Takeover Bids in the Target's Boardroom

By MARTIN LIPTON*

The heightened level of takeover activity during the past five years[1] has focused attention on the legal, moral and practical questions faced by the directors of a company that becomes the target of an unsolicited takeover bid.[2] While as far as is known no director has ever been held liable for the rejection of a takeover bid, almost every successful takeover defense results in shareholder lawsuits against the directors of the target.[3] Such decided cases as there

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The terms "takeover bid," "target" and "raider" are used in this article for clarity; there is no pejorative intent.

1. According to the W.T. Grimm Co. 1978 Merger Summary there were 325 acquisition proposals for public companies announced in 1978, an increase of 22% over 1977. Where the price was disclosed 24% were $100 million or larger.

2. One commentator has described the director's dilemma as follows:

> Attempts by the manager to reconcile the many conflicting interests is impossible. Among the goals the executive may pursue are 1) the shareholders' receiving a fair price for their shares, 2) the corporation's obtaining or maintaining good management, 3) the economy's producing goods and services more efficiently, 4) the general public's becoming better able to interact with powerful corporate institutions, and 5) his keeping his job. Suggestions that a corporate executive can always resolve this great dilemma ignore reality. A takeover creating a large, powerful corporation may give advantage to shareholders and improve economic efficiency, yet threaten further the ability of the individual to survive in our increasingly institutionalized society. Stopping a takeover may save the executive's job, maintain good management, and save individualism, yet cause the corporation to shrivel in the shadow of its larger competitors and thereby harm the shareholders.
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> There are no easy answers for management here, no suggested ranking of the relative importance of the conflicting goals of management, shareholders, and society.

Bowers, *It's A Raid! Strategies for Avoiding Takeovers*, 3 Wharton Magazine 22, 28 (Summer 1979).

Shareholders of companies that have rejected takeover bids sometimes charge "that most board members, particularly those from the management side, are only concerned with keeping their jobs, and will set up any kind of roadblock to keep tender offers from reaching shareholders directly, regardless of the financial benefits." Feinberg, *The Directors' New Dilemma*, in *The Takeover Crisis: A Special Report*, Institutional Investor, 32, 45 (June 1979). Faced with such charges, "directors from target companies often say that they're caught in the middle between their primary duty to shareholders and their ancillary responsibility—though one they believe to be almost equally important—to the corporation as a whole and its future as a business enterprise." *Id.* at 46. *See also, Heat on Directors*, Barron's, July 30, 1979, at 4, col. 1 ("it's still difficult to tell precisely what's expected of a director . . . in the event of a tender offer").

3. *See e.g.*, Labaton v. Universal Leaf Tobacco Co., 77 Civ. 119 (CMM) (S.D.N.Y. Aug. 2, 1979); Panter v. Marshall Field & Co., 80 F.R.D. 718 (1978); Berman v. Gerber Products Co., 454 F. Supp. 1310 (W.D. Mich. 1978); Grossman, Faber & Miller, P.A. v. Cable Funding Corp., [1974-1975 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,913 (D. Del. 1974). *See also, In re* Sunshine Mining Co. Securities Litigation, 77 Civ. 4020 (S.D.N.Y. May 25, 1979) *summarized*

are sustain the right of the directors of a target to reject a takeover on the grounds of inadequacy of price,[4] illegality of the offer,[5] illegality of the acquisition of control of the target by that raider,[6] and concern with the impact of the takeover on the employees of the target and the community in which it operates.[7] However, the debate continues to rage.[8] The following are the principal questions:

1) Must the directors accept any takeover bid that represents a substantial premium over the current market?

2) When faced with a takeover bid should the directors declare an open auction and seek to sell the company to the highest bidder?

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in 509 Sec. Reg. & L. Rep. (BNA) A-9, which held that even if it were assumed that the directors of a target were selfishly motivated in rejecting a takeover, there is no shareholder cause of action under the federal securities laws against the directors; the shareholders' rights are governed by the applicable state corporation law.

4. *See* Anaconda Co. v. Crane Co., 411 F. Supp. 1210, 1215 (S.D.N.Y. 1975) ("[I]t is clear . . . that a businessman could make a proper business judgment [on the basis of an investment banker's report] to recommend rejection of the Crane [tender] offer."); Northwest Industries, Inc. v. B.F. Goodrich Co., 301 F. Supp. 706, 712 (N.D. Ill. 1969) ("[M]anagement has the responsibility to oppose offers which, in its best judgment, are detrimental to the company or its shareholders."). *Cf.* Kaplan v. Goldsamt, 380 A.2d 556, 568 (Del. Ch. 1977); Danziger v. Kennecott Copper Corp., N.Y.L.J., Dec. 7, 1977 at 7, col. 1, *aff'd on the opinion below,* 400 N.Y.S.2d 724 (1st Dept. 1977) (both cases holding that directors may rely on investment banker's reports in determining whether to *make* an offer to purchase stock at a certain price).

5. *E.g.,* Berman v. Gerber Products Co., *supra* n. 3, at 1318-23 (target with "legitimate concerns" about raider's possible violations of securities laws in making offer did not violate fiduciary duty in bringing action against raider to halt tender offer); Consolidated Amusement Co. v. Rugoff, [1978 Transfer Binder] CCH Fed. Sec. L. Rep. (CCH) ¶ 96,584, at 94,475, 94,478 (S.D.N.Y. 1978); Copperweld Corp. v. Imetal, 403 F. Supp. 579 (W.D. Pa. 1975).

6. *E.g.,* Berman v. Gerber Products Co., *supra* n. 3; Gulf & Western Industries, Inc. v. Great Atlantic & Pacific Tea Co., 356 F. Supp. 1066 (S.D.N.Y.), *aff'd,* 476 F.2d 687 (2d Cir. 1973); Allis-Chalmers Manufacturing Co. v. White Consolidated Industries, Inc., 414 F.2d 506 (3d Cir. 1969), *cert. denied,* 396 U.S. 1009 (1970); Humana, Inc. v. American Medicorp., Inc., [1977-1978 Transfer Binder] CCH Fed. Sec. L. Rep. (CCH) ¶ 96,286, at 92,823, 92,833 (S.D.N.Y. 1978).

7. *See e.g.,* Herald Co. v. Seawell, 472 F.2d 1081 (10th Cir. 1972). In *Herald,* the court expressly held that directors—at least directors of certain kinds of corporations such as newspapers—have an obligation to "employees, and to the public," in addition to their duty to stockholders. Thus the directors in that case were justified in averting a takeover which they believed would have "an adverse impact on the character and quality" of the newspaper, and would lead to "poor relations with employees. . . ." *Id.* at 1092. *See also* American Rolling Mill Co. v. Commissioner, 41 F.2d 314 (6th Cir. 1930); Armstrong Cork Co. v. H.A. Meldrum Co., 285 F. 58 (W.D.N.Y. 1922) (both cases holding that it is within legitimate business purpose of corporations to make contributions and establish programs for the benefit of employees and the community in which the corporation operates); Dodd, *For Whom Are Corporate Managers Trustees?* 45 Harv. L. Rev. 1145 (1932) ("those who manage our business corporations should concern themselves with the interests of employees, consumers, and the general public, as well as of the stockholders"); Blumberg, *Corporate Responsibility and the Social Crisis,* 50 Boston U. L. Rev. 157 (1970).

8. *See e.g., The Takeover Crisis: Special Report,* Institutional Investor, June 1979, at 32; Wyser-Pratte, *Takeover Panel Needed to Protect Shareholders,* N.Y.L.J., June 4, 1979, at 25, col. 5; Fortune, March 12, 1979 at 159 (interview with William Klein II).

3) Should the directors consider the impact of the takeover on employees, customers, suppliers, the community; indeed is national policy a proper consideration?

4) Do the shareholders of the target have a right to decide for themselves no matter what the directors believe to be the best interests of the target as a business enterprise?

5) May the directors ignore a clear antitrust issue or litigate a minor antitrust issue; may the directors litigate other issues such as failure to comply with the disclosure requirements of the federal securities laws?

6) May the directors adopt a policy that the company will remain an independent business entity and authorize management to reject any overtures or feelers?

7) May the directors build an antitakeover fence picketed with shark-repellent charter amendments and specially lobbied local takeover laws?

8) May the directors authorize a standstill arrangement with a big brother who buys 20 percent of the target in order to block a takeover or authorize a premium purchase of shares of the target from a potential raider who has accumulated them in the market?

9) Are the management directors of the target so infected with self-interest that they are disqualified from participating in the ultimate decision to accept or reject a takeover bid?

10) Must an investment banker opine that a takeover bid is inadequate to justify rejection by the directors of the target?

11) Should a company and its directors prepare to deal with a takeover bid, if one were in the future to be made, by consulting in advance with experienced investment bankers and legal counsel?

12) Is a takeover bid so significantly different from other major business questions that the usual rules governing directors must be displaced by rules unique to takeovers?

It is believed that experience and common sense prove that:

1) Directors should not be forced to accept any takeover bid that is at a substantial premium and the usual rule that directors may accept or

reject a takeover bid if they act on a reasonable basis and in good faith should continue.[9]

2) Takeover bids are not so different from other major business decisions as to warrant a unique sterilization of the directors in favor of direct action by the shareholders.[10]

Many of the lawsuits and much of the agitation for changes in the existing rules come from certain arbitrageurs and professional investors whose short-term perspectives are not in accordance with the long-term interests of other shareholders and other constituencies of corporations and who do not share the concern of corporate management with the need for long-term planning in a high technology economy.[11] It would not be unfair to pose the policy issue as: *Whether the long-term interests of the nation's corporate system and economy should be jeopardized in order to benefit speculators interested not in the vitality and continued existence of the business enterprise in which they have bought shares, but only in a quick profit on the sale of those shares?* The overall health of the economy should not in the slightest degree be made subservient to the interests of certain shareholders in realizing a profit on a takeover. Even if there were no empirical evidence that refuted the argument that shareholders almost always benefit from a takeover (as noted below, the empirical evidence is to the contrary) and even if there were no real evidence,

9. *E.g.*, Panter v. Marshall Field & Co., *supra* n. 3; Berman v. Gerber Products Co., *supra* n. 3; Klaus v. Hi-Shear Corp., 528 F.2d 225, 233-34 (9th Cir. 1975); Heine v. Signal Cos., [1976-1977 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 95,898, at 91,311, 91,322 (S.D.N.Y. 1977); Northwest Industries, Inc. v. B.F. Goodrich Co., *supra* n. 4, at 711-12; Cheff v. Mathes, 199 A.2d 548, 554-56 (Del. 1964); Scott v. Stanton Heights Corp., 131 A.2d 113, 116 (Pa. 1957) ("other considerations . . . may weigh in the appraisal of the offer which the ordinarily prudent businessman would accept than money price alone"). *See generally*, E. Folk, The Delaware General Corporation Law, 75-76 (1972).

10. Most modern corporation statutes provide that "the business and affairs of a corporation shall be managed by the board of directors." N.Y. Bus. Corp. Law § 701. *See also*, Model Bus. Corp. Act. § 35; Del. Corp. Law § 141(a); Ill. Bus. Corp. Act § 33. Directors routinely make the decision whether or not to enter into contracts or embark on new business ventures. In general, questions of policy and management are left to the decision of the directors. *See generally*, Abbey v. Control Data Corp., (Current) Fed. Sec. L. Rep. (CCH) ¶ 96,721 (D. Minn. 1978); 2 W. Fletcher, Cyclopedia of the Law of Private Corporations § 505. In particular, directors may borrow money, *id.* § 515; mortgage and lease property, *id.* §§ 516, 521; make purchases and sales, *id.* §§ 517, 518; issue stock and determine dividends, *id.* §§ 523, 526; file voluntary proceedings in bankruptcy, *id.* § 532; and institute suits, *id.* § 535. Such decisions may have as great an impact on the corporation as the decision to oppose a tender offer. *See* text accompanying nn. 59-60, *infra*.

