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Anthony Augliera

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# SHAREHOLDER RIGHTS PLANS: SAYING NO TO INADEQUATE TENDER OFFERS

## INTRODUCTION

In *Moran v. Household International, Inc.*,<sup>1</sup> the Delaware Supreme Court upheld the share purchase rights plan ("rights plan" or "poison pill") as a legitimate defensive mechanism "in the arsenal of corporate takeover weaponry."<sup>2</sup> Although *Moran* settled the controversy in Delaware<sup>3</sup> surrounding the poison pill's legality,<sup>4</sup> the recent increase in takeover activity has rekindled the poison pill debate.<sup>5</sup> The issue now, however, is whether and under what circumstances a board of directors has a duty to redeem a poison pill<sup>6</sup> during a takeover attempt.<sup>7</sup>

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1. 500 A.2d 1346 (Del. 1985).

2. *Id.* at 1348.

3. *See id.* at 1357. The law of the state of incorporation governs the board's defensive actions during a takeover contest. *See* *McDermott Inc. v. Lewis*, 531 A.2d 206, 215 (Del. 1987); *cf.* *CTS Corp. v. Dynamics Corp. of America*, 481 U.S. 69, 91 (1987) (state has authority to regulate the affairs of domestic corporations). Delaware law applies in most of the takeover cases because most corporations are incorporated in Delaware. *See* Romano, *The State Competition Debate in Corporate Law*, 8 Cardozo L. Rev. 709, 720-25 (1987). Moreover, because Delaware offers a sophisticated court and a large body of case law its decisions are often followed by other courts. *See, e.g.*, *Dynamics Corp. of America v. CTS Corp.*, 794 F.2d 250, 253 (7th Cir. 1986) ("Indiana takes its cues . . . from the [more experienced] Delaware courts"), *rev'd on other grounds*, 481 U.S. 69 (1987). However, recent unfavorable decisions involving the poison pill have caused the creator of the poison pill, Martin Lipton, to suggest that clients consider incorporating outside of Delaware. *See* Cohen, *Lipton Tells Clients That Delaware May Not Be a Place to Incorporate*, Wall St. J., Nov. 11, 1988, at B7, col. 1.

4. Subsequently, other courts also approved of the poison pill. *See, e.g.*, *Dynamics Corp. of America v. CTS Corp.*, 635 F. Supp. 1174 (N.D. Ill.) (applying Indiana law), *aff'd in part, vacated in part*, 805 F.2d 705 (7th Cir. 1986); *Harvard Indus. v. Tyson*, [1986-1987 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 93,064 (E.D. Mich. Nov. 25, 1986) (applying Michigan law); *Horwitz v. Southwest Forest Indus.*, 604 F. Supp. 1130 (D. Nev. 1985) (applying Nevada law). Some courts have invalidated rights plans with flip-in provisions on the ground that they discriminate among shares of the same class. *See* *Asarco Inc. v. M.R.H. Holmes A. Court*, 611 F. Supp. 468, 480 (D.N.J. 1985); *Bank of New York Co. v. Irving Bank Corp.*, 536 N.Y.S.2d 923 (N.Y. Sup. Ct. 1988). Flip-in provisions allow target shareholders, other than the bidder, to purchase the target's shares at half price once the provision is triggered. *See infra* notes 37-39 and accompanying text. Other courts have upheld the flip-in provision as discriminating only against shareholders based on the number of shares they own. *See* *Dynamics Corp. of America v. CTS Corp.*, 805 F.2d 705, 718 (7th Cir. 1986); *Gelco Corp. v. Coniston Partners*, 652 F. Supp. 829, 847-48 (D. Minn. 1986), *aff'd in part, vacated in part*, 811 F.2d 414 (8th Cir. 1987); *Harvard Indus.*, Fed. Sec. L. Rep. (CCH) ¶ 93,064, at 95,924; *see also* Note, *Shareholder Rights Plans: Shields or Gavels?*, 42 Vand. L. Rev. 173, 192-99 (1989) (discussing the validity of poison pills under state law).

5. *See* Labaton, *The "Poison Pill" Takes a Beating*, N.Y. Times, Nov. 14, 1988, at D2, col. 1. Indeed, the most contested issue during the 1988 proxy season involved poison pills. *See* Hetherington, *Rights Plans: Reasonable Response to Threat*, N.Y.L.J., Sept. 28, 1988, at 38, col. 1.

6. *See* Cohen, *Lipton Asserts Corporate Boards Can Simply Reject Hostile Offers*, Wall St. J., Nov. 4, 1988, at B5, col. 1; *see also* O'Connell, *Defenses Help Boost Return to Shareholders*, N.Y.L.J., Sept. 28, 1988, at 38, col. 1 (board's refusal to redeem a rights plan is the most frequently litigated issue in rights plan cases).

The fiduciary standard applied when a board is faced with a request to redeem a rights plan is the test developed in *Unocal Corp. v. Mesa Petroleum Co.*<sup>8</sup> Before the board receives the protection of the business judgment rule,<sup>9</sup> the board must show first that it had "reasonable grounds for believing that a danger to corporate policy and effectiveness existed" and second, that the defensive mechanism was "reasonable in relation to the threat posed."<sup>10</sup>

Courts generally hold that a board does not breach its fiduciary duties when it refuses to redeem a rights plan in the face of two-tiered and partial tender offers.<sup>11</sup> Both types of tender offers are considered coer-

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7. Some changes in corporate control, such as a merger, are negotiated or "friendly" acquisitions. The management of the two corporations bargain over the terms, conditions and future management. If the target corporation's board of directors approves of the merger, it is submitted to the corporation's shareholders for approval. When a "friendly acquisition" cannot be arranged, the bidder may seek to gain control through a hostile takeover. The bidder makes a tender offer directly to the shareholders, thereby bypassing the board of directors. See L. Solomon, D. Schwartz & J. Bauman, *Corporations, Law and Policy: Materials and Problems* 1033-34 (2d ed. 1988); see also E. Aranow & H. Einhorn, *Tender Offers for Corporate Control* 70 (1973) (a tender offer is "[a] public offer or solicitation by a company, an individual or a group of persons to purchase during a fixed period of time all or a portion of . . . securities of a publicly held corporation at a specified price or upon specified terms for cash and/or securities"). Congress regulates tender offers through the Williams Act. Corporate Equity Ownership-Disclosure (Williams) Act, Pub. L. No. 90-439, 82 Stat. 454 (codified as amended at 15 U.S.C. § 781-78n (1982 & Supp. IV 1986)). Other less frequently used methods of gaining control include proxy contests, see L. Solomon, D. Schwartz & J. Bauman, *supra*, at 1040-43, and market sweeps, see Note, *Proposed SEC Regulation of Market Sweeps: Should Market Sweeps Be Governed By The Williams Act?*, 56 *Fordham L. Rev.* 797 (1988).

