to acquire 15% or more of Federated. However, in a press release at the time, Federated declared that it "wasn't aware of any accumulation of its stock, but was taking action 'to discourage any such activity.'" Nevertheless, the court found that the plan and subsequent amendments were reasonable in relation to the threats perceived. The court found the plan was useful in deterring coercive offers, and could be used to stimulate an auction.

The court also rejected CRTF's claim that the Revlon decision required that other defenses be abandoned and the poison pill rights redeemed once an auction is in progress. The court found that although defensive measures become more questionable once competing offers are similar or the company's break-up is imminent, the board's duty is to obtain the best price available rather than allow market forces to operate. It stated further that an auction was still underway, and that intervention by the court at that time would have been inappropriate. The court expressly reserved decision on the propriety of the rights plan if later invoked against a party that had made a final offer, yet selectively waived in favor of a bidder that had made an allegedly lower bid. The court stated that it would carefully examine a board's actions and any impermissible motivations to favor a particular bidder only when these auction ending events had occurred.

In conclusion, the court found the Federated board had "acted in good faith after reasonable investigation." As the poison pill was utilized as a reasonable response to the threat perceived, and as the auction was still in progress, the court conferred the benefit of the business judgment rule upon Federated's board and denied the motion for a preliminary injunction.

353. Id.
354. Id.
355. Id. at 439 (quotation omitted).
356. Id.
357. Id.
358. Id. at 441.
359. Id.
360. Id.
361. Id. at 441-42. The court further stated that it would not question the board's determination that the auction was still active, especially since CRTF had not represented that it had made its final bid. Id. at 442.
362. Id.
363. Id.
364. Id. at 443.
In a decision two weeks subsequent to the *Federated* holding, the plaintiff in *Desert Partners, L.P. v. USG Corp.*, met with a similar fate. In *Desert Partners*, the District Court for the Northern District of Illinois, applying Delaware law, denied a preliminary injunction sought by Desert Partners to enjoin USG's board from implementing its poison pill.

USG, a publicly-held Delaware corporation, had experienced very profitable growth in the previous decade. Because the company's stock price had not always reflected this performance, the USG board had adopted various defensive measures to deter future hostile takeovers. Included in this arsenal was the subject of the present litigation, the poison pill plan. The plan provided for a distribution of rights, exercisable once a party either acquired 20% or more of USG's outstanding shares, or made a tender offer for 30% or more of USG's outstanding shares. Upon a subsequent merger, "flip-in" and "flip-over" provisions operated to allow the purchase of $400 of either USG's stock or the acquiror's shares of stock for $200. Because the acquiror was excluded from participation in these rights, its holdings could be diluted up to 50%.

Desert Partners, after accumulating nearly 10% of USG's outstanding shares in the market, made various attempts over a period of several months to negotiate a friendly transaction with USG. After USG's chairman expressed a total lack of interest, Desert Partners commenced its two-tiered tender offer. The first tier proposal was for $42 cash per share for all shares tendered up to 85% of those

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366. *See infra* notes 367-94 and accompanying text.
368. *Id.* at 1290-92. The court noted that its growth rate ranked fourteenth and seventh on return-on-equity among Fortune 500 companies. Furthermore, the company's shares had appreciated 191% over the previous five years, compared with a 50% performance by the Standard & Poor 500. *Id.* at 1291.
369. *Id.*
370. *Id.*
371. *Id.* Once exercisable, the holder is allowed to purchase 1/10 share of preferred stock for $200. *Id.*
372. *Id.*
373. *Id.*
374. *Id.* The average market-price paid for these shares prior to the tender offer was $45. *Id.* It is interesting to note that the debilitative effects of the October 19, 1987 stock market crash allowed Desert Partners to commence its tender offer at $42 per share.
375. *Id.* at 1292. The court noted that the original offer was conditioned on the inapplicability of the Delaware takeover statute and a super-majority provision, but these challenges were apparently dropped before litigation. *Id.* at 1292 n.7.
outstanding. The second tier merger would enable the remaining USG shareholders to receive $42 in securities of an unspecified nature, which were believed to be debt securities and warrants to acquire additional shares. The USG board determined that the offer was "wholly inadequate," and unanimously voted to reject the offer. Desert Partners then filed a preliminary injunction action, alleging a breach of fiduciary duty and requesting redemption or invalidation of the rights under the poison pill plan.