11. Arbitrageurs such as Bache Halsey Stuart Shields' Guy Wyser-Pratte have been in the forefront of those suggesting, for example, that shareholders vote on proposed tender offers and that an independent "takeover panel" oversee offers. *See* Wyser-Pratte, N.Y.L.J., June 4, 1979, at 25, col. 5; Feinberg, *The Directors' New Dilemma* in The Takeover Crisis, *supra* n. 8, at 45-46. Takeover battles, particularly those that escalate into "bidding wars," have been a "bonanza" for arbitrageurs and similar short-term speculators. *See, Carborundum Stake May Be Bonanza For Broker Who Foresaw Bidding War*, Wall St. J., Nov. 28, 1977, at 4, col. 1; *Arbitrage: It's the Hottest Game in Town*, Bus. Week, Jan. 17, 1977, at 71.

but only suspicion, that proscribing the ability of companies to defend against takeovers would adversely affect long-term planning and thereby jeopardize the economy, the policy considerations in favor of not jeopardizing the economy are so strong that not even a remote risk is acceptable.

Role of Directors

Before turning to an analysis of the specific questions, it is helpful to review briefly the role played by directors in the corporate governance system as it exists today. Our corporate governance system is structured similarly to our national government. Ultimate power rests with the shareholders who cannot act directly but only through their elected representatives—the directors. The directors are elected annually and both state and federal law provide mechanisms which enable the shareholders either to change the composition of the board of directors or to instruct the directors to take action desired by the shareholders.[12] Directors are considered to owe a fiduciary duty to the shareholders—that is, they are supposed to act as prudent businessmen, in good faith and on a reasonable basis to assure that the business of the corporation is operated for the benefit of its shareholders.[13] Corporation laws generally permit directors to rely on reports prepared by management and by outside experts such as lawyers, accountants and investment bankers, in discharging the directors' duties.[14]

In the early years of this century almost the sole focus of the directors of a corporation was its shareholders. Efforts to broaden the concerns of directors to include employees, consumers, the community, the environment and the national welfare have reached full fruition only during the last 20 years. It is now well settled through legislation and court decisions that corporations:

a) must protect the environment,[15]

b) must protect the health and safety of employees,[16]

c) must protect the pensions of employees,[17]

d) must produce safe products and replace products found to have defects,[18]

12. *E.g.*, Model Bus. Corp. Act § 28; N.Y. Bus. Corp. Law § 602; Del. Corp. Law § 211(d) (provisions for special meetings of stockholders). SEC rule 14a-8 requires management to include in its proxy statements certain kinds of proposals submitted by shareholders.

13. *E.g.*, Singer v. Magnavox Co., 380 A.2d 969 (Del. 1977); Cheff v. Mathes, *supra* n. 9; Model Bus. Corp. Act § 35; N.Y. Bus. Corp. Law § 717; Cal. Corp. Code § 309.

14. *E.g.*, Model Bus. Corp. Act. §§ 35, 48; N.Y. Bus. Corp. Law § 717; Del. Corp. Law § 141(e).

15. *See* 42 U.S.C.A. §§ 7401-7642 (1978 Pamphlet) (Environmental Protection Act).

16. *See* 29 U.S.C. §§ 651-678 (1976) (Occupational Safety and Health Act).

17. *See* 29 U.S.C. §§ 1001-1381 (1976) (Employee Retirement Income Security Act).

18. *See* 15 U.S.C. §§ 2051-2081 (1976) (Consumer Product Safety Act).

e) may make charitable contributions from corporate funds,[19]

f) may spend corporate funds, or assign employees to engage in activities, for the betterment of communities in which the corporation operates,[20]

g) may organize political action committees.[21]

The movement to further the interests of the community, employees, the environment, consumers and perceived national policy at the expense of maximum profits and maximum benefit to shareholders has not abated. In addition to the specific legislation and court decisions reflected above, the concept of federal chartering of major corporations for the purpose of assuring their adherence to national policy continues to be advanced.[22] Our present system of corporate governance places the directors at the center of corporate decisionmaking and has expanded the corporation's responsibilities to safeguard interests broader than those of shareholders alone.

Contrary to Popular Belief Shareholders Usually Win When a Takeover Is Rejected

Central to an analysis of the questions posed at the outset is an examination of the ultimate effect on shareholders when a corporation rejects a takeover. Contrary to popular belief on Wall Street, the decision to accept or reject a takeover is not so heavily weighted in favor of acceptance that as a matter of experience it can be said that the shareholders are always disadvantaged by rejection. The 36 unsolicited tender offers that were rejected and defeated by the target between the end of 1973 and June 1979 (believed to be all such tender offers filed with the SEC during this period) show that the shares of more than 50 percent of the targets are either today at a higher market price than the rejected offer price or were acquired after the tender offer was defeated by another company at a price higher than the offer price. This is particularly true with respect to those tender offers that were defeated prior to 1978.[23] Eight of the 36—four where on the basis of market price as opposed to rejected offer price the shareholders of the target won as a result of the successful defense; and four where on the same basis the shareholders lost—have been selected as illustrations. While neither these illustrations nor

19. *E.g.*, A. P. Smith Manufacturing Co. v. Barlow, 98 A.2d 581 (N.J. 1953), *appeal dismissed*, 346 U.S. 861; Theodora Holding Corp. v. Hendersen, 257 A.2d 398 (Del. 1969); Cal. Corp. Code § 802(g); Del. Corp. Law § 122(9), (12); N.Y. Bus. Corp. Law § 202(a)(12). Virtually all states have similar provisions. *See* Blumberg, *supra* n. 7, at 167, 192-202, 208-10.

20. *E.g.*, American Rolling Mill Co. v. Commissioner, *supra* n. 7; Huntington Brewing Co. v. McGrew, 112 N.E. 534 (Ind. App. 1916). *See generally*, Blumberg, *supra* note 7.

21. *See* 2 U.S.C. § 441b (1976).

22. *See* Nader, Green & Seligman, Constitutionalizing the Corporation: The Case for the Federal Chartering of Giant Corporations (1976).

23. *See* Exhibit A.

Exhibit A distinguishes between cash tender offers and exchange offers and while the amounts and securities values have not been adjusted to present values or for interim dividends, it is apparent that the basic point is clearly established: the shareholders of more than 50 percent of the targets are better off today than if the defeated tender offer had succeeded. The following table shows the target, the raider, the date the offer was announced, the market price of the target one month and one week before the announcement, the price offered and the price at August 10, 1979 for the eight tender offers chosen as illustrations:

Target	Raider	Date	Market 1 Month Prior	Market 1 Week Prior	Offer Price	Price August 10, 1979
Dictaphone	Northern Electric	9/24/74	$ 7.12	$ 8.37	$12.00	$28.00[24]
Foremost McKesson	Sharon Steel	5/17/76	15.50	16.62	27.00	24.00
Gerber Products	Anderson, Clayton	8/1/77	29.75	32.62	37.00	28.12
Marshall Field	Carter Hawley Hale	2/1/78	32.75[25]	29.62	42.00	17.87
Mead	Occidental Petroleum	8/11/78	21.50	23.25	35.00	26.75
Sabine	Hamilton Brothers	9/22/76	21.50	22.19	30.00	40.12
Sterndent	Cable Funding	2/13/75	8.75	9.25	14.00	21.62
Universal Leaf Tobacco	Congoleum	10/8/76	12.13	11.94	16.25	23.25

There are no readily available studies which show the results of rejected takeover bids which did not reach the actual tender offer stage. Personal experience leads to the belief that the Viacom International illustration is not atypical. In January, 1977 when Viacom was selling for $10 per share, Storer Broadcasting offered $20 per share for a "friendly" takeover. Viacom rejected the offer. In August, 1979 the market price of Viacom was more than $30 per share.[26]

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24. Acquired by Pitney-Bowes for $28.00 per share in 1979.

25. Prior to a previous offer by Carter Hawley Hale, the market for Marshall Field was $22 per share.

26. Another illustration of the win-some, lose-some nature of takeovers is a comparison of the offer by United Technologies in 1977 for Babcock & Wilcox with the offer by United Technologies in 1978 for Carrier. *See, United Technologies Makes a Bid For All Babcock & Wilcox Stock,* Wall St. J., March 30, 1977, at 3, col. 1; *United Technologies Will Bid $510 Million for Babcock's Stock,* N.Y. Times, March 30, 1977, at § IV, p. 1, col. 6; Wall St. J., Nov. 13, 1968, at 30-31 (tombstone announcement of United Technologies' *Offer to Purchase;* Carrier offer). The Babcock offer was $42.00 per share as compared to an average 30-day preoffer market of $32.65. The Carrier offer was $28 as compared to an average 30-day preoffer market of $24.30. In each case the target was advised by Morgan Stanley that the offer was inadequate. In each case the target raised an antitrust defense (in each case the Government also brought an antitrust case) and after several months of legal proceedings, including trial of the antitrust proceedings, the offer was allowed to be made. *See* Babcock & Wilcox Co. v. United Technologies Corp., 435 F. Supp. 1249 (N.D. Ohio 1977); Carrier Corp. v. United Technologies Corp., [1978-2 Transfer Binder] Trade Cas. (CCH) ¶ 62,393 (N.D.N.Y. Dec. 6, 1978), *aff'd,* [1978-2 Transfer Binder] Trade Cas. (CCH) ¶ 62,405 (2d Cir. Dec. 18, 1978). In the Babcock situation a white knight, J. Ray McDermott, acquired the target for the equivalent of $65 per share. In the Carrier situation United acquired Carrier at the original $28 offer price. Babcock built the reactor involved in the Three Mile Island incident and the McDermott stock issued to Babcock shareholders at a value of $65 at the end of June 1979 had a market value of $53.25.

Two further points should be noted in determining the impact of rejection of a takeover bid on the shareholders of the target. First, the experience of the past five years shows that the stock market has been valuing most companies at between 50 percent and 66⅔ percent of what they are worth to someone acquiring control and also that the premiums that acquirors are willing to pay for companies have been increasing continuously during this period.[27] Therefore unless there has been a material downturn in the business of a target that has rejected a takeover, even if the market price of its stock has not caught up with the offer price, there has been no change in the fundamental value of the target and it could today be sold for more than the rejected offer price.[28] The proper comparison is not between the price of the stock in the market and the rejected offer price, but between the rejected offer price and the amount that could be obtained otherwise upon the sale of the entire company. While the damage suits that have been brought against directors of targets that have rejected takeovers are premised on the supposed loss to shareholders resulting from the difference between the offer price and the market price, if the directors were to be found to have acted wrongly, the proper measure of damages should not be the difference between the market price and what was offered, but between what was offered and the true value at that time.[29] Only if it were assumed that the raider was acting contrary to its self-interest and proposing to pay more than true value, would there have been any damage to the shareholders of the target that could be recoverable in such a lawsuit. Second, in about 95 percent of the cases where a company has been acquired after initially having resisted an unsolicited takeover bid, the shareholders have ended up with a higher price than the original offer.[30] One court has expressly held that it is appropriate for the target to resist a tender offer by litigation for the purpose of gaining time to get the best deal possible for the shareholders.[31]

Experience does not prove that the shareholders of the target are better off if the target accepts a takeover bid. Experience shows that from the standpoint of whether the shareholders win or lose, the decision to accept or reject is about 50/50 on market price alone and, if sale value today as opposed to yesterday's rejected offer price is used as the basis of comparison, the

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See also, Shareholder Beware! Takeovers Don't Pay, The (London) Sunday Times, Oct. 1, 1978, at 61, col. 1.