8. 493 A.2d 946 (Del. 1985). The *Unocal* test represents the Delaware rule in the takeover context, and has been followed in other states. See *Amanda Acquisition Corp. v. Universal Foods Corp.*, 708 F. Supp. 984, 1009 (E.D. Wis.) (applying Wisconsin law), *aff'd on other grounds*, 877 F.2d 496 (7th Cir. 1989); *Gelco Corp. v. Coniston Partners*, 652 F. Supp. 829, 845 (D. Minn. 1986) (applying Minnesota law), *aff'd in part, vacated in part*, 811 F.2d 414 (8th Cir. 1987). Some states, such as Ohio, have rejected the *Unocal* test and have instead codified the traditional business judgment rule even in the takeover context. See Ohio Rev. Code Ann. § 1701.59(C) (Anderson 1985 & Supp. 1988).

9. See *infra* notes 56-61 and accompanying text.

10. *Unocal*, 493 A.2d at 955. After the *Moran* court concluded that the board had the authority to adopt the rights plan, the court applied the *Unocal* test to examine whether the board met its fiduciary burdens. See *Moran v. Household Int'l, Inc.*, 500 A.2d 1346, 1355-56 (Del. 1985). The court held that the board had fulfilled its fiduciary obligations under *Unocal* in adopting the rights plan. See *id.* at 1357. Moreover, the court indicated that the board's ultimate response in determining whether or not to redeem a rights plan would be judged by the *Unocal* standard. See *id.* Thus, courts have applied this test when considering whether the board should redeem a rights plan during a takeover attempt. See *City Capital Assocs. v. Interco Inc.*, 551 A.2d 787, 790 (Del. Ch. 1988); cf. *Southdown, Inc. v. Moore McCormack Resources, Inc.*, 686 F. Supp. 595, 600-02 (S.D. Tex. 1988) (citing *Unocal* standard, but stating that "the standard to be applied should be whether a fully informed, wholly disinterested, reasonably courageous director would dissent from the board's act in any material part").

11. See *Desert Partners, L.P. v. USG Corp.*, 686 F. Supp. 1289, 1298-99 (N.D. Ill. 1988); *CRTF Corp. v. Federated Dep't Stores, Inc.*, 683 F. Supp. 422, 440 (S.D.N.Y. 1988). A partial tender offer is an offer to buy a controlling interest in a corporation, but less than all of its shares. A two-tiered tender offer is a partial tender offer plus an an-

cive<sup>12</sup> and therefore a threat to a corporation and its shareholders. A rights plan may also be kept in place to assist a corporation, after the first offer, to sell itself to the highest bidder in an auction,<sup>13</sup> in which case the board is charged with getting the highest price for their shareholders.<sup>14</sup>

Courts and commentators, however, debate whether a board should be forced to redeem rights when the bidder has made an all-cash offer for 100 percent of a target's shares<sup>15</sup> which the board considers inadequate.<sup>16</sup> An all-cash, all-shares offer, unlike two-tiered offers, has been viewed as noncoercive and therefore not a threat to shareholders.<sup>17</sup> The board typically refuses to redeem the rights plan because it concludes after an evaluation study that the hostile tender offer is financially inadequate.<sup>18</sup> As

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nounced plan to follow up with a second step merger to eliminate the remaining shareholders. In most instances, less consideration is offered in the second step than in the first step. See Finkelstein, *Antitakeover Protection Against Two-Tier and Partial Tender Offers: The Validity of Fair Price, Mandatory Bid, and Flip-over Provisions Under Delaware Law*, 11 Sec. Reg. J. 291, 293 (1984); Note, *Protecting Shareholders Against Partial and Two-Tiered Takeovers: The "Poison Pill" Preferred*, 97 Harv. L. Rev. 1964, 1966-67 (1984).

12. Two-tiered tender offers and partial tender offers are considered coercive because they pressure shareholders into tendering in the first tier out of fear of receiving less value in the back end of the transaction or of becoming locked in as holders of devalued minority shares. See *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 956 (Del. 1985); see also 1 M. Lipton & E. Steinberger, *Takeovers & Freezeouts* § 1.08[1] (1988); *infra* notes 80-82 and accompanying text.

13. In *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986), the court stated that an auction arises when it becomes apparent to all that the break-up of the company is inevitable and that the company will be sold. See *id.* at 182; *infra* notes 74-79 and accompanying text.

14. See *infra* notes 74-79 and accompanying text.

15. Although bidders offer to purchase all of the target's outstanding shares, they usually condition the offer upon a certain percentage of shares being tendered. See *City Capital Assocs. v. Interco Inc.*, 551 A.2d 787, 792 (Del. Ch. 1988).

16. Compare *Amanda Acquisition Corp. v. Universal Foods Corp.*, 708 F. Supp. 984, 1013-16 (E.D. Wis.) (board permitted to reject an inadequate all-cash, all-shares offer), *aff'd on other grounds*, 877 F.2d 496 (7th Cir. 1989) and *Gelco Corp. v. Coniston Partners*, 652 F. Supp. 829, 849-50 (D. Minn. 1986) (same), *aff'd in part, vacated in part*, 811 F.2d 414 (8th Cir. 1987) and *Cohen, supra* note 6, at B5 (noting view that board may reject inadequate tender offers) with *Grand Metro. Pub. Ltd. v. The Pillsbury Co.*, 558 A.2d 1049, 1060 (Del. Ch. 1988) (holding board's refusal to redeem rights plan unreasonable) and *City Capital Assocs. v. Interco Inc.*, 551 A.2d 787, 798-800 (Del. Ch. 1988) (same) and *Oesterle, Target Managers as Negotiating Agents for Target Shareholders in Tender Offers: A Reply to the Passivity Thesis*, 71 Cornell L. Rev. 53, 87 n.115 (1985) (board's ability to defeat tender offer for 100% of stock should be limited).

17. See *City Capital Assocs. v. Interco Inc.*, 551 A.2d 787, 796 (Del. Ch. 1988); *Robert M. Bass Group, Inc. v. Evans*, 552 A.2d 1227, 1239 (Del. Ch. 1988). Since all-cash, all-shares offers allow shareholders to tender all of their shares, shareholders are not subject to proration risks. See 1 M. Lipton & E. Steinberger, *supra* note 12, at § 1.09[3]. However, for a discussion of the coercive effect inherent in all tender offers, see notes 143-53 and accompanying text.