Upon review of the poison pill plan, the court found that the board was concerned about the threat of two-tiered, coercive takeovers and their effects in the marketplace, thereby satisfying the first step of the *Unocal* inquiry. Realizing further that the price of USG's stock historically had not reflected its true value, the court found the adoption of the poison pill plan a reasonable reaction to the perceived threats. The court noted that the board's extensive interaction with counsel and its investment bankers amounted to "good faith and reasonable investigation," and found that the USG plan did not deter all hostile offers as a potential acquiror could formulate its offer to circumvent the plan. It reasoned that Desert Partners had done so in the present case, and therefore, "although a takeover may be more expensive with the poison pill in place, such a takeover is not impossible."

Desert Partners next asserted that the poison pill plan was an unreasonable response to the threat posed in that the exercise price of the rights was not reasonably related to the USG stock price. The court found that the exercise price was set within the reasonable range presented by USG's investment bankers. Although Desert Partners further argued that the board failed to adjust the exercise price after a stock split, the court stated that it would not "require

footnotes:

376. *Id.* at 1292.
377. *Id.*
378. *Id.*
379. *Id.* at 1293.
380. *Id.* The board was also informed about the occurrence of bust-up takeovers, self-dealing, and the harms that further befall shareholders. *Id.*
381. *Id.* at 1295.
382. *Id.* at 1296 (quoting Ivanhoe Partners v. Newmont Mining Corp., 535 A.2d 1334, 1341 (Del. 1987)).
383. *Id.* The court stated that an acquiror could condition the offer on either a redemption of the rights or a transfer of sufficient stock and rights to offset the dilutory effects of the plan, or could solicit proxies to replace the board with persons who would redeem the rights. *Id.*
384. *Id.*
385. *Id.* Salomon Brothers, USG's investment bankers, stated that the typical exercise price was 200% to 500% of a company's stock price. *Id.* When the board set the exercise price at $200, the market price of USG stock closed at $66 3/8, thus making the 300% penalty within the reasonable range. *Id.* at 1296-97.
DEFENSIVE TECHNIQUES

the [b]oard to modify the exercise price in response to every fluctuation in the stock price."\(^{386}\)

The court then proceeded to evaluate the directors' actions in failing to negotiate or redeem the rights, focusing first on whether the board reasonably perceived that the Desert Partners tender offer was a threat to the corporate enterprise.\(^{387}\) The court found it reasonable for the board to perceive the offer price as not reflecting the long-term value of the company, and despite objections from Desert Partners, concluded it unnecessary for USG to estimate the long-term value of its shares.\(^{388}\) The court deemed that USG had undertaken "a careful analysis of USG's performance potential" in light of Desert Partners' tender offer which constituted a threat to USG's policy and effectiveness.\(^{389}\)

The court then examined the second prong of the Unocal test, whether the failure to negotiate was reasonable in relation to the threat perceived.\(^{390}\) It found the board had not breached its fiduciary duties by declining negotiations on the offer, as it would convey the impression that the company was for sale.\(^{391}\) Because the board had decided to keep the company independent, the court found it had no duty to auction the company or negotiate with bidders.\(^{392}\) Thus, the court concluded that the directors' actions in failing to negotiate with Desert Partners were reasonable in relation to the threat posed\(^{393}\) and denied its motion for a preliminary injunction.\(^{394}\)

DECISIONAL SUMMARY

The Unocal, Moran, and Revlon decisions discussed above provide a framework for analyzing recent case law concerning defensive takeover techniques. In Unocal, the Delaware Supreme Court, recognizing the inherent potential for board self-interest in the takeover context, developed a threshold inquiry that effectively modified the business judgment rule.\(^{395}\) First, a target's board must have reasonable grounds for a belief that a danger to corporate policy exists.\(^{396}\)

\(^{386}\) Id. at 1297. The stock split resulted in a market price of $34 3/8, thus effectively raising the penalty to 567%, outside of the reasonable range.

\(^{387}\) Id. at 1298.

\(^{388}\) Id. at 1299.

\(^{389}\) Id. The court noted that the board had reviewed financial forecasts, historical trends, and USG's past and future earnings potential. Id. at 1299 n.23.