27. *See* Ehrbar, *Corporate Takeovers Are Here to Stay,* Fortune, May 8, 1979, at 91.

28. *See* Dictaphone and Sterndent in chart at pp. 132–33, *supra.* Typically those companies which become the subject of unsolicited takeover bids are just those which are perceived by the raider as having bright prospects which are not adequately reflected in the market's current valuation of the target's shares.

29. *Cf.* Labaton v. Universal Leaf Tobacco Co., *supra* n. 3.

30. Unpublished study by Goldman, Sachs & Co. of 85 takeover bids during the period January 1, 1976 to June 8, 1979.

31. *See* Commonwealth Oil Refining Co. v. Tesoro Petroleum Corp., 394 F. Supp. 267, 274–75 n. 1 (S.D.N.Y. 1975).

shareholders have profited in the overwhelming majority of defeated takeovers. There is no empirical evidence to support an absolute requirement that the directors of a target accept any takeover bid. The fact that a raider chooses for *its* economic purposes to make a takeover bid does not mean that the directors of the target have a fiduciary obligation to cause a sale of the company either to the raider or a white knight which outbids the raider.

Requiring Acceptance of Any Takeover Bid is the Equivalent of Mandating a Periodic Decision to Sell or Liquidate

There is no logical distinction between a requirement that directors accept any takeover bid that represents a substantial premium over market and a requirement that the directors determine annually whether it would be possible to sell or liquidate the company at a substantial premium over market and that, if possible, the directors do so. The fact that a raider has taken the initiative is no basis for distinction. If the directors have an obligation to sell whenever a substantial premium is available, it should make no difference who initiates the activity. Indeed, if that is the rule, the directors should not await a raider's initiative, but are required to take the initiative themselves. Nor is the greater certainty created by a takeover bid as compared to the directors' assessment of what might be realized on sale or liquidation a basis for distinction. The skill and sophistication demonstrated by the major investment bankers in finding white knights or auctioning major companies like Carborundum[32] and General Crude[33] prove that the advice of such a banker as to saleability and price is, for the purpose of this type of assessment by the directors, as certain as an unsolicited takeover bid made by a third party.

What, then, would be wrong with a requirement for annual assessment by the directors as to whether the company should be sold or liquidated? First, it shortens the directors' perspective to the present and forces them to ignore the long term. It defies common sense and ordinary business practices to mandate that a company be sold today for a substantial premium even though the directors believe it could be sold in the future for a larger premium, or that future market value plus interim dividends have a greater present value than the premium price now available. Second, a requirement for an annual life or

32. *See, Carborundum Stake May Be Bonanza for Broker Who Foresaw Bidding War,* Wall St. J., Nov. 28, 1977, at 4, col. 1; *Carborundum Deal Created Suspense,* N.Y. Times, Nov. 21, 1977, at 60, col. 1. For an account of the Carborundum bidding war *see, Control Battle for Carborundum Emerges as Eaton Enters Picture,* N.Y. Times, Nov. 3, 1977, at § IV, p. 1, col. 5; *Eaton Officially Offers $47 a Share for Carborundum,* N.Y. Times, Nov. 10, 1977, at § IV, p. 1, col. 2; *Kennecott Offers $66 a Share in Bid for Carborundum,* N.Y. Times, Nov. 16, 1977, at § IV, p. 1, col. 6; *Directors Approve Kennecott's Offer for Carborundum,* N.Y. Times, Nov. 17, 1977, at § IV, p. 1, col. 4.

33. *See, Mobil Oil Said to Prepare Offer for General Crude,* N.Y. Times, Mar. 15, 1979, at § IV, p. 1, col. 1; *Would-Be Acquirers Line Up for Change at General Crude,* N.Y. Times, Mar. 18, 1979, at § III, p. 15, col. 2; *Mobil Bids $765 Million For General Crude Oil,* N.Y. Times, Mar. 23, 1979, at § IV, p. 1, col. 4.

death assessment would have a fundamental impact on the way in which corporations operate. Executives, employees, customers, suppliers and others dependent on doing business with the company would have no assurance of continuity. The scramble by each of these constituencies to protect against sale or liquidation would cause major disruptions in the manner in which business is now conducted. These disruptions would favor the short term at the expense of the long-term planning that is essential in a high technology economy. Third, there is no reason to believe that the experience with mandated annual life or death assessments would be any different than the experience with rejection of unsolicited tender offers. In sum, there is no empirical evidence or logic to support a requirement that sale or liquidation of the company be treated any differently from any other major business decision.

In this era of takeovers the directors of a company may find that it is good business management to take steps to assure employees, suppliers, customers and communities in which the company operates that the company intends to continue its current business policies and to that end intends to remain in independent entity and not be taken over. The adverse reaction of authors and editors to the Houghton Mifflin[34] and McGraw-Hill[35] takeover attempts illustrates that this may be particularly appropriate where a company is heavily dependent on highly paid and mobile employees. These assurances may take the form of a company policy not to engage in merger discussions;[36] a charter amendment requiring the directors to consider the interests of employees, customers, suppliers and others when considering a merger or takeover bid;[37] charter amendments designed to deter unsolicited takeover bids;[38] and

34. *See, Authors Protest Conglomerate Deal,* N.Y. Times, Apr. 20, 1978, at § III, p. 17, col. 5. The authors' protest was instrumental in thwarting Western Pacific's takeover attempt. After receiving numerous letters from authors, Western Pacific chairman Howard (Mickey) Newman came to the conclusion that "I'm going to buy this company and I ain't going to have nothing." *See,* The Takeover Crisis, *supra* n. 8, at 40.

35. *See, McGraw-Hill Bid Stirs Editorial Fears,* N.Y. Times, Jan. 14, 1979, at 51, col. 3; Friendly, *McGraw-Hill and a Free Press,* Wall St. J., Jan. 16, 1979, at 14, col. 4. As was the case with Western Pacific, American Express was eventually persuaded that McGraw-Hill was a "people company," and that, given the reaction of authors and editors, "there wasn't going to be anything left when they took over." *See* The Takeover Crisis, *supra* n. 8, at 35.

36. *See* 1 Lipton & Steinberger, Takeovers & Freezeouts 69, 290 (1978).

37. McDonald's Corporation recently added charter amendments charging directors with considering "the social, legal and economic effects on franchises, employees, suppliers, customers and business" when confronted with a takeover bid. *See, McDonald's Proposes Increased Protection Against Takeover Bids,* Wall St. J., Mar. 30, 1979, at 10, col. 2. Control Data Corporation had previously adopted a similar charter amendment. *See, Control Data Asks Holders to Approve Antitakeover Step,* Wall St. J., at 17, col. 2; Cuniff, Supplementary Material from New York Times News Service and the Associated Press, October 12, 1978. The Control Data charter provision reads as follows:

> The Board of Directors of the Corporation, when evaluating any offer of another party to (a) make a tender or exchange offer for any equity security of the Corporation, (b) merge or consolidate the Corporation with another corporation, or (c) purchase or otherwise acquire all or substantially all of the properties and assets of the Corporation, shall, in connection

migration to a state with laws that inhibit unsolicited takeovers.[39] In addition, a company may make special provisions in employment contracts, employee

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with the exercise of its judgment in determining what is in the best interests of the Corporation and its stockholders, give due consideration to all relevant factors, including without limitation the social and economic effects on the employees, customers, suppliers and other constitutents of the Corporation and its subsidiaries and on the communities in which the Corporation and its subsidiaries operate or are located.

See Lipton & Steinberger, *supra* n. 36, at 65–66.

38. One such amendment is a provision requiring a supermajority vote to approve any business combination with a person owning a specified percentage of the company's shares. *See* Lipton & Steinberger, *supra* n. 36, at 266–71 (1978). The efficacy of such provisions is the subject of debate. *See id.* at 266; Securities Week, June 26, 1978, at 9.

Rubbermaid, Inc. coupled a supermajority provision with an amendment giving shareholders who do not tender shares during an offer the right to submit them for redemption—at the offer price or the highest market price during the previous 18 months, whichever is higher—should the raider obtain more than 50% of the company's stock. *See, Rubbermaid Seeks Nod From Holders on Plan to Deter Tender Bids,* Wall St. J., Apr. 18, 1978, at 17, col. 2.

See also, Jewelcor Inc. v. Perlman, 397 F. Supp. 221, 231 (S.D.N.Y. 1975) (company's "defensive strategy in the event of a tender offer" included charter amendments increasing the number of directors, creating three classes of directors with staggered terms, and requiring a two-thirds vote for repeal of the above provisions).

39. Three companies responding to a National Association of Accountant's survey stated that they had made this complicated change. *See* National Association of Accountants, Takeovers: The State of the Corporate Defense Art Q8 (1978).

Shark-repellent charter amendments, migration to a state with a strong takeover law and similar actions, while legal and proper under the circumstances described in the text, may not be desirable. There is great doubt as to the constitutionality of the state takeover laws. *See* Great Western United Corp. v. Kidwell, 439 F. Supp. 420 (N.D. Tex. 1977), *aff'd,* 577 F.2d 1256 (5th Cir. 1978), *rev'd on other grounds,* (Current) Fed. Sec. L. Rep. (CCH) ¶ 96,900 (U.S. Sup. Ct. June 26, 1979). In addition, the SEC requires extensive disclosures with respect to shark-repellent provisions; its views are set forth in Securities Exchange Act Release No. 15230 (October 13, 1978), *reprinted in* [1978 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 81,748. In general, the SEC requires explicit statements with respect to the negative impact on the shareholders and the benefits to management. The release details the nature of the disclosures the SEC will demand with respect to supermajority voting provisions, staggered boards, special classes of voting stock, and other shark-repellent provisions.

While the SEC release does not establish new disclosure requirements, it does serve to emphasize the negative aspects of shark-repellent provisions. *First,* except in rare situations of companies that would be attractive to bootstrappers, they are not a real practical deterrent to a takeover attempt. *Second,* they cast doubt on the legitimacy of rejection of takeover proposals that might be received in the future. *Third,* they advertise that the company fears that it is a takeover candidate. *Fourth,* they may create a false sense of security. *Fifth,* there is danger (particularly where there are large institutional holdings) that they will not receive the requisite vote and thereby advertise that the shareholders are receptive to a takeover. *See, PSA Inc. Is Winner In Proxy Fight Tied to Curbing Takeovers,* Wall St. J., Dec. 15, 1978, at 31, col. 3:

> PSA Inc. won a hotly contested proxy fight over management's proposals to discourage takeovers by 32,455 votes, or fewer than 1% of the 3,339,498 shares eligible to vote on the issue.
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> The company, parent of Pacific Southwest Airlines, said it received 1,702,205 affirmative votes, with 1,148,136 votes cast against. It needed a majority of shares outstanding to make the changes in its certificate of incorporation. The changes will eliminate cumulative voting for directors, institute staggered board terms and require an 80% shareholder vote for some types of mergers involving holders of at least 20% of PSA stock. Under cumulative voting, each holder has as many votes as the number of his shares multiplied by the number of directors up for election. He may concentrate, or distribute, these votes and thus can gain board representation even with a relatively small minority interest.

benefit plans and material agreements with customers and suppliers to assure against abrogation or change in the event of a takeover.[40] In connection with the question whether the directors of a target may consider constituencies other than the shareholders in passing on a takeover bid, it should be noted that the Carter Administration in connection with proposed legislation designed to *rescue* Chrysler Corp. insisted that Chrysler show that its shareholders, employees, suppliers and others are making *maximum sacrifices.*[41] If employees, suppliers and others must participate in rescuing a company from bankruptcy, it is hard to argue that they should be *ignored* when the question is a takeover that will benefit the shareholders.