18. A board might refuse to redeem rights and reject the takeover bid for reasons other than price inadequacy. See *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 955 (Del. 1985) (board may consider the impact of proposed transaction on "constituencies" other than shareholders, including creditors, customers, employees and perhaps even community in general). The *Unocal* "constituencies" concept has also been codified

an alternative to the tender offer, the board may propose to its shareholders a financial restructuring that is designed to provide greater short-term value than the tender offer.<sup>19</sup> The board may also decide to "just say no" to the tender offer by rejecting the offer, declining to propose an alternative transaction and determining to proceed with the company's long-term business plan.<sup>20</sup> In either case, bidders argue that because the offer is noncoercive and the only arguably objectionable feature of the offer is price, the board should only be allowed to present information about the offer and not to use the rights plan to prevent shareholders from deciding whether to accept the offer.<sup>21</sup>

Some courts hold that an inadequate all-cash, all-shares offer represents a threat under *Unocal* and that a board's refusal to redeem rights is, therefore, a reasonable response.<sup>22</sup> These courts reason that a board has a duty to protect the corporation and shareholders from harm, and consider an inadequate offer harmful.<sup>23</sup> Certain Delaware Chancery Court cases, however, have indicated that a board may not preclude shareholders from acting on an all-cash, all-shares tender offer.<sup>24</sup> In *City Capital Assocs. v. Interco Inc.*<sup>25</sup> and *Grand Metro. Pub. Ltd. v. The Pillsbury*

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by many states. See Ohio Rev. Code Ann. § 1701.59(E) (Anderson Supp. 1988); Me. Rev. Stat. Ann. tit. 13-A, § 716 (Supp. 1988); Minn. Stat. Ann. § 302A.251 (West Supp. 1989); Mo. Ann. Stat. § 351.347(4) (Vernon Supp. 1989). Whether a board may reject a tender offer based on its effect on noninvestor interests is hotly debated. Compare Lipton, *Takeover Bids in the Target's Boardroom*, 35 Bus. Law. 101, 106 (1979) ("Our present system of corporate governance places the directors at the center of corporate decision-making and has expanded the corporation's responsibilities to safeguard interests broader than those of shareholders alone.") with Easterbrook & Fischel, *The Proper Role of a Target's Management in Responding to a Tender Offer*, 94 Harv. L. Rev. 1161, 1191 (1981) (management is only accountable to shareholders). Price inadequacy, however, is invariably the primary reason given for rejecting an offer and this Note focuses on whether a board can refuse to redeem rights based on its inadequacy determination. For a discussion of inadequacy, see *infra* note 90.

19. For an example of such a response, see *Interco*, 551 A.2d at 793-94.

20. Commentators have termed the board's actions when it does not propose an alternative transaction the "just say no" defense. See Cohen, *supra* note 6, at B5; see also Norris, *Universal Foods' Takeover Defense*, N.Y. Times, Mar. 31, 1989, at D8, col. 1 (in "just say no" defense, board asserts that proposed takeover is unwise and uses its poison pill to prevent shareholders from selling shares to bidder).

21. See *Grand Metro. Pub. Ltd. v. The Pillsbury Co.*, 558 A.2d 1049, 1053-54 (Del. Ch. 1988); *City Capital Assocs. v. Interco Inc.*, 551 A.2d 787, 798 (Del. Ch. 1988).

22. See *BNS Inc. v. Koppers Co.*, 683 F. Supp. 458, 475 (D. Del. 1988) (declining to order redemption of rights plan because an inadequate offer represents a threat to shareholders); *Gelco Corp. v. Coniston Partners*, 652 F. Supp. 829, 849 (D. Minn. 1986) (applying Minnesota law) (board's refusal to redeem rights plan was reasonable response to inadequate offer), *aff'd in part, vacated in part*, 811 F.2d 414 (8th Cir. 1987); *Nomad Acquisition Corp. v. Damon Corp.*, [1988-1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,040, at 90,872 (Del. Ch. Sept. 16, 1988).

23. See *BNS*, 683 F. Supp. at 475; *Gelco*, 652 F. Supp. at 849; *Nomad*, Fed. Sec. L. Rep. at 90,872.

24. See *Pillsbury*, 558 A.2d at 1060; *Interco*, 551 A.2d at 799-800. But see *Nomad*, Fed. Sec. L. Rep. (CCH) at 90,872 (Delaware Chancery Court allowing board to reject inadequate tender offer).

25. 551 A.2d 787 (Del. Ch. 1988).

Co.,<sup>26</sup> the Delaware Chancery Court held that a board may keep a rights plan in place to buy time to consider and develop alternatives, but once the end-stage<sup>27</sup> of a takeover contest is reached, the board must redeem the rights and allow shareholders to decide the merits of the tender offer themselves.<sup>28</sup>

This Note examines the fiduciary duty of a board that is faced with a request to redeem rights after the bidder has made an all-cash, all-shares tender offer that the board considers inadequate. Part I describes the mechanics of a rights plan and the fiduciary duties governing requests to redeem rights. This part analyzes the board's duties to redeem a rights plan in the contexts of auctions and two-tiered tender offers, and also reviews the Delaware Chancery Court's recent holdings in all-cash, all-shares tender offer situations. Part II examines whether a board breaches its fiduciary duties by refusing to redeem a rights plan when the bidder has made an all-cash, all-shares tender offer which the board considers inadequate and discusses the shortcomings of the *Interco* end-stage approach. Part III outlines the considerations that are appropriate in evaluating a board's decision to reject an offer based on price inadequacy. This Note concludes that all-cash, all-shares tender offers are coercive, and that a board should be allowed to refuse to redeem rights if it has reasonably concluded that a tender offer is inadequate.

## I. THE POISON PILL AND FIDUCIARY STANDARDS GOVERNING REDEMPTION

### A. *The Mechanics of the Poison Pill*

A poison pill is a defensive mechanism that a board of directors may adopt in response to, or in anticipation of, a takeover attempt.<sup>29</sup> "The device most frequently associated with the term 'poison pill' is the Share Purchase Rights Plan."<sup>30</sup>

Generally, the rights plan enables a board to create and distribute to its common stockholders a dividend of one right to purchase common or preferred stock, or both, of the issuer (target) or the acquiring entity.<sup>31</sup> Initially, the rights are transferrable only with the common stock and are

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26. 558 A.2d 1049 (Del. Ch. 1988).

27. See *Interco*, 551 A.2d at 798. For a discussion of the end-stage of a takeover attempt, see *infra* notes 154-56 and accompanying text.