\(^{390}\) Id. at 1300.

\(^{391}\) Id.

\(^{392}\) Id.

\(^{393}\) Id.

\(^{394}\) Id. at 1300-01.

\(^{395}\) See supra notes 171-92 and accompanying text.

\(^{396}\) See supra note 186 and accompanying text.
Second, the defensive measure undertaken must be reasonable in relation to this perceived threat.\(^{397}\)

In *Moran*, the Delaware Supreme Court applied this modified business judgment rule and affirmed the propriety of Household International’s poison pill.\(^{398}\) The court noted the threats perceived by Household’s board to be: (1) general use of bust-up takeovers; (2) takeover prevalence in the financial services industry; and (3) concern for various interested parties in keeping the company viable.\(^{399}\) The board’s adoption of the poison pill was considered reasonable as the plan was adopted in advance of a specific threat, it was not absolute in that it did not deter all hostile takeovers, and the board’s actions would be subsequently reexamined when the poison pill deterred an actual takeover threat.\(^{400}\)

*Revlon* concerned the use of an asset lock-up given to a white knight in consideration of an agreement to uphold the market value of previously issued notes.\(^{401}\) The Delaware Supreme Court found that the acquiror’s incremental bidding and the Revlon board’s decision to negotiate with third parties was in effect a decision to sell.\(^{402}\) As the directors had become auctioneers charged with maximizing the value received by shareholders, selective dealing through a lock-up to stifle the efforts of a particular acquiror was inappropriate.\(^{403}\) Preference for the noteholders constituted a breach of the board’s duty of loyalty, and as the board foreclosed the bidding for inadequate reasons, the modified business judgment rule adopted in *Unocal* was not met.\(^{404}\)

In the most recent decisions concerning the use of takeover defenses, *Black & Decker* dealt with the validity of a recapitalization plan that included an alleged lock-up of $130 million in favor of American Standard’s management.\(^{405}\) The United States District Court for the District of Delaware, after determining that a change of control could constitute a sale under *Revlon*, utilized the auctioneer rule when it examined the board’s actions in amending the retirement and severance plans.\(^{406}\) The court enjoined the recapitalization

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397. See supra note 188 and accompanying text.
398. See supra notes 193-215 and accompanying text.
399. See supra note 200 and accompanying text.
400. See supra notes 205-15 and accompanying text.
401. See supra notes 228-29 and accompanying text. The white knight was Forstmann Little & Co., who agreed to support the Revlon notes through an exchange of new Forstmann notes. *Revlon*, 506 A.2d at 178-79.
402. See supra note 236 and accompanying text. The acquiror was Pantry Pride.
403. See supra note 237 and accompanying text.
404. See supra notes 241-47 and accompanying text.
405. See supra notes 264-92 and accompanying text.
406. See supra notes 270-82 and accompanying text.
lock-up because: (1) the plans treated competing bidders unequally, while the offers were substantially similar; and (2) the actions taken benefitted the employees rather than maximizing shareholder value.\(^\text{407}\)

However, the Eleventh Circuit subsequently approved a lock-up under its own interpretation of *Revlon* in *Cottle*, a case that included an asset lock-up granted to KKR, one of two bidders for Storer.\(^\text{408}\) The court, noting that the issue was whether a fair auction was conducted rather than whether the lock-up ended the bidding contest, found that the Storer board negotiated extensively and the offers were nearing expiration.\(^\text{409}\) As the accepted offer was superior and the sale prices of certain assets under the lock-up were reasonable, the auctioneer rule was satisfied and the directors were afforded the protection of the business judgment rule.\(^\text{410}\)

In the area of poison pill litigation, the Delaware court in *Federated* approved a poison pill rights plan under the modified business judgment rule of *Unocal*.\(^\text{411}\) Relying partially on a majority of independent directors and the preventative nature of the defense to validate the plan, the court reserved decision on the board's duty under *Revlon* to act as an auctioneer because the auction for Federated was still in progress.\(^\text{412}\)