There Is No Requirement to Negotiate or Sell

If we accept the premise that directors should not be compelled either to assess annually the continuance of the company as an independent entity or accept any substantial premium opportunity to sell or liquidate, and that it may be important to the good management of the business of the company to provide assurances against a takeover, we answer some of the questions with which we started. It follows that:

1) A company need not have a perpetual "for sale" sign on its front lawn, *i.e.,* there is no requirement that the management or the directors engage in acquisition discussions at another person's initiative;[42] on the contrary, a company may have an express policy of continuing as an independent business enterprise.

2) The directors are not required when faced with a takeover bid to declare an auction and seek to sell the company to the highest bidder.

PSA also denied a request by the leading opponent of its proposals to review the balloting, and said it would file the new certificate immediately.

Harold Simmons, who owns about 20% of PSA's stock and led the fight to block the antitakeover measures, said in a telephone interview from Dallas, "We're definitely going to challenge; we demand the right to inspect the ballots." He said that "it's unusual" for a certificate to be filed immediately after such a close vote, and "I'm told by my attorneys that 1% of the votes normally are challengeable," he said.

40. *See* Freedman v. Barrow, 427 F. Supp. 1129, 1154 (S.D.N.Y. 1976). Placement of reasonable provisions in such plans and contracts is fully consistent with the directors' fiduciary duties. Assurance of fair and adequate treatment of officers, employees, customers and suppliers in the event of a takeover is a major factor in the consideration of any takeover proposal. Such provisions are not in the category of shark repellents designed to entrench management but are just the opposite—reasonable provisions designed to protect important constituents of the company and assure full and fair consideration of the takeover proposal.

41. *Financing Unit of Chrysler Sets Receivables Sales,* Wall St. J., Aug. 13, 1979 at 3, Col. 1: "Treasury Secretary G. William Miller made clear last week that the burden is on the company to produce a workable plan, including the 'substantive contributions or concessions' that are to be made by the auto-maker's management, employees, bankers, stockholders and others."

42. Such discussions are often misperceived by the potential acquiror and result in unwanted takeover offers. Disclosure of such discussions (usually "leaks") may have the same type of unsettling effect on employees, customers, suppliers and communities as an unsolicited takeover bid.

3) A company may make special provisions, such as full vesting and immediate cash-out in the event of a change of control, in its employee stock option and other benefit plans to protect the beneficiaries in the event of a takeover.

4) A company may attempt to discourage takeovers through such tactics as shark-repellent charter amendments and lobbies for takeover laws that have the same effect.

A Shareholder Referendum Is Not the Answer

Assuming that a raider makes a firm takeover offer at a substantial premium, must the directors ignore questions as to the adequacy of the price, the legality of the acquisition, the impact on employees, customers, suppliers, communities and national policy and let the shareholders decide for themselves?

In pursuing this discussion it will be assumed that the holders of a majority of the shares of the target would accept the offer. This has been the experience in almost every tender offer during the past five years. One prominent exception was the 1976 tender offer by Airco for Unitek at a 30 percent premium which resulted in Airco acquiring less than 22 percent of the Unitek shares.[43] Only a few substantial companies in addition to Unitek have been successful in convincing their shareholders not to accept a tender offer. The failure of management to convince shareholders not to accept a tender offer is the result of several factors. First, the special dynamics of a tender offer are such that the decision of shareholders is almost always a foregone conclusion —they will tender, therefore, it is misleading to speak of a free shareholder choice at all. The existence of an offer to acquire a controlling interest in a company makes it almost impossible for a shareholder in the target to prudently retain his shares unless he does so for the purpose of exchanging them in a promised subsequent tax-free exchange. Once a raider has acquired control—and target shareholders must assume that the raider will acquire control—it is highly unlikely that shareholders will receive a higher price than that initially offered: since there is no possibility of a competing offer at a higher price, the public trading market (if one still exists) will have been capped at the price offered in the tender offer and the raider is not likely to offer more for the target's shares once it has achieved control. Retaining the target's shares in the face of a tender offer will bring the shareholder no benefit. He is likely to be forced out through a merger at a later date for the

43. *See* Wall St. J., May 10, 1976, at 16 (tombstone announcement of Airco *Offer to Purchase* at $30 per share). Airco received only 15% of Unitek's shares in response to the tender offer. *See, Airco Acknowledges It Failed in Attempt to Acquire Unitek,* Wall St. J., June 8, 1976, at 42, col. 2. Through subsequent purchases, Airco increased its holdings to 21.7%. *See* Wall St. J., March 22, 1977, at 21, col. 1. More than a year after the Airco offer at $30 per share Unitek was acquired by Bristol-Myers for $59.14 per share in a negotiated merger; another example of the shareholders winning by the rejection and defeat of a takeover.

same price he could have realized upon the initial offer.[44] The outcome of a shareholder referendum conducted in the form of a tender offer cannot realistically be said to reflect a careful appraisal of the merits or demerits of the offer. Each individual shareholder must look to his own interest and must pragmatically assume that most other shareholders will tender with the result that the nontendering shareholder will be left in a minority, illiquid investment position. Thus, any uncoerced decision *against* acceptance of a tender offer can *only* be made at the board of directors level.

The second factor which accounts for acceptance of tender offers by shareholders is the shift of equities from individuals to professional investment managers during the last 30 years; a shift that has closely paralleled the growth of institutions such as pension funds, private foundations and mutual funds. Today, practical control, *i.e.*, 20 percent to 50 percent of the stock of a large number of major corporations is held by professional investors. As predicted by A.A. Berle, we have now reached the tertiary stage of capitalism. Control of American business passed from the founder-shareholders to the professional managers who held sway until the 1970s and now, at least in the sense of ability to control in the event of a tender offer or proxy contest, to the professional managers of pension funds, foundations and mutual funds.[45] In addition to the holdings of the institutional investors, professional and amateur arbitrageurs will frequently purchase 10 percent to 50 percent of the shares of a target. While some of the arbitrage stock comes from the institutions, it is not infrequent that the institutions and arbitrageurs together quickly end up with a greater than 50 percent interest in a target and thus have the ability to determine its destiny. It is rare for a target to survive as an independent company after such a situation develops.

The only interest of the arbitrageur is in a quick sale at a profit. Some of the institutions may have a longer investment perspective, but in the competition to demonstrate performance among professional investment managers, the lure of improving performance and the ability of tax-exempt funds to realize gains without incurring any tax almost always results in a decision to sell even when there is no more attractive long-term investment available. Frequently this decision to sell is motivated in part by a desire to avoid becoming a minority holder—often with a loss of market liquidity—in a target that will be controlled by the raider. This is so even where the control is less than 50%.

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44. *See e.g.*, Singer v. Magnavox Co., *supra* n. 13. *See also* Borden & Weiner, *An Investment Decision Analysis of Cash Tender Offer Disclosure*, 23 N.Y.L. Sch. L. Rev. 553 (1978); Schwartz, *Response: Some Thoughts on the Directors' Evolving Role*, 30 Hast. L. Rev. 1405, 1406 n. 1 (1979).

45. *See generally* Berle, *The Modern Corporation Revisited*, 64 Colum. L. Rev. 1410 (1964); Berle & Means, The Modern Corporation and Private Property (1932); W. Cary, Corporations 229-37 (4th ed. unabridged 1969). *See also* Wellman v. Dickinson, [Current] Fed. Sec. L. Rep. (CCH) ¶ 96,918 (S.D.N.Y. July 9, 1979).

In sum, an unsolicited tender offer is often successful not because a majority of the shareholders of the target determine that it is a good acquisition, but because the dynamics of a tender offer trigger motivations by different minority segments of the shareholder body, such as those who:

a) believe that once the raider gets control it will probably move to obtain 100% ownership and it is unlikely that they will be able to realize any more for their shares than the takeover price;

b) need to show performance;

c) desire to avoid a loss of market liquidity;

d) believe that the raider is not a good manager;

e) desire not to be a minority shareholder in a controlled company;

f) have a tax incentive to sell;

g) fear poor treatment on a second step freezeout by the raider;

that in aggregate creates an *ad hoc* consortium of sellers of a majority of the shares of the target. The United Technologies Corporation tender offer for Carrier illustrates this point.[46] The tender offer, which was vigorously opposed and litigated by Carrier, was oversubscribed even though United Technologies had initially announced its willingness to negotiate a merger at a higher price than the tender offer price.

Even in the face of such an *ad hoc* consortium, the necessity from technological, social and economic standpoints for long-term planning by business requires a policy decision in favor of not mandating decisions that ignore or penalize long-term planning. Rather than forcing directors to consider only the short-term interests of certain shareholders, national policy requires that directors also consider the long-term interests of the shareholders and the company as a business enterprise with all of its constituencies in addition to the short-term and institutional shareholders. There would be a compelling argument for this result even if experience had proven that all takeovers turned out better for the shareholders of the target if they sold at the takeover price. Since experience proves that the decision to sell or remain independent is not clear, and that even when measured by comparing the rejected offer price with the market price, in more than 50 percent of the rejected takeovers the shareholders did better by the target remaining independent. There is no reason to remove the decision on a takeover from the reasonable business judgment of the directors. On the contrary, the policy considerations are overwhelmingly in favor of specific recognition that the directors not only have the right to make takeover decisions based on their

46. *See* discussion in n. 26, *supra*.

reasonable business judgment, but that macrosocioeconomic issues must be considered along with the long-term interests of the shareholders and the company as a business enterprise.

If the shareholders are dissatisfied with the directors' rejection of a takeover bid, they have the right, through the normal proxy machinery, to replace the directors or to instruct the directors to accept a takeover bid. This right, however, should not be translated into an absolute requirement that the directors pass to the shareholders the direct right to accept or reject any takeover bid. To do so would be the equivalent of mandating sale whenever an unsolicited takeover bid is made.

The proponents of direct reference to the shareholders point out that the usual procedure on a merger is for the directors to approve the merger agreement and refer the matter to a shareholder vote.[47] The proponents argue by analogy that substantially the same procedure should be followed with respect to unsolicited takeover bids and the directors should have the right, if they are so minded, to issue strong advice to reject the takeover. In the case of a merger, however, nonapproval by the directors means that it is not submitted to the shareholders. There is not, and there should not be, any requirement that, just because a raider requests approval or nonopposition by the directors of the target, they accede to the request without making the same study and determination they would make in the case of a negotiated merger.

Where the only issue in a tender offer is price, our present legal structure permits a raider, after compliance with the applicable federal and state laws, to short-circuit acceptance by the directors of the target and to make its offer directly to the shareholders of the target. The shareholders then have the power, independent of the directors, to determine whether or not to accept the offer. Even under the most far-reaching of the state takeover statutes, no tender offer has been blocked on the question of price.[48] The decisions are uniform that where there is a cash tender offer, the state will not determine what is a fair premium but will leave that determination to the shareholders.[49]

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47. *E.g.*, Model Bus. Corp. Act § 73; N.Y. Bus. Corp. Law § 903; Del. Corp. Law § 251(b), (c).