28. See *Pillsbury*, 558 A.2d at 1060; *Interco*, 551 A.2d at 798.

29. See Dawson, Pence & Stone, *Poison Pill Defensive Measures*, 42 Bus. Law. 423 (1987).

30. 1 M. Lipton & E. Steinberger, *supra* note 12, at § 6.03[4][a]. Poison pills of this nature are similar to the rights plan upheld in *Moran v. Household Int'l, Inc.*, 500 A.2d 1346, 1353-57 (Del. 1985). See generally Chittur, *Wall Street's Teddy Bear: The Poison Pill as a Takeover Defense*, 11 J. Corp. L. 25, 26-32 (1985) (discussing earlier versions of the poison pill).

31. See 1 M. Lipton & E. Steinberger, *supra* note 12, at § 6.03[4]; Dawson, Pence & Stone, *supra* note 29, at 426-27.

not exercisable.<sup>32</sup> However, once a triggering event<sup>33</sup> occurs, separate rights certificates are distributed to the common stockholders and the rights become exercisable.<sup>34</sup>

Although the rightholder is entitled to purchase either the issuer's common or preferred stock once a triggering event occurs, the exercise price of the right makes this purchase economically unfavorable to the rightholder.<sup>35</sup> Exercise of the right becomes financially worthwhile only if the bidder triggers either the flip-in or flip-over provisions of the plan which deter takeovers by increasing the cost of acquisition.<sup>36</sup>

The flip-in provision is triggered if the bidder acquires a specified amount of the issuer's stock.<sup>37</sup> The provision enables common stockholders of the issuer (the target) to purchase stock in the issuer at a discount, typically at half price.<sup>38</sup> This in turn substantially increases the shares the bidder must acquire. Thus, the flip-in provision makes an acquisition far more expensive because it dilutes the investment and voting power of an acquiring entity.<sup>39</sup>

The flip-over provision is triggered if the bidder attempts to acquire

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32. See *id.*

33. See *Desert Partners, L.P. v. USG Corp.*, 686 F. Supp. 1289, 1291 (N.D. Ill. 1988); *CRTF Corp. v. Federated Dep't Stores, Inc.*, 683 F. Supp. 422, 437 (S.D.N.Y. 1988). A triggering event is usually the earlier of ten days after an entity acquires a certain percentage of the issuer's stock (typically 20%) or commences a tender offer that would result in the acquiring person (the bidder) owning a certain percentage of the issuer's stock (typically 30%). See *Federated Dept. Stores*, 683 F. Supp. at 437.

34. See Dawson, Pence & Stone, *supra* note 29, at 427.

35. See *id.* The exercise price is intended to reflect the company's long-term value. See *Desert Partners*, 686 F. Supp. at 1296 & n.14. The price, however, is usually "out of the money" and does not have much impact on the effect of the plan. See *Moran v. Household Int'l, Inc.*, 490 A.2d 1059, 1066 (Del. Ch.), *aff'd*, 500 A.2d 1346 (Del. 1985); see also *Federated Dep't Stores*, 683 F. Supp. at 437 (shareholders will not purchase stock because exercise price of right is disadvantageous).

36. See Dawson, Pence & Stone, *supra* note 29, at 427-28.

37. See *Amanda Acquisition Corp. v. Universal Foods Corp.*, 708 F. Supp. 984, 1006 (E.D. Wis.), *aff'd on other grounds*, 877 F.2d 496 (7th Cir. 1989); *City Capital Assocs. v. Interco Inc.*, 551 A.2d 787, 791 (Del. Ch. 1988). Some rights plans contain flip-in provisions that are triggered upon the occurrence of a self-dealing transaction involving the issuer. See Dawson, Pence & Stone, *supra* note 29, at 428.

38. For example, assuming an exercise price of \$75.00, the rightholder would be able to purchase \$150.00 worth of its own company's stock for \$75.00. Thus, if the company's stock is trading at \$35.00 in the market, the provision allows each shareholder to purchase at a 50 percent discount over four new shares for each share held. See *Universal Foods Corp.*, 708 F. Supp. at 1006; Dawson, Pence & Stone, *supra* note 29, at 428.

39. The dilutive effect of a flip-in provision was noted in *Grand Metro. Pub. Ltd. v. The Pillsbury Co.*, 558 A.2d 1049, 1051 n.2 (Del. Ch. 1988). The exercise price of Pillsbury's rights plan was \$100.00. Under the rights plan, once the triggering event occurred, the rightholder received the right to purchase \$200.00 worth of Pillsbury's stock for \$100.00. See *id.* Therefore, if Grand Metropolitan (the acquiring corporation) acquired 85 percent of Pillsbury's stock in its \$60.00 per share tender offer, the exercise of Pillsbury's rights would reduce Grand Metropolitan's equity interest in Pillsbury from 85 percent to 56.3 percent. Moreover, its equity investment would decline by more than \$700 million. See *id.*

control of the target through a merger or similar business combination.<sup>40</sup> Under the flip-over provision, the rightholder is entitled to purchase stock in the acquiring entity at a discount, again almost always at half price, thereby diluting the equity of the acquiring entity's existing stockholders.<sup>41</sup>

The rights plan's redemption provision enables the board to redeem the rights for a nominal price.<sup>42</sup> By redeeming the rights the board can eliminate the devastating effects of the rights plan and allow a takeover to occur.<sup>43</sup> Thus, the redemption provision gives the board leverage to negotiate with the bidder and the ability to reject the bidder's offer.<sup>44</sup>

### B. *The Board's Fiduciary Duties During a Takeover Attempt*

Under state common law, the board is an active participant in the tender offer process.<sup>45</sup> The board's role in takeover contests is grounded

40. See *Universal Foods Corp.*, 708 F. Supp. at 1007; *Interco*, 551 A.2d at 791-92; *Dawson, Pence & Stone*, *supra* note 29, at 427.

*Moran* validated a rights plan containing only a flip-over provision. See *Moran v. Household Int'l Inc.*, 500 A.2d 1346, 1349 (Del. 1985). Today, many rights plans have both flip-in and flip-over provisions. See Note, *supra* note 4, at 184 (plans contain both flip-in and flip-over provisions because flip-over provisions do not operate unless bidder attempts merger).

41. For example, assuming an exercise price of \$150.00, the rightholder would be able to purchase \$300.00 worth of the acquiring entity's stock for \$150.00. See *Dawson, Pence & Stone*, *supra* note 29, at 427.

42. Typically, the board reserves the power to redeem rights at \$.01, .05 or .50 per share any time before an entity acquires 20 percent or more of the issuer's stock or within a specified time following such an accumulation. See 1 M. Lipton & E. Steinberger, *supra* note 12, at § 6.03[4][a].