A similar conclusion emanated from *Desert Partners*, a case arising in the United States District Court for the Northern District of Illinois.\(^\text{413}\) The court, noting board concerns about two-tiered offers and the undervaluation of USG's stock, relied upon the *Unocal* decision in approving USG's poison pill.\(^\text{414}\) After disposing of a claim related to the exercise price of the rights, the court found it reasonable for the USG board to perceive the Desert Partners offer as not reflecting USG's true long-term value and a threat to the corporate enterprise.\(^\text{415}\) The court further held that USG's refusal to negotiate with the acquiror was a reasonable defensive action due to its desire
to keep the company independent. 416

IMPLICATIONS ON THE USE OF TAKEOVER DEFENSES

The above-cited case law mandates certain considerations when adopting poison pills, lock-ups, and similar takeover devices. The decisions also provide a framework for examining recent judicial applications of the *Unocal* modified business judgment rule and the *Revlon* auctioneer duty. 417

THE POISON PILL AND THE UNOCAL INQUIRY

A review of the above poison pill plans reveals that certain standard aspects have been considered acceptable by the courts. The following triggering percentages in poison pills have been uniformly adopted: a 20% trigger for acquisitions and a 30% trigger for tender-offer announcements. 418 However, the United States District Court for the Southern District of New York went one step further, validating a 15% trigger that enabled the board to selectively enforce the poison pill against any entity it determined was an “adverse person.” 419 While the court found that the 15% tender offer announcement trigger was reasonable in relation to the perceived threats, the court failed to justify its conclusion because the company did not have notice of any party accumulating its stock. 420 Therefore, at least in the southern district of New York a target can apparently initiate stronger responses when the perceived threats are minimal.

Another aspect of a poison pill plan relates to the challenge asserted in *Desert Partners, L.P. v. USG Corp.* concerning the unreasonableness of that plan’s exercise price. 421 The exercise price was set at 300% of the prevailing market price; the court considered this figure within an acceptable range of values provided by the defendant’s investment banker. 422 Although the plaintiff claimed that the exercise price was unreasonable after the stock split, the court stated that it would not require a modification of the exercise price “in re-
sponse to every fluctuation in the stock price."423 Thus, the court allowed an unreasonably high exercise price by failing to distinguish a board-initiated stock split from a market fluctuation.

Furthermore, courts have used questionable reasoning in upholding poison pill plans on the basis that such plans provide a protective measure that is not absolute, and that certain actions can be undertaken to circumvent those plans.424 Courts have determined that these plans do not deter all hostile tender offers, and although takeovers may be more expensive with a poison pill in place, acquisitions are not impossible.425 However, poison pills should not be validated on the basis that they do not deter every conceivable takeover. Rather, the proper inquiry into poison-pill validity is whether a threat to corporate policy exists and whether the plan adopted is reasonable in relation to that perceived threat.426 For example, when a target perceives the only threat as the general occurrence of two-tiered offers in the marketplace, a court should question the use of an extremely distasteful pill. Thus, courts which validate poison-pill plans by reasoning that such plans do not deter all potential takeovers fail to apply the proper analysis.

Certain considerations should also be noted regarding the extent of inquiry that a board must exhibit in order to constitute good faith and reasonable investigation in determining a perceived threat under the first prong of the Unocal Corp. v. Mesa Petroleum Co. test. In Moran v. Household International, Inc., for instance, the propriety of the flip-over provision was at the heart of the controversy.427 Although the board received no opinion from its counsel on the validity of the flip-over, the Delaware Supreme Court found that this lack of information did not constitute gross negligence, and thus was not a breach of the duty of due care.428 However, in a tender offer context such as Moran, a board must make reasonable efforts to obtain pertinent information about the offer, and available defenses and a failure to procure advice of counsel will amount to a breach of the duty of due care.429

A similar situation occurred in Desert Partners wherein the court found that the defendant board had exhibited "a careful analy-

424. See supra notes 208, 382 and accompanying text.
425. See supra note 383 and accompanying text.
426. See supra notes 186-88 and accompanying text.
427. See supra note 198 and accompanying text.
428. See supra note 213 and accompanying text.
429. See supra note 80 and accompanying text.
sis of USG’s performance potential.” Although the court found it reasonable for the board to conclude that the plaintiff’s offer did not reflect the long-term value of the company, the court failed to place any emphasis on the fact that no analysis was performed to determine a range of future share values. The lack of this computation prevented the board from accurately determining whether a present offer was actually at an inadequate price.