48. The general attitude of the state securities commissions has been to "rely on the market mechanism to assure fairness as to cash tender offers. . . ." *In re* EZ Paintr Corp., [1971-1978 Transfer Binder] Blue Sky Rep. (CCH) ¶ 71,063, at 67,318 (Wisc. Comm'r Sec., 1973).

49. *See* n. 43, *supra; In re* Elkhart Lake's Road America, Inc., 3 Blue Sky Rep. (CCH) ¶ 71,410 (Wisc. Comm'r Sec., 1977) ("We will not substitute our subjective evaluation of the shares' worth for that of the market"); *In re* Proposed Acquisition of CNA Financial Corp. by Loews Corp., Findings, Conclusions and Recommendations, Hearing No. 1522 (Ill. Dept. Ins. July 30, 1974) (" 'fairness' is an elusive concept at best and the decision of each stockholder . . . to sell or hold his securities is as good an evaluation as any"); *In re* Hein-Weiner Corp., 3 Blue Sky L. Rep. (CCH) ¶ 71,448, at 68,473, 68,479 (Wisc. Comm'r Sec., 1979) ("It is not the province of the Commissioner to determine whether a proposed takeover offer is desirable from a social or economic standpoint or whether the interests of the state or local community, or the employees or management of the target company, might be adversely affected by a successful takeover"). *See generally* Lipton & Steinberger, *supra* n. 36, at 254-58.

If that is the law and that is what has happened, why the issue? Primarily, because price is rarely the only issue. Most major takeovers raise other issues such as:

a) antitrust,[50]

b) regulatory approval,[51]

c) disclosures (actually failures to make material disclosures) by the raider,[52]

d) conflict of interest by those advising or financing the raider,[53]

e) impact on constituencies other than the shareholders of the target,[54]

f) poor quality of the raider's securities in an exchange offer.[55]

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50. *E.g.*, Berman v. Gerber Products Co., *supra* n. 3; Babcock & Wilcox Co. v. United Technologies Corp., *supra* n. 26; Carrier Corp. v. United Technologies Corp., *supra* n. 26.

51. *See e.g.*, Babcock & Wilcox Co. v. United Technologies Corp., *supra* n. 26 (question of need for approval of Nuclear Regulatory Commission). Examples of offers raising potential regulatory problems include the 1977 offer by Northwest Industries, Inc. for The Coca-Cola Bottling Company of Los Angeles (possible need for FCC approval; *see* Lipton & Steinberger, *supra* n. 36, at 170), the American Express offer for McGraw-Hill (possible need for FCC approval; *see, American Express Gets a Loan,* New York Times, Jan. 12, 1979, at § IV, p. 1, col. 4; *McGraw-Hill Replies to Suit,* N.Y. Times, Jan. 25, 1979, at § IV, p. 5, col. 6), and the recent attempts to buy National Airlines (possible need for CAB approval; *see, Airline Files to Control National Air,* N.Y. Times, July 29, 1978, at 23, col. 3; *Separate Study Set on Eastern Air's Bid For National Air,* Wall St. J., Dec. 22, 1978, at 8, col. 1). *See generally* Lipton & Steinberger, *supra* n. 36, at 169–72.

52. *E.g.*, Berman v. Gerber Products Co., *supra* n. 26; Jewelcor Inc. v. Pearlman, *supra* n. 38, at 233.

53. *E.g.*, Humana, Inc. v. American Medicorp, Inc., *supra* n. 6 (alleged conflict of interest of investment banker); Washington Steel Corporation v. TW Corp., Civ. No. 79-0166 (3d Cir. July 20, 1979) (alleged breach of fiduciary duty by financing bank). During the recent American Express bid for McGraw-Hill, McGraw-Hill asserted that there were conflicts of interest as a result of both the President of Amex' service on the McGraw-Hill board of directors, and the participation of McGraw-Hill's bank, Morgan Guaranty Trust Company, in the financing of the offer. *See, McGraw Rift: Focus on Role of a Director,* N.Y. Times, Jan. 18, 1979, at § IV, p. 1, col. 3; *McGraw-Hill Puts Outside Directors in Legal Limbo,* Wall St. J., Feb. 2, 1979, at 12, col. 3; *McGraw-Hill Bid Raises Questions on Bank's Role,* N.Y. Times, Jan. 23, 1979, at § IV, p. 1, col. 1; *Some Banks Accused of Conflicts of Interest in Hostile Takeovers,* Wall St. J., Mar. 16, 1979, at 1, col. 6.

54. *E.g.*, Herald Co. v. Seawell, *supra* n. 7 (impact of newspaper takeover on employees and the community). *See also* text accompanying nn. 30–31 *supra* (adverse reaction of authors and editors to attempted takeovers of Houghton Mifflin and McGraw-Hill).

55. *E.g.*, Humana, Inc. v. American Medicorp, Inc., *supra* n. 6, at 92,823, 92,824; *In re* Pabst Brewing Co., 3 Blue Sky L. Rep. (CCH) ¶ 71,415, at 68,354, 68,359–64 (Wisc. Comm'r Sec., June 6, 1978). During the recent exchange offer by Occidental Petroleum for Mead, Mead contended that the Occidental securities offered in exchange were a "bad investment". *See* The Takeover Crisis, *supra* n. 8, at 35.

At a recent NACD conference, NACD President I. Cummings advised directors to consider, when faced with a tender offer, such price related factors as whether the current market price was depressed and whether a better bid might be expected, and such non-price related factors as the effect of the offer on joint ventures, financing arrangements, and relationships with customers, suppliers, creditors and employees. *See, Heat on Directors, supra* n. 2, at 4.

In a negotiated merger these issues are sorted out in the screening and negotiating stages. One or more of these issues frequently cause the demise of a merger that both parties desire. In an unsolicited tender offer there is no opportunity to fully evaluate and negotiate them and, as noted above, the dynamics of the tender offer, as distinguished from the negotiated merger where there is an opportunity for careful advance consideration by the directors, assisted by counsel, accountants, investment bankers and other experts, often resulting in the holders of a majority of the shares of the target being coerced into accepting the tender offer without full exploration and consideration of the issues. In addition the directors of the target must take into account the impact on the target if they fail to take action to block a tender offer which they believe is or may be illegal and such tender offer is in fact subsequently enjoined or otherwise determined to have been illegal.[56] The failure of the target to attempt to defeat a tender offer which is later blocked by government or other action may result in loss of key employees, disaffection of customers and suppliers and other problems, with the result that the business of the target is damaged and the shareholders never get the opportunity to sell at the tender offer price. One possible result of such a situation might be a large arbitrage position, sufficient to determine control of the target, that is dumped by the arbitrageurs and purchased by a new raider, at a low price, who then is able to take over the target at a lower price than could have been obtained if the target was able to seek a buyer. The target of an unsolicited tender offer must successfully litigate or be faced with a *fait accompli* in much less time than a reasonable study of the same questions takes in a negotiated merger.[57] Thus the directors of the target are faced with two basic questions beyond price:

56. *See* nn. 59 and 65, *infra.*

57. Wachtell, *Special Tender Offer Litigation Tactics,* 32 Bus. Law. 1433 (1977), describes the lightning-fast timetable which governs in tender offer litigation:

> You are operating in a pressure atmosphere where you have constant surprise. You have very little turnaround time. The company goes running for counsel: help us. You have to commence litigation immediately. You have to get out your deposition notices. You have to make your motions for expedited discovery. You have to set up your teams for taking what could be two or three sets of simultaneous depositions, often in different cities. You have to be prepared to flow all the information you're getting from depositions and documents into affidavits and briefs almost simultaneously with the taking of the depositions and the review of the documents. You have to be scheduling your applications for temporary restraining orders, stays, preliminary injunctions and the like. You are essentially compressing into a span of four, five or six days what would normally be months and months, if not years, of typical big case litigation, including analysis of antitrust ramifications, industry studies, competitive lines of products and the like. It is unique.

Should (or must) they consider the legality and other policy aspects of the takeover (or an aborted takeover) or merely close their eyes and leave it to the shareholders and the government?[58]

Should (or must) they consider the impact of the takeover (or an aborted takeover) on constituencies other than the shareholders and is this an independent justification for rejection?

After five decades of continuous efforts both to raise the consciousness of directors with respect to antitrust, disclosure and other issues of national policy, and to impose on corporations and their directors obligations to employees, customers and communities, it is impossible to contemplate a rule that would vitiate these concerns when the question is solely whether the shareholders may have an opportunity immediately to realize a premium over the current market price for their shares. It can be argued that the directors

58. *E.g.*, when the directors of Reliance Electric Co. were recently confronted with a proposed tender offer by Exxon Corp. they decided neither to endorse nor oppose the offer, maintaining that "the stockholders of Reliance should determine for themselves whether to accept the offer if and when made by Exxon." *See, Reliance Electric Doesn't Oppose Exxon's Proposal,* Wall St. J., June 13, 1979, at 6, col. 1. In contrast, the board of Carrier Corp. fought United Technologies' proposed tender offer by, among other things, filing an antitrust action. *See* Carrier Corporation's *Notice of Special Meeting of Stockholders,* July 5, 1979. The government did indeed seek to enjoin the Exxon offer for Reliance. The following excerpt from an affidavit Felix G. Rohatyn submitted on behalf of Reliance in FTC v. Exxon Corp., No. 79-1975 (D.C.D.C. 1979) illustrates the point made in the text that the impact on the target of a determination that a tender offer is illegal may be severe:

> 6. We believe that if the purchase of the shares is not consummated by Exxon there will be extremely confused trading in Reliance stock for an indefinite period. There is likely to be heavy selling which would result in a drastic reduction of the price of Reliance stock. In such a market, Reliance would be unable to make a satisfactory equity offering of the type which had been an integral part of its financing program. This would make it necessary for Reliance to achieve its refinancing, at least at the first stage, entirely through a debt placement. This would be significantly more costly to Reliance because of the inability of Reliance to improve its equity base. In addition, Reliance would have reduced flexibility in future financial planning. As the costs to the Company increase, Reliance's ability to compete effectively would be negatively affected.
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> 7. During the period following collapse of the proposed acquisition the volatile trading in Reliance's stock would create a high level of probability that a third party, possibly foreign, could obtain control of the Company by purchasing stock at distressed prices. The mere fact that Reliance had experienced a substantial change in the composition of its shareholder body and had been identified as a desirable acquisition target would increase the probability that it would not be able to remain an independent entity following a failure to complete the proposed acquisition by Exxon.
>
> 8. It is also apparent that if the purchase of the shares is not completed and litigation continues, Reliance will be injured by the continuing uncertainty which will not only plague its financial planning but will undoubtedly harm its ability to attract and retain qualified personnel. As long as there is uncertainty about the future ownership and control of Reliance, its management will lack both direction and incentive in planning and implementing Reliance's future activities. As the uncertainty continues, Reliance will inevitably lose ground as an effective entity in its areas of operation; a company in limbo cannot remain an effective competitor.