43. See *Harvard Indus. v. Tyson*, [1986-1987 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 93,064, at 95,294 (E.D. Mich. Nov. 25, 1986).

44. See *Moran v. Household Int'l Inc.*, 490 A.2d 1059, 1066, 1083 (Del. Ch.), *aff'd*, 500 A.2d 1346 (Del. 1985); see also *Dynamics Corp. of America v. CTS Corp.*, 794 F.2d 250, 259 (7th Cir. 1986) (bidder has to negotiate with management in order to buy target).

45. See *Panter v. Marshall Field & Co.*, 646 F.2d 271, 288 (7th Cir.), *cert. denied*, 454 U.S. 1092 (1981); *Treadway Cos. v. Care Corp.*, 638 F.2d 357, 381 (2d Cir. 1980) (applying New Jersey law); *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 954 (Del. 1985); see also *Northwest Indus., Inc. v. B. F. Goodrich Co.*, 301 F. Supp. 706, 712-13 (N.D. Ill. 1969) (applying New York law) (board may take any legal steps to oppose harmful takeover).

State common law allows the board to participate in tender offer situations, but unlike traditional changes in corporate control, such as mergers and sales of assets, state corporation statutes are silent on a board's role during a tender offer. See, e.g., Del. Code Ann. tit. 8, §§ 251(b), 252(c), 253(a), and 254(d) (1983 & 1988 Supp.) (requiring board approval for mergers before shareholders are permitted to vote on the matter); Del. Code Ann. tit. 8, § 271(a) (1983 & 1988 Supp.) (requiring board approval for sale of all or substantially all of corporation's assets before shareholders vote on matter). Some commentators, therefore, have argued that the board should act passively during tender offers. See *Easterbrook & Fischel*, *supra* note 18, at 1194. Others, recognizing the similarity between mergers and tender offers, call for active board involvement. See *Lipton*, *supra* note 18, at 116. The Delaware Supreme Court expressly rejected the passivity theory in *Unocal*. See *Unocal*, 493 A.2d at 955 n.10.



in its responsibility to manage the business affairs of the corporation<sup>46</sup> in accordance with its fiduciary obligations to the corporation and its shareholders.<sup>47</sup>

Generally, the board has a fiduciary duty to act in the best interests of the corporation and its shareholders.<sup>48</sup> This duty encompasses the obligation to protect the corporate enterprise, including the shareholders, from reasonably perceived harm.<sup>49</sup> Thus, a board may actively oppose a tender offer when, in the board's judgment, the offer is not in the best interests of the corporation or its shareholders.

The board's duty to protect the corporation from harm, however, is not absolute.<sup>50</sup> The board must exercise its discretion in a manner consistent with its traditional duties of care<sup>51</sup> and loyalty.<sup>52</sup> The directors' duty of care includes the obligation to act in an informed manner,<sup>53</sup> while the duty of loyalty prohibits the board from engaging in self-dealing.<sup>54</sup> The board must fulfill these duties when conducting its activities and exercising its business judgment.<sup>55</sup>

Courts employ the business judgment rule to evaluate the board's business decisions. Under the business judgment rule, directors' business decisions are presumed to be informed, made in good faith and with the honest belief that it is in the company's best interests.<sup>56</sup> Courts will not

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46. See Del. Code Ann. tit. 8 § 141(a) (1983); see also *Unocal*, 493 A.2d at 953 (board's "duties and responsibilities proceed from the inherent powers conferred by 8 Del.C. § 141(a)" to manage the corporation).

47. See *Pogostin v. Rice*, 480 A.2d 619, 624 (Del. 1984); *Guth v. Loft, Inc.*, 5 A.2d 503, 510 (Del. 1939).

48. See *Guth*, 5 A.2d at 510.

49. See *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 954 (Del. 1985).

50. See *id.* at 955.

51. The duty of care is the responsibility of a director to exercise the care that a "reasonably prudent person in a similar position would use under similar circumstances." *Norlin Corp. v. Rooney, Pace Inc.*, 744 F.2d 255, 264 (2d Cir. 1984); see also *New York Bus. Corp. Law* § 717(a) (McKinney 1986 & Supp. 1989); *Rev. Model Bus. Corp. Act* § 8.30(a) (1984) (director shall act in good faith, with the care of an ordinarily prudent person in a like position under similar circumstances and with company's best interests in mind).

52. The duty of loyalty requires that the board act in good faith and that the board not appear on both sides of a transaction or engage in self-dealing. See *Norlin*, 744 F.2d at 264; *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984); see also *Rev. Model Bus. Corp. Act* § 8.31 (1984) (potential conflict of interest occurs when director has direct or indirect interest in transaction).

53. See *Aronson*, 473 A.2d at 812; see also *Smith v. Van Gorkom*, 488 A.2d 858, 872 (Del. 1985) (duty of care imposes on directors obligation "to proceed with a critical eye in assessing information").

54. See *Norlin*, 744 F.2d at 264.

55. See *Van Gorkom*, 488 A.2d at 872-73. In Delaware the standard of care applicable to a directors' duty of care is gross negligence. See *id.* at 873; *Aronson*, 473 A.2d at 812 n.6. But see *Hanson Trust PLC v. ML SCM Acquisition, Inc.*, 781 F.2d 264, 274 (2d Cir. 1986) (applying New York law) (applying reasonable diligence standard).

56. See *Aronson*, 473 A.2d at 812; *Gries Sports Enters. Inc. v. Cleveland Browns Football Co., Inc.*, 26 Ohio St. 3d 15, 20, 496 N.E.2d 959, 964 (1986); see also *Sinclair Oil Corp. v. Levien*, 280 A.2d 717, 720 (Del. 1971) (court will not substitute its judgment for that of board if board's decision can be attributed to any rational business purpose). See

interfere with the board's judgment unless the party challenging the board's decision rebuts the presumptions of the business judgment rule.<sup>57</sup> Although the business judgment rule was initially developed to protect the board's judgments on questions of everyday corporate policy and management,<sup>58</sup> it is also applied in takeover contests.<sup>59</sup> In the takeover context, where defensive tactics are being employed, the courts focus on the duty of loyalty because a board has an obvious conflict of interest when making decisions about changes in corporate control.<sup>60</sup>

*Unocal* significantly changed the application of the business judgment rule to contests for corporate control and, ultimately, to the redemption of rights.<sup>61</sup> The Delaware Supreme Court adopted a two-prong test

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generally Arshnt, *The Business Judgment Rule Revisted*, 8 Hofstra L. Rev. 93, 130 (1979) (rebuttable presumption that directors exercised their business judgment in good faith and with corporation's best interests in mind).