Although the above actions may constitute a nonfulfillment of board duties, the context in which the poison pills were challenged must be understood. In Moran, the action was brought by a dissident director in advance of any specific threat. Although the plan was upheld, the court stated that board rejection of any subsequent offers would be reevaluated under the same fiduciary standards as when the plan was adopted. The courts in Desert Partners and CRTF Corp. v. Federated Department Stores, Inc. also validated poison pill plans adopted well in advance of any specific takeover threat. Therefore, when a poison pill is adopted to deter future advances rather than a specific takeover threat, it seems even more likely that the plan will withstand judicial scrutiny under the Unocal modified business judgment rule. Although strict adherence to the Unocal analysis appears to require a close inquiry regarding a technique adopted in response to a future, less-serious threat, the lack of an immediate threat apparently affords business judgment rule treatment as the probability of management self-interest in job retention is decreased.

Another factor which helps satisfy the modified business judgment rule is the approval of the plan by a majority of outside, independent directors. Because there is no underlying motive for such a committee to entrench themselves, their approval of a defensive measure “materially enhances” the chances that the defensive technique will be deemed reasonable in relation to the threat posed. However, this deferential treatment is premised on the mistaken assumption that all nonmanagement directors are truly independent. If independent director approval is to be factored into the reasonableness equation of Unocal, it should at least require the establishment of a wholly independent, separate committee to weigh

431. See supra note 388 and accompanying text.
432. See supra notes 201-02 and accompanying text.
433. See supra note 215 and accompanying text.
434. See supra notes 369-70 and accompanying text.
435. See supra note 187 and accompanying text.
Another consideration concerning the adoption of poison pill plans is that poison pills result in less harm to the structure and financial situation of a corporation than certain other defenses such as "scorched earth" tactics. Furthermore, the poison pill can even be utilized to stimulate auctions for corporate control. However, in a situation in which shareholders face either a hostile tender offer or a management recapitalization, the poison plan must not be invoked to favor management. After a reasonable time has elapsed for the board to ratify an alternative proposal, the shareholders should be given the freedom to determine their own destiny.

It should finally be noted that various courts seem quite willing to validate poison pills even under the Unocal modified business judgment rule; thus, the powerful effects of poison pills on shareholder wealth maximization should be questioned. Given the "omni-present specter that a board may be acting primarily in its own interests," ready validation by the judiciary may serve to substantiate fears of management entrenchment.

THE LOCK-UP OPTION & REVLON'S AUCTIONEER DUTY

As discussed above, the courts have struggled with the validity of lock-up options utilized in connection with the corporate bidding process. An analysis of the two cases in which respective lock-ups were enjoined, Revlon and Black & Decker, provides an interesting comparison.

While lock-ups are not per se illegal, there is a danger that improper lock-ups will deter or halt the bidding process. Additional significance attaches to the bidding process when, as in Revlon, the potential acquiror conveys its intent to control the target. The court in Revlon found that the acquiror's incremental bidding and the board's initiation of negotiations with third parties was "a recog-

437. See Simpson, The Emerging Role of the Special Committee-Ensuring Business Judgment Rule Protection in the Context of Management Leveraged Buyouts and Other Corporate Transactions Involving Conflicts of Interest, 43 BUS. LAW. 665 (1988). The author and others have noted that the establishment of an independent committee of outside directors to weigh alternative offers in change-of-control transactions will aid in the application of the business judgment rule. However, they have yet to endorse the establishment of a truly independent committee, comprised of individuals having no connection with the subject company.

438. See supra notes 142-43 and accompanying text.
439. See supra note 357 and accompanying text.
440. See supra notes 127-30 and accompanying text.
441. See supra notes 133 and accompanying text.
442. See supra notes 216-92 and accompanying text.
443. See supra notes 163-66 and accompanying text.
444. See supra note 226.
nition that the company was for sale.\textsuperscript{445} Similarly, in \textit{Black \& Decker} the court found that consistent increases in the parties' offers meant a bidding contest had begun.\textsuperscript{446} Thus, incremental bidding and a conveyed intent to acquire a target can develop an auction, making a court less likely to approve a lock-up granted to a party already involved in that auction process.