Also see n. 61, *infra.*

should and must consider these issues,[59] which are not for the shareholders to decide directly any more than decisions to produce the Edsel, introduce Crest, buy the Xerox patents, compete with IBM, or file a bankruptcy petition were questions for direct answer by the shareholders of Ford, Procter & Gamble, Haloid, GE, and W.T. Grant. A takeover bid is no different than any other fundamental business decision. Many corporations annually or periodically face decisions with respect to capital expenditures, new product introductions, adoption of new processes, termination or disposition of businesses or bankruptcy,[60] that may have as significant an impact on the market value of the corporation as a takeover bid. As long as matters such as capital expenditures, discontinuances of businesses and bankruptcy are for the reasonable business judgment of the directors, there is no reason to put acceptance or rejection of a takeover bid on any different basis.[61] If the shareholders do not like the directors' decisions, they have the right and power to change the directors.

What the Directors Should Do

If we accept the premises that the directors of a target do not have an absolute duty to accept a takeover bid and that there is no absolute requirement that the question be referred for direct action by the shareholders, we are left only with the questions as to how the directors of a target should approach a takeover bid.

1) Are the management directors disqualified?

2) Should the independent directors or a committee of independent directors obtain separate legal and investment banking advice?

3) Must an investment banker be consulted or may the directors reach their own decision?

4) May the directors litigate any legal issues that may exist, even minor issues?

5) If the directors determine that the takeover is not in the best interests of the target, may they acquire a company that would create an antitrust or regulatory problem for the raider, issue additional shares

59. *See e.g.*, Gould v. American-Hawaiian Steamship Co., F.2d 761, 776-77 (3d Cir. 1976) (even disinterested directors are liable for failure to act to prevent violation of securities laws).

60. *See* n. 10, *supra*.

61. The courts have recognized in analogous areas that, even in extreme cases, the directors, not the shareholders, must make the business decisions for the corporation. *See e.g.*, Burks v. Lasker, 99 S. Ct. 1831 (1979) (committee of independent directors can stop derivative suit against other directors); Abbey v. Control Data Corp., *supra* n. 10 ("most important corporate decisions are to be made by the corporation's board of directors," and thus committee of independent directors can make decision to terminate derivative suit against other directors); Auerbach v. Bennett, No. 323 (N.Y. July 9, 1979) (decision by committee of independent directors to terminate derivative action is beyond judicial inquiry under the business judgment doctrine).

of the target to a big brother or purchase shares of the target at a premium for the purpose of defeating the takeover?

6) What standard should govern the directors' determination?

There are some takeover bids so devoid of antitrust or other legal issues and so attractive in price that no competent director would reject them. There are some takeover bids—particularly partial offers and exchange offers—that are so bad that only a negligent director would fail to oppose them. Our problem rests not with the extreme takeover bids which are so rare that they do not warrant special rules, but with the vast majority of takeover bids as to which reasonable men may differ as to price or the other issues. As to these, so long as the directors act in good faith and on a reasonable basis, their decision to accept or reject a takeover bid should not be subject to being second guessed. As noted above, as far as is known no director has ever been held liable for the rejection of a takeover bid and, if the guidelines set forth below are followed, it is hoped that none ever will.

Since we are dealing with takeovers which by definition are within a broad band of discretion, and since some might believe that there are conflicts between management's self-interest in preserving the independence of a target company and the directors' decision to accept or reject a takeover bid, it may be helpful to follow those procedures which in other areas have proven to eliminate or minimize conflicts and produce well founded objective decisions. Thus:

A) Management (usually with the help of investment bankers and outside legal counsel) should make a full presentation of all of the factors relevant to the consideration by the directors of the takeover bid, including:
   (1) historical financial results and present financial condition
   (2) projections for the next two to five years and the ability to fund related capital expenditures
   (3) business plans, status of research and development and new product prospects
   (4) market or replacement value of the assets
   (5) management depth and succession
   (6) can a better price be obtained now
   (7) timing of a sale; can a better price be obtained later
   (8) stock market information such as historical and comparative price earnings ratios, historical market prices and relationship to the overall market, and comparative premiums for sale of control
   (9) impact on employees, customers, suppliers and others that have a relationship with the target

(10) any antitrust and other legal and regulatory issues that are raised by the offer

(11) an analysis of the raider and its management and in the case of a partial offer or an exchange offer pro forma financial statements and a comparative qualitative analysis of the business and securities of both companies.

B) An independent investment banker or other expert should opine as to the adequacy of the price offered and management's presentation.[62]

C) Outside legal counsel should opine as to the antitrust and other legal and regulatory issues in the takeover and as to whether the directors have received adequate information on which to base a reasonable decision.[63]

D) If a majority of the directors are officers or otherwise might be deemed to be personally interested, other than as shareholders, a committee of independent directors, although not in theory necessary, from a litigation strategy standpoint may be desirable.[64] The exigencies and pressures of a takeover battle are such that it is desirable to avoid proliferation of committees, counsel and investment bankers. The target will be best served if it is advised by one investment banker and one outside law firm.

E) It is reasonable for the directors of a target to reject a takeover on any one of the following grounds:

(1) inadequate price

(2) wrong time to sell

(3) illegality

(4) adverse impact on constituencies other than the shareholders

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62. *See e.g.*, Kaplan v. Goldsamt, *supra* n. 4, at 568 (to extent that directors relied on responsible investment banker's reports, individuals cannot be held accountable for improper conduct); Danziger v. Kennecott Copper Corp., *supra* n. 4, at 7, col. 1, *aff'd on the opinion below*, 400 N.Y.S.2d 724 (reliance on investment banker's report evidence of directors' thorough consideration of transaction). The investment banker's opinion must be adequately prepared, however. In *In re* Royal Industries, Inc., [1976-1977 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 95,863 (C.D. Cal. 1976), the court held that it was misleading for the target to include in a press release the statement that it had been "guided" in its decision to reject the offer by an investment banker's report, because the report had been prepared "virtually overnight and without the necessary time and deliberation for a fair evaluation. . . ." *Id.* at 91, 139-40.

See generally Lipton & Steinberger, *supra* n. 36, at 291-92.

63. *Cf.*, Tannenbaum v. Zeller, 552 F.2d 402, 416-29 (2d Cir.), *cert. denied*, 434 U.S. 934 (1977) (in finding that directors of mutual fund did not breach fiduciary duty by decision to forego recapture of brokerage commissions, court stressed that "every administrative, judicial and legislative development pertaining to recapture" had been brought to board's attention, and stressed need for advice of outside counsel). *See also* Leech & Mundheim, The Outside Director of the Public Corporation 27 (1976).

64. *See* n. 51, *supra*.

(5) risk of nonconsummation[65]
(6) failure to provide equally for all shareholders
(7) doubt as to quality of the raider's securities in an exchange offer.

Once the directors have properly determined that a takeover should be rejected they may take any reasonable action to accomplish this purpose,[66] including litigation,[67] complaints to governmental authorities,[68] the acquisition of a company to create an antitrust or regulatory problem for the raider,[69]

65. Directors may properly take into account that even if the price is right, if the partner is wrong because of legal or other problems, the takeover may be enjoined or abandoned by the raider and the target may have suffered serious damage through employee, customer, or supplier disaffections without the shareholders having enjoyed the premium they thought they would get. This is a major factor in negotiated deals where one of the very early, if not first, steps is to determine whether antitrust or other legal problems make the merger impractical. It is even more important in takeover situations. *See* n. 59, *supra*.

66. *See* Northwest Industries, Inc. v. B.F. Goodrich Co., *supra* n. 4, at 712–13 ("[M]anagement has the responsibility to oppose offers which, in its best judgment, are detrimental to the company or its stockholders.... After [making a carefully considered decision] the company may then take any step not forbidden by law to counter the attempted capture"); Berman v. Gerber Products Co., *supra* n. 3, at 1323.

67. *See* n. 66, *supra*.

68. *Cf.*, Leech & Mundheim, *supra* n. 63, at 25–27:

> Despite ... obstacles to effective outside director action, it nevertheless may be desirable to establish a committee of outside directors whose major function would be to determine, from time to time, whether continuation of the fight against the tender offer makes sense. Management would inform the committee about its reasons for contesting the tender offer and about any other relevant facts. The committee would also meet separately with the company's investment bankers and outside counsel. The separate meetings with the outside professional consultants should help give the committee a sense of the available information on which the conclusion to continue the fight is based. Moreover, the need to deal with the outside directors and to answer their questions should remind the outside consultants of their responsibility to the corporation and place on them the burden of furnishing full information to the committee.
>
> The committee of outside directors may also have to consider whether it will meet separately with representatives of the offeror.

As set forth in the text we do not accept the Leech and Mundheim position. Indeed, we do not believe that a takeover bid presents the type of self-interest conflict that warrants abstention by the management directors or deference to an independent committee. *See*, Tyco Laboratories, Inc. v. Kimball, 444 F. Supp. 292 (E.D. Pa. 1977): "Thus, this Court is required to decide whether the directors' interest in retaining control allows for the corporation, as represented by its shareholders, to be substituted for the board of directors, in the formula for determining whether there has been a deception under section 10(b). This Court finds that the directors' interest in retaining control is not a sufficient interest to permit this Court to change the formula."

69. *E.g.*, Anaconda Co. v. Crane Co., *supra* n. 4; Altman v. Knight, 431 F. Supp. 309 (S.D.N.Y. 1977). *But see*, Royal Industries, Inc. v. Monogram Industries, Inc., *supra* n. 62, at 91,131, 91,136–37 ("If a tender offer target makes a defensive acquisition whose compelling reason or sole, controlling or primary purpose is to block a tender offer, the acquired company or its management violate ... their fiduciary duties to their shareholders. ...")

the issuance of shares to a big brother,[70] or the premium purchase of shares of the target from the raider.[71]

While in theory there should be no distinction in judicial treatment of the various tactics that may be selected by a target to defeat an unsolicited takeover, the courts appear to be forging a pragmatic distinction. Where the target asserts its legal rights through litigation and complaints to government authorities the standard seems to be the business judgment rule.[72] Where the target issues stock to a big brother, buys a company to create an antitrust block, purchases its shares from a raider at a premium or takes similar action, the standard seems to be a primary purpose rule—the action will be sustained unless the primary purpose was to keep the management in office rather than to serve the best interests of the company and its shareholders.[73] It may be argued that where the primary purpose test has been applied, the cases really turned on the courts' belief that the directors had not acted in good faith or on a reasonable basis, but rather than reach those issues, the court based the decision on the primary purpose test. Even where the courts have found a defensive tactic to have been improper and held the management directors who had a personal interest liable therefor, they have refused to find any liability on the part of the outside directors who did not benefit.[74] Where the directors have made a reasonable good-faith decision to reject the takeover on one or more of the bases set forth above, the business judgment rule should apply equally to any and all defensive tactics.

The Directors Meet

The process of consideration by a board of directors of a takeover bid is illustrated by the minutes of a recent meeting of the Board of Target Corporation.

"A special meeting of the Board of Directors of Target Corporation was held at the office of the Corporation at 10:00 A.M. on June 25, 1979. All of the directors were present. Also present were Mr. Thomas Thompson, Executive Vice President-Finance; Mr. Karl Freeman, Executive Vice President and General Counsel; Messrs. Robert Sachs and Stephen Redhill of Sachs,

70. *See e.g.*, Northwest Industries, Inc. v. B.F. Goodrich Co., *supra* n. 4; Klaus v. Hi-Shear Corp., *supra* n. 9. *But see* Applied Digital Data Systems, Inc. v. Milgo Electronic Corp., 425 F. Supp. 1145 (S.D.N.Y. 1977) (target's sale of unissued shares for the purpose of defeating tender offer violates § 14(e) if done without a valid business purpose).

71. *E.g.*, Heine v. The Signal Cos., *supra* n. 9; Cheff v. Mathes, *supra* n. 9.