The business judgment rule derives from, and is an acknowledgment of, the broad powers given to directors to manage the affairs of a corporation. See *Asarco Inc. v. M.R.H. A. Court*, 611 F. Supp. 468, 473 (D.N.J. 1985); *Zapata Corp. v. Maldonado*, 430 A.2d 779, 782 (Del. 1981); see also Quillen, *Trans Union, Business Judgment, and Neutral Principles*, 10 Del. J. Corp. L. 465, 490 (1985) (courts respect directors' business decisions because Delaware General Corporation Law § 141(a) provides that directors make decisions). The business judgment rule also recognizes that courts are not equipped to evaluate business judgments. See *Auerbach v. Bennett*, 47 N.Y.2d 619, 630-31, 393 N.E.2d 994, 1000, 419 N.Y.S.2d 920, 926 (1979).

57. See *Panther v. Marshall Field & Co.*, 646 F.2d 271, 293 (7th Cir.) (courts will not interfere with board's business judgment unless plaintiff shows fraud, bad faith, gross overreaching or abuse of discretion), *cert. denied*, 454 U.S. 1092 (1981); *Aronson*, 473 A.2d at 812; see also Arshnt, *supra* note 56, at 111 (court will not set aside a corporate transaction that does not involve self-dealing unless directors do not exercise due care, good faith or reasonably believe that transaction was in corporation's best interests). If the challenging party rebuts one of the rule's presumptions then the board loses the protections of the rule and the transaction will be subject to judicial scrutiny. See *Hanson Trust PLC v. ML SCM Acquisition, Inc.*, 781 F.2d 264, 280 (2d Cir. 1986) (board did not fulfill duty of care so court enjoined a lock-up option). If the transaction involves self-dealing the business judgment rule does not apply and the board must show the intrinsic fairness of the transaction. See *Weinberger v. UOP, Inc.*, 457 A.2d 701, 710 (Del. 1983). Intrinsic fairness involves an analysis of both fair dealing and fair price. *Id.*

58. See *Minstar Acquiring Corp. v. AMF Inc.*, 621 F. Supp. 1252, 1259 (S.D.N.Y. 1985).

59. See *Panther v. Marshall Field & Co.*, 646 F.2d 271, 295 (7th Cir.), *cert. denied*, 454 U.S. 1092 (1981); *Treadway Cos. v. Care Corp.*, 638 F.2d 357, 382 (2d Cir. 1980); *Crouse-Hinds Co. v. Internorth, Inc.*, 634 F.2d 690, 701 (2d Cir. 1980); *Johnson v. Trueblood*, 629 F.2d 287, 292 (3d Cir. 1980), *cert. denied*, 450 U.S. 999 (1981); *Pogostin v. Rice*, 480 A.2d 619, 627 (Del. 1984).

60. See *Bennett v. Propp*, 187 A.2d 405, 409 (Del. 1962); see also *Northwest Indus., Inc. v. B.F. Goodrich Co.*, 301 F. Supp. 706, 712 (N.D. Ill. 1969) (directors may be accused of acting to save their jobs at corporation's expense when tender offer is rejected). Courts, however, recognize that the board cannot avoid the conflict of interest problem in takeover situations, and therefore should not lose altogether the presumptions of the business judgment rule. See *Johnson v. Trueblood*, 629 F.2d 287, 292 (3d Cir. 1980), *cert. denied*, 450 U.S. 999 (1981); see also Marsh, *Are Directors Trustees? Conflict of Interest and Corporate Morality*, 22 Bus. Law. 35, 60 (1966) (takeover attempt thrusts directors into unavoidable conflict of interest situation).

61. Prior to *Unocal*, plaintiffs had to show that a board's primary motive in the takeover context was to retain control in order to rebut the presumptions of the business

which must be satisfied before the board's decisions in the takeover context are protected by the business judgment rule.<sup>62</sup> First, the board must show that it had "reasonable grounds for believing that a danger to corporate policy and effectiveness existed."<sup>63</sup> This burden is satisfied by a showing of "good faith and reasonable investigation."<sup>64</sup> Second, the board's defensive measure must be "reasonable in relation to the threat posed."<sup>65</sup>

The *Unocal* test governs the board's conduct when adopting or implementing rights plans and other defensive mechanisms.<sup>66</sup> Although some commentators have questioned whether *Unocal* subjects directors to greater scrutiny,<sup>67</sup> others have noted that its reasonableness requirement completely overwhelms the traditional duty of care and loyalty require-

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judgment rule. If that burden was met, the directors would then have to show that the transaction had a valid corporate purpose. See *Treadway*, 638 F.2d at 382; *Trueblood*, 629 F.2d at 293. The test, known as the "primary purpose test," was similar to the traditional business judgment rule where the board had to show that it acted in the best interests of the corporation or for a rational business purpose. See *Cheff v. Mathes*, 199 A.2d 548, 556 (Del. 1964); Note, *Corporate Auctions and Directors' Fiduciary Duties: A Third-Generation Business Judgment Rule*, 87 Mich. L. Rev. 276, 282 n.30 (1988). The *Unocal* test represents an intermediate position between the traditional business judgment rule and the intrinsic fairness test which is employed in self-dealing situations. See *Robert M. Bass Group, Inc. v. Evans*, 552 A.2d 1227, 1239 (Del. Ch. 1988); Gilson & Kraakman, *Delaware's Intermediate Standard for Defensive Tactics: Is There Substance to Proportionality Review?*, 44 Bus. Law. 247, 248-51 (1989).

62. The court created an enhanced duty "[b]ecause of the omnipresent specter that a board may be acting primarily in its own interests, rather than those of the corporation and its shareholders." *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 954 (Del. 1985).

63. *Id.* at 955. The first prong of the *Unocal* test ensures that a defensive measure designed to prevent a takeover is motivated by a good faith concern for the welfare of the corporation and its shareholders. See *id.* The court listed examples of concerns which a board might have in analyzing the nature of a bid including: (a) inadequacy of the price offered; (b) nature and timing of the offer; (c) questions of illegality; (d) the impact on constituencies other than shareholders; (e) the risk of nonconsummation; and (f) the quality of the securities being offered in an exchange. See *id.* *Unocal* also states that a finding that the first prong is satisfied will be materially enhanced if the defensive measure was approved by a majority of the outside independent directors. See *id.* The importance of a vote of independent directors was taken from an earlier Delaware case. See *Puma v. Marriott*, 283 A.2d 693, 695 (Del. Ch. 1971).