In \textit{Black \& Decker}, this situation was obvious because management had formulated its own recapitalization to compete with Black \& Decker's tender offer.\textsuperscript{447} However, as this recapitalization was determined to be an illegal lock-up, the question remains whether a board will be able to take action when its own recapitalization is similarly valued to a hostile bid. In such an instance, arguably the shareholders should then have the opportunity to independently choose between the alternative offers.

A second congruence between \textit{Revlon} and \textit{Black \& Decker} exists with respect to the competing bids in each situation. The court in \textit{Revlon} noted that although Forstman's bid was \$1 higher than Pantry Pride's immediate cash offer, it should be discounted for the time delay involved in a subsequent merger.\textsuperscript{448} The court in \textit{Black \& Decker} also found the bids at issue to be "substantially similar," noting that the recapitalization plan was worth \$74 to \$75 per share while Black \& Decker's offer was valued at \$73 per share.\textsuperscript{449} However, the large debt load associated with the recapitalization plan and the fact that Black \& Decker's bid was for all shares made the bids essentially equal.\textsuperscript{450}

Another similarity was that both of the successful litigants were faced with interested-party transactions.\textsuperscript{451} The \textit{Revlon} case dealt with a leveraged buyout,\textsuperscript{452} while in \textit{Black \& Decker} American Standard was being acquired by management through stock and options.\textsuperscript{453} It was apparent, especially in American Standard's situation, that there existed more than a mere possibility of self-interest that would justify the \textit{Unocal} analysis.\textsuperscript{454} Arguably, because of self-interest in \textit{Black \& Decker}, the court could have utilized the more probing "intrinsic fairness" standard.\textsuperscript{455}

\textsuperscript{445} See supra note 236 and accompanying text.
\textsuperscript{446} See supra note 277 and accompanying text.
\textsuperscript{447} See supra notes 254-57 and accompanying text.
\textsuperscript{448} See supra note 245 and accompanying text.
\textsuperscript{449} See supra notes 286-87 and accompanying text.
\textsuperscript{450} See supra notes 288-89 and accompanying text.
\textsuperscript{451} See supra notes 224-25, 275-76 and accompanying text.
\textsuperscript{452} See supra note 224 and accompanying text.
\textsuperscript{453} See supra note 276 and accompanying text.
\textsuperscript{454} See supra notes 93-96 and accompanying text.
\textsuperscript{455} See supra notes 85-87 and accompanying text.
In *Cottle v. Storer Communication, Inc.*, the court formulated a different rule from the above two cases. *Cottle* involved a shareholder derivative action wherein the Eleventh Circuit formulated its own revised definition of the *Revlon* auctioneer rule.\(^{456}\) The Delaware Supreme Court in *Revlon* stated that once the parties recognize the company is for sale, the board's role changes from defending the enterprise to seeking the best price possible for shareholders.\(^{457}\) Therefore, the use of defensive techniques to ward off perceived takeover threats are no longer appropriate, and lock-ups that deter or effectively end an auction become impermissible.\(^{458}\) The *Revlon* auctioneer rule was then substantiated by *Black & Decker*, wherein the court stated that any lock-up must be undertaken to maximize shareholder wealth rather than halt bidding.\(^{459}\)

The Eleventh Circuit in *Cottle*, however, found that the issue under the auctioneer rule was not whether the lock-up ended the bidding contest, but whether the target company had conducted a fair auction and whether the successful bidder had made the best offer.\(^{460}\) The court further noted that the lock-up must be viewed in light of the entire transaction.\(^{461}\) As a result, the court inquired into the extent of the negotiations, whether the board dutifully listened to presentations and the fact that it obtained fair prices for the optioned assets.\(^{462}\)

The *Revlon* auctioneer rule, however, does not contemplate a quaint survey of these factors. It commands a duty to sell the corporation at the highest price available to maximize shareholder welfare.\(^{463}\) When an active auction is underway, consideration for other interested parties must be disregarded in an effort to sell the company to the highest bidder.\(^{464}\) Although the court in *Cottle* noted that the bid by KKR, the white knight, was $7.50 higher than Comcast's bid, it relegated to a footnote the fact that the actual disparity was $2.25 per share.\(^{465}\) In the court's view, this price differential was enough to distinguish the case from *Revlon*, which involved bids that were even closer to an equal value.\(^{466}\)