72. *E.g.*, Berman v. Gerber Products Co., *supra* n. 3, at 1319-23; Humana, Inc. v. American Medicorp, Inc., *supra* n. 6, at 92,823, 92,833; Anaconda Co. v. Crane Co., *supra* n. 4.

73. *E.g.*, Cheff v. Mathes, *supra* n. 9, at 554-56; Anaconda Co. v. Crane Co., *supra* n. 4, at 1219-20; Podesta v. Calumet Industries, Inc., [1978 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 96,433, at 93,549, 93,551-57 (N.D. Ill. 1978); Royal Industries, Inc. v. Monogram Industries, Inc., *supra* n. 62, at 91,131, 91,135-38; Klaus v. Hi-Shear Corp., *supra* n. 9, at 233-34. *See generally* Fleischer, Tender Offers: Defenses, Responses and Planning 83-85, 147-52 (1978).

74. *E.g.*, Consolidated Amusement Co. v. Rugoff, *supra* n. 5, at 94,475, 94,485-86. *See also* Cheff v. Mathes, *supra* n. 9, at 553 (discussing lower court decision).

Morgan & Co., the Corporation's investment banker; Messrs. Joseph Lipton and Martin Flom of Skadden & Wachtell, special counsel to the Corporation, and Mr. Richard Martens of Cromwell & Polk, special counsel to Sachs, Morgan & Co.

"The Chairman stated that the business of the Special Meeting was consideration of the June 20, 1979 proposal by Raider Inc. to acquire all of the shares of the Corporation for $75 per share in cash. He noted that prior to the announcement of the June 20 proposal the market price of the shares was $40 and that the current market price is $68. He stated that this was one of the most serious matters that the Board of Directors of the Corporation had ever faced. He suggested that the Board take as much time as it deemed appropriate and said that arrangements had been made to continue the meeting through the day and thereafter if the Board so desired. He also expressed the desire that each director reach his or her own individual judgment and that no director feel in any way obligated to agree with the management of the Corporation. He requested that each director feel free to comment on the June 20 proposal and the presentations of the financial and legal advisers and that each director feel free to raise questions at any time.

"The Chairman stated that since 9 of the 13 directors were not employed by the Corporation and he and the other officer-directors did not feel any personal conflict of interest, it was management's recommendation that the June 20 proposal be considered by the Board as a whole and that it was not appropriate to establish a special committee of outside directors for that purpose. Mr. Freeman stated that in his opinion and that of Skadden & Wachtell there is no legal requirement that the Board delegate consideration of the June 20 proposal to a special committee or that the Corporation retain investment bankers and legal counsel who have had no prior relationships with the Corporation. The Board concurred unanimously in the management recommendation.

"The Chairman and Mr. Thompson then presented and explained in detail a summary of the Corporation's financial position, earnings and future prospects, a copy of which was distributed to each director. At the conclusion of this report, the Chairman stated that he and the management of the Corporation had complete confidence in both the short-range and the long-range future of the Corporation; that they believe this is not the time to sell or merge the Corporation; that they believe Raider is not the appropriate partner for the Corporation; and that they believe that if the Corporation were to accept the June 20 proposal, there would be serious legal questions with respect to a combination of the Corporation and Raider that would result in long delay before consummation, with a high risk of nonconsummation of the combination because of legal or regulatory prohibition, and that in the interim, the business of the Corporation would have been seriously adversely affected by the uncertainties created by the unresolved situation.

"The Chairman then asked Robert Sachs of Sachs, Morgan & Co. to report to the Board with respect to Sachs, Morgan's opinion of the June 20 proposal. Mr. Sachs introduced his partner, Stephen Redhill, who had participated with him since June 20 in a continuing study of the Corporation and Raider's proposal. Mr. Sachs also introduced Richard Martens, partner of Cromwell & Polk, special counsel to Sachs, Morgan. Mr. Sachs described in detail the study that had been performed by Sachs, Morgan, including the extensive work done for the Corporation prior to the assignment to study the June 20 proposal, and the Sachs, Morgan firm meeting held to discuss the June 20 proposal.

"Mr. Sachs stated that in the opinion of Sachs, Morgan, the June 20 proposal is inadequate from a financial viewpoint. Mr. Sachs further stated that in the opinion of Sachs, Morgan, this is not the appropriate time to undertake the sale or merger of the Corporation.

"Mr. Sachs then explained the analyses and procedures followed by Sachs, Morgan in reaching its conclusion. Director Pell asked Mr. Sachs to describe in more detail the factors that Sachs, Morgan studied and the methodology employed in reaching its opinion. Mr. Sachs gave a lengthy and detailed answer in which he described the various procedures followed by Sachs, Morgan and referred to the various work sheets that had been used in the Sachs, Morgan analysis of comparable acquisitions and the relative price earnings ratios reflected by such acquisitions. Mr. Sachs referred to several recent transactions and stated that in those transactions in which the acquired company had a return on equity comparable to that of the Corporation, the average price earnings ratio of the acquisition price was approximately 15 which would result in a substantially higher price for the Corporation than $75. Mr. Sachs noted that in several instances of recent transactions where the acquired corporation had a return on equity approximately 75 per cent of that of the Corporation, the acquisition price was at an average price earnings ratio that also would result in a price for the Corporation in excess of $75 per share. Mr. Sachs noted that the Corporation ranked 29 among the Standard and Poor's 425 industrial companies with respect to return on capital and that the consistency between the Corporation's forecasts and actual results (indeed, that results regularly exceeded forecasts) were highly favorable factors in merger valuation and negotiation.

"Director Smith asked whether Sachs, Morgan had delivered to the Corporation the analyses and other information used by it in its study of the Corporation and Raider's proposal. Mr. Sachs stated that these were internal working documents of Sachs, Morgan and not in form for delivery to the Corporation, although they were present at the meeting and he would be pleased to have the directors look at them and ask questions with respect to them.

"Director Tubbs asked Mr. Sachs whether Sachs, Morgan had taken into account the public policy aspects of a sale of the Corporation to Raider. Mr. Sachs replied that Sachs, Morgan confined its analysis to the financial aspects and that its opinion was based only on its judgment with respect to the present financial condition and future prospects of the Corporation and its judgment with respect to the timing and manner by which the optimum sale price could be achieved, if it were determined to sell or merge.

"Director Stone requested that Mr. Sachs explain the Sachs, Morgan view of the Corporation from an investment standpoint. Mr. Sachs replied that Sachs, Morgan believes the Corporation to be one of the best investment opportunities available today. Based on the recent history of the Corporation, Sachs, Morgan's opinion of the Corporation's management and personnel and Sachs, Morgan's opinion of the various businesses in which the Corporation is engaged, Sachs, Morgan believes that the Corporation will experience better than average growth and market acceptance in the 1980's. Mr. Sachs stated that if no takeover proposal had been made at this time and Sachs, Morgan had been consulted with respect to whether the Corporation should seek a sale or merger, Sachs, Morgan would have advised the Corporation that this is not the time so to do. Mr. Sachs added that Sachs, Morgan was very impressed with the planning and budgeting procedures followed by the Corporation and that Sachs, Morgan has confidence in the Corporation's projections of future earnings.

"Director Peters asked whether Sachs, Morgan had reached a determination as to what would be a fair price for the Corporation at this time. Mr. Sachs stated that Sachs, Morgan had not made such a determination but that Sachs, Morgan is of the opinion that a price higher than $75 per share could be obtained at this time. Mr. Sachs also noted that Sachs, Morgan believes that there are several companies that would be interested in acquiring the Corporation for more than $75 per share and that if the Corporation experiences three more years of sustained growth, as predicted, the value of the Corporation would be greatly enhanced.

"The Chairman asked Mr. Joseph Lipton to report on the opinion of Skadden & Wachtell. Mr. Lipton introduced his partner, Martin Flom. Mr. Lipton reviewed the opinion of Skadden & Wachtell, a copy of which had previously been furnished to each director. Mr. Lipton also reviewed in detail the legal issues inherent in a combination of Raider and the Corporation and described why his firm felt that there was a substantial likelihood that those problems would preclude the consummation of such a combination even if the Corporation were to accept the June 20 proposal. Mr. Lipton concluded by stating that the decision as to whether to accept or reject the June 20 proposal was one that the directors should make based on their own judgment; that the directors had before them an adequate basis on which to make the decision; and that while it should be assumed that if the directors were to reject the June

20 proposal, they would be named as defendants in shareholder lawsuits, they would in his firm's opinion be acting entirely properly and within the law and would not ultimately be held liable for such rejection.

"Director Lawton asked Mr. Lipton whether the Board could take the position that it would not pass on the matter and make no recommendation to the shareholders. Mr. Lipton replied that while on a narrow legal basis there was no requirement that the Board take a position, in his opinion the issue is so fundamental that the Board should take a position and that the Board should either accept or reject the June 20 proposal. Mr. Lipton stated that the Board should take all the time it felt appropriate to study and discuss the issue.

"Director Tubbs asked whether there were any precedents sustaining the rejection of an acquisition proposal on the sole ground that there were serious issues as to legality of a combination of the two companies. Mr. Lipton referred to the *Gerber* case and described the court's decision in detail.

"Director Pell asked whether in the opinion of counsel it would be illegal to accept the June 20 proposal. Mr. Lipton replied that his firm had not opined on the issue of whether it would be illegal for the Board to accept the June 20 proposal; that, if the Board deemed, based upon counsel's opinion, that the offer raised serious questions of legality, the issue of whether the Board would nonetheless be entitled to accept the proposal could not be said to be free from doubt. He said that the Board could take such serious legal questions and the consequent risks of nonconsummation of the proposed transaction into account in reaching its overall business judgment determination as to whether to accept or reject the June 20 proposal.

"Director Pell asked Mr. Lipton whether in the opinion of counsel the directors had an adequate basis on which to reach a decision at this time or whether the decision should be postponed. Mr. Lipton stated that the decision itself and the time of the decision were solely for determination by the Board: it was for the Directors to decide in their reasonable judgment how much time was appropriate for them to consider the matter. As previously stated, it was the opinion of counsel that the Board, if it should determine to go forward with its decision, presently had an adequate basis on which to make such decision. Mr. Lipton pointed out that the Board might wish to consider the potential for misunderstanding by shareholders and the public of any delay in reaching a decision and the impact on the market. The Chairman and several other directors voiced concern as to the effect of delay upon employee morale as well.

"Director Tubbs asked whether there were any issues which should be considered by the Board that had not been mentioned. The Chairman stated that he viewed employee morale and the impact on the Corporation of a nonconsummated transaction with Raider to be of great significance. He stated that the greatest risk of a transaction with Raider would be a collapse of employee morale and, if ultimately there were to be no transaction with

Raider, as he believed would be the case, the Corporation would have been seriously damaged without the shareholders having received the $75 price.

"Director Jones stated that on financial grounds he felt the long range interest of the Corporation would be best served by rejecting the June 20 proposal. Additionally, he expressed deep concern about the conduct of Raider in making its proposal in that Raider had obtained 80 percent of the funds necessary for the acquisition from the Fifth National Bank which is the principal bank for the Corporation and which had confidential information about the Corporation and that Raider had just prior to making the proposal attempted to hire the former Chairman of the Corporation as a consultant. Director Jones stated that he was so troubled by the ethics of Raider that he believed that Raider was not a company with which the Corporation should negotiate or contract. Director Jones noted that the nonconsummation of the transaction with Raider would be harmful to the Corporation in that he believed that going forward with such transaction would have a serious adverse effect on suppliers, customers and others on whom the Corporation is dependent for both products and sales.