64. See *Unocal*, 493 A.2d at 955.

65. *Id.* at 955. The second prong adds an element of balance by requiring that the board analyze the nature of the takeover bid and its effect on the corporation. Because of the balancing requirement, the test is sometimes referred to as the proportionality test. See *TW Services, Inc. v. SWT Acquisition Corp.*, [Current Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,334, at 92,174 (Del. Ch. Mar. 2, 1989); Gilson & Kraakman, *supra* note 61, at 249-51.

66. See *Moran v. Household Int'l, Inc.*, 500 A.2d 1346, 1354, 1356 (Del. 1985).

67. See Note, *Discrimination Against Shareholders in Opposing a Hostile Takeover*, 59 S. Cal. L. Rev. 1319, 1330 (1986) (first prong of *Unocal* test is still weak because board can always articulate that a threat exists); Comment, *Unocal Corp. v. Mesa Petroleum Co.*, 72 Va. L. Rev. 851, 867 (1986) (first prong is still the traditional business judgment rule).

ments.<sup>68</sup> One court noted that the *Unocal* test increases the possibility that a court will substitute its judgment for that of the board.<sup>69</sup> Until recently, however, courts rarely found that a defensive response was unreasonable in relation to the threat posed.<sup>70</sup>

### C. Redemption of Rights Plans Under the *Unocal* Standard

#### 1. Auctions and Two-Tier Tender Offers

Court decisions evaluating a board's use of a rights plan may be separated into three categories: requests to redeem rights during an auction of a company,<sup>71</sup> requests to redeem rights when a bidder has made a two-tiered tender offer,<sup>72</sup> and requests to redeem rights when the bidder has made an all-cash, all-shares tender offer.<sup>73</sup>

Courts have refused to grant the bidder's request for redemption of the rights plan during an auction of the company. In *Revlon, Inc. v. MacAn-*

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68. See Oesterle, *The Negotiation Model of Tender Offer Defenses and the Delaware Supreme Court*, 72 Cornell L. Rev. 117, 118 (1986).

69. See *City Capital Assocs. v. Interco Inc.*, 551 A.2d 787, 796-97 (Del. Ch. 1988); see also Gilson & Kraakman, *supra* note 61, at 271-73 (suggesting active judicial review for effective proportionality test).

70. Prior to *Interco* and *Pillsbury*, only two Delaware courts found defensive responses unreasonable in relation to the threat posed. See *Robert M. Bass Group, Inc. v. Evans*, 552 A.2d 1227 (Del. Ch. 1988); *AC Acquisitions Corp. v. Anderson, Clayton & Co.*, 519 A.2d 103 (Del. Ch. 1986).

71. See *CRTF Corp. v. Federated Dep't Stores, Inc.*, 683 F. Supp. 422, 440-41 (S.D.N.Y. 1988); *Doskocil Cos. Inc. v. Griggy*, No. 10,095 (Del. Ch. Oct. 7, 1988) (LEXIS, States library, Del file); *Tate & Lyle PLC v. Staley Continental, Inc.*, [1987-1988 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 93,764, at 98,586-87 (Del. Ch. May 9, 1988); *Facet Enters., Inc. v. Prospect Group, Inc.*, No. 9746 (Del. Ch. Apr. 15, 1988) (LEXIS, States library, Del file).

In most cases, standing to sue for redemption of the rights plan is not at issue. Typically, the bidder acquires stock in the target corporation before announcing a tender offer and is also a shareholder when it files suit seeking redemption. The *Interco* court held that the bidder has standing to assert the rights of a shareholder of a target company. See *City Capital Assocs. v. Interco Inc.*, 551 A.2d 787, 800 (Del. Ch. 1988); see also *Lipton v. News Int'l*, 514 A.2d 1075, 1078-79 (Del. 1987) (suggesting shareholder seeking control has standing to assert breach of fiduciary duty claims). In any event shareholder class actions typically proceed on the same schedule as an action by the bidder. See *Grand Metro. Pub. Ltd. v. The Pillsbury Co.*, 558 A.2d 1049, 1050 (Del. Ch. 1988) (shareholder action consolidated with bidder's action); *Interco*, 551 A.2d at 800 n.18.

72. See *Desert Partners, L.P. v. USG Corp.*, 686 F. Supp. 1289, 1298-99 (N.D. Ill. 1988); *CRTF Corp. v. Federated Dep't Stores, Inc.*, 683 F. Supp. 422, 440 (S.D.N.Y. 1988) (also involved an auction situation).

73. See *Amanda Acquisition Corp. v. Universal Foods Corp.*, 708 F. Supp. 984 (E.D. Wis.), *aff'd on other grounds*, 877 F.2d 496 (7th Cir. 1989); *Southdown, Inc. v. Moore McCormack Resources, Inc.*, 686 F. Supp. 595 (S.D. Tex. 1988); *BNS Inc. v. Koppers Co.*, 683 F. Supp. 458, 461 (D. Del. 1988); *Gelco Corp. v. Coniston Partners*, 652 F. Supp. 829, 837 (D. Minn. 1986), *aff'd in part, vacated in part*, 811 F.2d 414 (8th Cir. 1987); *Grand Metro. Pub. Ltd. v. The Pillsbury Co.*, 558 A.2d 1049, 1053 (Del. Ch. 1988); *City Capital Assocs. v. Interco Inc.*, 551 A.2d 787, 792 (Del. Ch. 1988); *Nomad Acquisition Corp. v. Damon Corp.*, [1988-1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,040 (Del. Ch. Sept. 16, 1988).

*drews & Forbes Holdings, Inc.*,<sup>74</sup> the Delaware Supreme Court held that the board's duty changes during an auction.<sup>75</sup> Generally, an auction situation arises when the board recognizes that the company will be sold.<sup>76</sup> During an auction the board's role is that of an auctioneer; it must get the best price for the shareholders.<sup>77</sup> Courts have used the *Revlon* principle to deny requests to redeem the rights plan during an active auction because of the ability of the rights plan to generate the highest price for shareholders.<sup>78</sup> The plan's redemption provision gives the board time to conduct a proper auction and negotiate leverage which enables it to elicit higher bids.<sup>79</sup>

Courts also deny requests to redeem a rights plan when the offeror has made a two-tiered tender offer.<sup>80</sup> Two-tiered tender offers have the effect

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74. 506 A.2d 173 (Del. 1986).

75. *See id.* at 182.