The court also summarily treated the fact that Dillon Read, the

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456. See supra notes 316-18 and accompanying text.
457. See supra notes 236-38 and accompanying text.
458. See supra notes 237-44 and accompanying text.
459. See supra notes 291-92 and accompanying text.
460. See supra note 317 and accompanying text.
461. See supra note 318 and accompanying text.
462. See supra notes 319-26 and accompanying text.
463. See supra note 350 and accompanying text.
464. See supra note 281 and accompanying text.
465. See supra note 324.
466. See supra note 324 and accompanying text.
target's own investment banker, considered the Comcast offer $2.00 superior to KKR's.\textsuperscript{467} Even under the assumption that the Dillon Read analysis was correct, the court stated there nevertheless must be a "gross inadequacy" of price to overcome the business judgment rule.\textsuperscript{468} Thus, the Eleventh Circuit found that mechanical procedural steps and an arguably inadequate price will satisfy the \textit{Revlon} auctioneer rule.

The court in \textit{Cottle} buttressed its position by noting that the efforts to find an investor were winding down, the offers were expiring, and it "was time to end the auction."\textsuperscript{469} However, KKR's proposal was set to expire on 5:00 p.m. that day, whereas Comcast's offer was extended until 5:00 p.m. the next day.\textsuperscript{470} It is evident that an intelligent auctioneer would forego acceptance of an expiring offer if a comparable offer was still available. By doing so, the auctioneer creates an environment for further and possibly higher bidding. Furthermore, KKR, who was exerting pressure on the target, was granted the lock-up on the same day that its offer was stated to expire.\textsuperscript{471} In summary, \textit{Cottle} stands for the proposition that under the auctioneer duty in the Eleventh Circuit, allows boards to consider factors other than the maximum price attainable for the shareholders. In fact, the court ultimately acted to protect a board threatened by bidder coercion, rather than protecting shareholder interests.

\textbf{CONCLUSION}

The recent development of judicial standards such as the \textit{Unocal} modified business judgment rule and the \textit{Revlon} auctioneer duty presumably constitutes a recognition of the inherent self-interest of target boards when inacting defensive techniques. However, while this entrenchment motivation has been identified, courts incorporating these standards when determining the propriety of defensive tactics reach the same conclusion as those provided by the traditional business judgment rule analysis. Thus, the modified business judgment rule has continued the deference to target management that its predecessor rule had fostered.

The fact specific nature of takeover bids and defensive techniques make the application of concrete rules unworkable. Despite this fact specific inquiry, defensive tactics are generally ratified when adopted in response to two-tiered tender offers. Target manage-

\begin{itemize}
\item \textsuperscript{467} See supra note 328 and accompanying text.
\item \textsuperscript{468} See supra note 329 and accompanying text.
\item \textsuperscript{469} See supra note 321 and accompanying text.
\item \textsuperscript{470} See supra notes 305-06 and accompanying text.
\item \textsuperscript{471} See supra note 306 and accompanying text.
\end{itemize}
ment's fear of two-tiered tender offers in general appears to justify the implementation of a poison pill rights plan and satisfaction of the *Unocal* modified business judgment rule. Given this negative treatment, bidders are now shelving the two-tiered offer in favor of 100% all cash offers. An all cash offer greatly decreases the threat perceived by management because the element of coercion that is otherwise present in the two-tiered tender offer no longer exits.

The extent, if any, to which the cash tender offer constitutes a threat and the courts' acceptance of responsive defensive techniques to cash tender offers is an open question. Perhaps management should have an opportunity to utilize defensive tactics for a reasonable period of time to allow them to structure an alternative plan which would provide greater per share value to the shareholders. Once a recapitalization or similar plan is formulated by management, all defenses should be abandoned and the shareholders should be allowed to decide which offer to accept. The increased use of all cash tender offers should compel the courts to re-examine the deference given target management, even after the development of the *Unocal* and *Revlon* standards.

Despite the conflict between management self-interest and maximization of shareholder wealth, courts have failed to sufficiently consider the latter. If this unfortunate trend continues to the extent that a reversion to traditional business judgment rule analysis prevails, a "hands off" approach would then be preferable as market forces, rather than legal uncertainty, would ultimately prevail.

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