"The Chairman noted that, although some shareholders had been quoted in support of the proposal, the Corporation had also received a number of letters from shareholders who were opposed to an acquisition of the Corporation by Raider.

"Director Jones asked whether if there was a new offer by a company other than Raider, would the Board consider it. The Chairman stated that it was his opinion that any bona fide offer must be considered by the Board and that if any such offers were presented to him he would refer them to the Board. The Chairman further stated that while he believes that it is important to its business that the Corporation remain an independent entity, if a new offer was extremely attractive from a financial standpoint, came from a responsible company with good employee, customer, supplier and community relationships, and there was a relatively low risk of nonconsummation of the transaction, it would be his recommendation that such an offer be carefully considered. The Chairman expressed his belief that an offer from the right company under the right circumstances might be understood and accepted by the employees, suppliers and customers and accordingly, there could be circumstances where an acquisition would present only minimal risk of harm to the Corporation and its shareholders if such a transaction were not consummated.

"Director Tubbs stated that he felt that he had all of the information and opinions necessary for him to reach a conclusion and that it appeared to him that the other directors felt the same way.

"Director Tubbs moved that the June 20 proposal be rejected and this motion was seconded by Director Jones. The Chairman requested legal

counsel to state such resolution for consideration by the Board, which Mr. Freeman did. The Chairman asked whether there was any further discussion.

"The Chairman called for a vote and the following resolution was unanimously adopted by an individual poll of the directors:

> "RESOLVED that based on the advice of the Corporation's management, legal counsel and investment bankers, the Board of Directors has determined that the proposal by Raider to acquire the Corporation for $75 cash per share of common stock as set forth in Raider's letter to the Board of Directors, dated June 20, 1979, is not in the best interests of the Corporation and its shareholders and that the Chairman of the Board is authorized and directed to inform Raider that such proposal has been rejected by the Board of Directors.

"There being no further business the meeting was adjourned at 4:00 P.M."

Conclusion

The answers to the questions with which we started are:

1) Directors are not required to accept any takeover bid that represents a substantial premium over market.

2) When faced with a takeover bid the directors are not required to declare an open auction and sell the company to the highest bidder.

3) The directors should consider the impact of the takeover on employees, customers, suppliers, and the community. National policy is a proper consideration.

4) If the directors believe that a takeover is not in the best interests of the company as a business enterprise, there is no requirement that the takeover bid be submitted by the directors to the shareholders.

5) The directors may not ignore clear legal issues. The directors may litigate any issue which they reasonably believe to be pertinent.

6,7,8) A company may have a policy of remaining an independent business entity. The directors may implement that policy with shark-repellent charter amendments, standstill agreements, premium purchases from potential raiders, specially lobbied local takeover laws, and special provisions in employee benefit plans and material contracts.

9) While the management directors are not disqualified from participating in the decision to accept or reject a takeover bid, procedures should be followed that assure both the appearance and the actuality of a good faith decision on a reasonable basis.

10,11) The advice of an investment banker as to the financial issues and legal counsel as to the legal issues is desirable. Prior consultation with investment bankers and legal counsel who have experience with mergers and takeovers so that the company and its directors are adequately prepared to deal with a takeover bid, if one should happen, is also desirable.

12) The business judgment rule applies to takeovers in the same manner as it applies to other major business decisions.

*) The fear of lawsuits should not deter directors from rejecting a takeover that they believe not to be desirable.

Defeated Tender Offers 1974 to June 1979*

	Target	Offering Company
(a)	Missouri Portland Cement Co.	Cargill, Inc.
	ICM Realty	Cabot, Cabot & Forbes Land Trust
	Towle Manufacturing Co.	Nortek, Inc.
	Funding Systems Corp.	Equimark Corp.
(b)	Latrobe Steel Co.	Eastmet Corp.
(c)	Dictaphone Corp.	Northern Electric Co., Ltd.
	RSC Industries, Inc.	Hoskins Manufacturing Co. (Armada Corp.)
(d)	Sterndent Corp.	Magus Corp. (Cable Funding Corp.)
(e)	Vail Associates, Inc.	Contran Corp.
(f)	Inspiration Consolidated Copper	Anglo-American Corp. of S. Africa
(g)	GSC Enterprises, Inc.	Sierra Capital Corp., Clyde Engle, Robert Weston
	Boyertown Burial Casket Co.	Amedco, Inc.
	National Paragon Corp.	R. T. French Co.
	Craddock-Terry Shoe Corp.	Caressa, Inc.
	Pargas, Inc.	Empire Gas Corp.
(h)	Unitek Corp.	Airco, Inc.
	Foremost McKesson Inc.	Sharon Steel Corp.
(i)	Braden Industries, Inc.	Valley Industries, Inc.
(j)	Sabine Royalty Corp.	Hamilton Brothers Corp.
	Universal Leaf Tobacco Co., Inc.	Congoleum Corp.
	Baird-Atomic	Xonics
	Sonesta International Hotel Corp.	Loews Corp.
	Sonesta International Hotel Corp.	Minneapolis Shareholders Group
	Gerber Products Co.	Anderson, Clayton & Co.
(k)	Detroit International Bridge	Wesco Financial Corp.
(l)	Pabst Brewing Co.	APL Corp.
(m)	Electro-Nite Co.	Yates Industries, Inc.
	Property Trust of America	Federated Reinsurance Corporation
	Marshall Field & Co.	Carter Hawley Hale Stores, Inc.
(n)	Rowan Companies, Inc.	CBI Industries, Inc.
	Mead Corp.	Occidental Petroleum Corp.
	Wurlitzer Co.	Xcor International Inc.
	McGraw-Hill Inc.	American Express Inc.
	Ludlow Corporation	AMBG Corporation
(o)	Chicago Rivet & Machine Co.	Mite Holdings Inc.
(p)	Sunshine Mining Co.	Hunt International Resources Corp.
	F. W. Woolworth Co.	Brascan Ltd.

*See p. 134 for footnotes to above exhibit

EXHIBIT A

Announcement	Market Price One Mo. Before Ann.	Market Price One Week Before Ann.	Offering Price	Premium	Market Price Aug. 10, 1979
12/19/73	$18.40	$17.80	$19.20	1.348x	$30.000(t)
2/4/74	14.87	16.87	13.50	0.800	11.375
2/20/74	7.00	7.25	11.50	1.586	28.250
3/15/74	2.62	2.62	3.00	1.145	2.500
6/7/74	6.25	6.25	11.00	1.760	14.280(t)
9/24/74	7.12	8.37	12.00	1.434	28.000(t)
12/19/74	1.00	0.87	2.00	2.299	3.125
2/13/75	8.75	9.25	14.00	1.514	21.625
4/28/75	5.75	6.62	10.00	1.511	11.250
5/28/75	34.25	31.75	32.00	1.008	33.000(t)
6/12/75	1.00	1.25	1.50	1.200	1.150(t)
12/22/75	10.50	10.50	16.00	1.524	11.500(q)
3/24/76	8.50	8.50	12.75	1.500	2.375
4/7/76	6.75	6.75	9.50	1.407	10.375
5/5/76	13.00	15.37	18.50	1.204	18.500
5/7/76	24.00	23.12	30.00	1.298	59.140(t)
5/17/76	15.50	16.62	27.00	1.625	24.000
6/29/76	5.12	4.75	7.25	1.526	7.000(r)
9/22/76	21.50	22.19	30.00	1.352	40.125(s)
10/8/76	12.13	11.94	16.25	1.362	23.125(s)
1/27/77	2.38	2.50	4.00	1.600	6.375
4/6/77	3.00	3.25	7.00	2.154	12.000
7/1/77	5.25	5.25	7.00	1.333	12.000
8/1/77	29.75	32.62	37.00	1.134	28.125
9/29/77	17.00	17.25	20.00	1.159	25.000(t)
10/20/77	25.25	24.25	40.00	1.649	12.875
12/14/77	7.75	7.75	10.00	1.290	14.250
1/19/78	5.12	4.75	6.00	1.263	6.188
2/1/78	32.75	29.62	42.00	1.418	17.875
7/3/78	17.75	22.37	24.50	1.095	27.875
8/11/78	21.50	23.25	35.00	1.505	26.750
9/25/78	11.75	18.50	22.00	1.189	8.875
1/9/79	24.12	24.37	34.00	1.395	26.625
2/9/79	12.37	13.12	19.00	1.448	16.125
2/12/79	22.00	28.62	31.00	1.083	20.375
2/14/79	11.12	12.87	15.00	1.166	14.375
4/9/79	22.00	23.25	35.00	1.505	25.875

FOOTNOTES:

(a) Subsequently acquired by H. K. Porter Company through a $26 per share tender offer in January 1976 and a merger in which each share of Missouri Portland received $30 principal amount of 10% subordinated debentures. Missouri stock split 5-4 in January 1974.
(b) Subsequently acquired by merger by LSC, Inc. (The Timken Company) in January 1975 at the rate of .48 shares of Timken per share of Latrobe, valued at $14.28 per share.
(c) Subsequently acquired by PB Holding Corp., a subsidiary of Pitney-Bowes Inc., in December 1978 at $28 per share.
(d) Cooper Laboratories Inc. obtained approximately 22% in November 1978 by open market purchases. Merger discussions are continuing concerning Cooper's $28 offer for the rest of Sterndent's common. Cooper revised the offer in August 1979 from $28 cash to $3 cash and $25 in 10% 20-year notes.
(e) Goliad Oil and Gas Co. acquired 400,000 shares in September 1976 at $14 per share.
(f) Subsequently acquired by Hudson Bay Mining and Smelting, an indirect subsidiary of Anglo American, in July 1978 for $33 per share.
(g) Subsequently acquired by merger by 13 dissident shareholders including Engle and Weston in October 1977 at the rate of $1.15 face value of 8½% capital notes per share.
(h) Subsequently acquired by Bristol-Myers in November 1977 at the rate of 1.733 shares of Bristol-Myers for each share of Unitek, valued at $59.14 per share.
(i) Valley Industries obtained approximately 23% pursuant to its offer, increasing its holdings to 28%. Braden partially liquidated in January 1977 with a liquidating distribution of $7.52.
(j) Rejected a tender offer by Hamilton Brothers Petroleum Corp. for $60 a share in September 1976. Sabine signed a letter of intent for a tax-free merger, but negotiations broke down on price.
(k) Wesco obtained approximately 14.3% pursuant to its offer, increasing its holdings to 24.9%. Subsequently, Central Cartage Co. and Fallbridge Holdings Ltd. acquired approximately 49.5% in open market purchases and offered $25 per share for the remainder. The offer is currently enjoined.
(l) Price represents principal amount of 10% debenture offered in exchange for each Pabst share.
(m) Yates obtained approximately 8.1% pursuant to its offer, increasing its holdings to 20.8%.
(n) Schlumberger acquired approximately 18% in October 1978 by open market purchases.
(o) Mite Corporation had agreed to make a tender offer for $31 a share in February 1979, but withdrew the offer in March 1979.
(p) Hunt International Resources Corp. had owned 28% since October 1977. Sunshine Mining Co. repurchased these shares in June 1979 subsequent to an unsuccessful takeover bid in March 1979.
(q) Last bid recorded on May 23, 1979.
(r) Last bid recorded on March 13, 1979.
(s) Offer price and market prices prior to offer reflect two-for-one stock split.
(t) Represents value of final tender offer or merger.