76. Although *Revlon* indicated that an auction arises when the break-up of the company is inevitable, it is not always clear when a *Revlon* auction arises, ends or is conducted fairly. *See, e.g.,* Mills Acquisition Co. v. Macmillan, Inc., [1988-1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,071, (Del. Ch. Oct. 17, 1988) (involving fairness of auction process), *rev'd*, [Current Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,401 (Del. May 3, 1989); City Capital Assocs. v. Interco Inc., 551 A.2d 787, 801-03 (Del. Ch. 1988) (restructuring plan did not require *Revlon* auction); Ivanhoe Partners v. Newmont Mining Corp., 535 A.2d 1334, 1345 (Del. 1987) (*Revlon* duties did not arise because target was never for sale and there was no bidding contest or sale); *see also* Note, *supra* note 61, at 276 n.8.

77. *See Revlon*, 506 A.2d at 182.

78. *See* CRTF Corp. v. Federated Dep't Stores, Inc., 683 F. Supp. 422, 440 (S.D.N.Y. 1988) (holding that refusal to redeem rights is reasonable response in auction situation); Mills Acquisition Co. v. Macmillan, Inc., [1988-1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,071, at 91,024 (Del. Ch. Oct. 17, 1988) (board may maintain rights plan to promote continuation of auction, but once auction ends plan should be redeemed to allow shareholders to choose between two competing offers), *rev'd on other grounds*, [Current Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,401 (Del. May 3, 1989); Doskocil Cos. v. Griggy, No. 10095 (Del. Ch. Oct. 7, 1988) (LEXIS, States library, Del file) (board not required to redeem rights when conducting auction even if first tender offer is adequate); Tate & Lyle Acquisition Corp. v. Staley Continental, Inc., [1987-1988 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 93,764 (Del. Ch. May 9, 1988) (court did not order redemption during continuing auction because current market price was higher than tender offer); Facet Enters., Inc. v. Prospect Group, Inc., No. 9746 (Del. Ch. Apr. 15, 1988) (LEXIS, States library, Del file) (did not order redemption because auction was about to begin).

79. *See Federated Dep't Stores*, 683 F. Supp. at 438-40. Most commentators recognize that the rights plan benefits shareholders during an active auction. *See* Gilson, *A Structural Approach to Corporations: The Case Against Defensive Tactics in Tender Offers*, 33 Stan. L. Rev. 819, 868-70 (1981) (management may use bargaining tactics to get shareholders higher premium); Oesterle, *supra* note 16, at 91 (the redemption provision makes the rights plan a legitimate defensive tactic because target managers can negotiate for a higher price); Note, "*Poison Pills*" as a Negotiating Tool: *Seeking a Cease-Fire in the Corporate Takeover Wars*, 1987 Colum. Bus. L. Rev. 459, 471-77 (1987); Note, *supra* note 4, at 204-07. *But see* Easterbrook & Fischel, *supra* note 18, at 1175 (management's resistance to tender offer designed to increase the premium offered is harmful because it will ultimately reduce the number of premium tender offers).

80. Because of its enhanced coercive effect, the two-tiered tender offer was considered the most effective way of completing a tender offer during the early 1980's. *See* 1 M. Lipton & E. Steinberger, *supra* note 12, at 1.08[1].

of coercing shareholders into tendering their shares in the first tier because of the uncertainty concerning the consideration to be received in the second tier.<sup>81</sup> Because of the coercive nature of the offer, courts have concluded that refusing to redeem a rights plan is a reasonable response when the bidder has made a two-tiered tender offer.<sup>82</sup>

## 2. All-Cash, All-Shares Tender Offers

Today, most tender offers are all-cash, all-shares tender offers.<sup>83</sup> The bidder typically promises to merge out, in a second step, any untendered shares for the same consideration as the original tender offer.<sup>84</sup> Some courts hold that this type of offer does not pose a significant threat to shareholders and, thus, are less inclined to allow a target board to use a rights plan to preclude shareholders from deciding on the tender offer.<sup>85</sup> This view emphasizes that the shareholders are the owners of the corporation and, therefore, they have the right to make the ultimate decision concerning the sale of their shares.<sup>86</sup>

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81. See *Minstar Acquiring Corp. v. AMF Inc.*, 621 F. Supp. 1252, 1255 (S.D.N.Y. 1985). The coercive aspect of the two-tiered tender offer is commonly known as the prisoner's dilemma.

Under the "prisoner's dilemma," individual dispersed shareholders are forced to tender their shares into a partial offer regardless of whether they think the offer being proposed gives them full and fair value. They act out of fear that other shareholders, with whom they cannot communicate or collaborate, will tender and thus enable the bidder to relegate the non-tendering shareholder to the distinctly less attractive position of minority shareholder in a company controlled by a majority interest.

*Id.* at 1255; see also Lowenstein, *Pruning Deadwood in Hostile Takeovers: A Proposal for Legislation*, 83 Colum. L. Rev. 249, 307-09 (1983) (discussing prisoner's dilemma); Note, *supra* note 11, at 1966 (same). But see Gilson, *supra* note 79, at 859 (prisoner's dilemma present only if gain from premium offered is less than anticipated loss on shares retained after offer's success).

82. See *Desert Partners, L.P. v. USG Corp.*, 686 F. Supp. 1289, 1298-99 (N.D. Ill. 1988) (two-tiered offer coerces shareholders into tendering their shares and threatens target's corporate effectiveness); *CRTF Corp. v. Federated Dep't Stores, Inc.*, 683 F. Supp. 422, 440 (S.D.N.Y. 1988) (board clearly has the right to reject two-tiered tender offer).

83. See 1 M. Lipton & E. Steinberger, *supra* note 12, at 1.08[1] (availability of junk bond financing has made two-tiered tender offers rare). The all-cash, all-shares offer is also preferred because bidders are well aware of courts' dissatisfaction with coercive two-tier offers. See *TW Services, Inc. v. SWT Acquisition Corp.*, [Current Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,334, at 92,176 (Del. Ch. Mar. 2, 1989) (bidder amended hostile partial tender offer to an all-shares offer). Moreover, bidders recognize that an all-cash, all-shares bid at a substantial premium over market will put pressure on a board to redeem a rights plan. See Cohen, *supra* note 6, at B5. If a board refuses to redeem rights and a bidder withdraws the tender offer, the board may face the wrath of angry shareholders who were denied a chance to sell their stock at a premium. See *id.*

84. See *City Capital Assocs. v. Interco Inc.*, 551 A.2d 787, 796 (Del. Ch. 1988); see also *Amanda Acquisition Corp. v. Universal Foods Corp.*, 708 F. Supp. 984, 1007 (E.D. Wis.) (majority of tender offers in 1988 intended back-end mergers), *aff'd on other grounds*, 877 F.2d 496 (7th Cir. 1989).

85. See *Grand Metro. Pub. Ltd. v. The Pillsbury Co.*, 558 A.2d 1049, 1060 (Del. Ch. 1988); *Interco*, 551 A.2d at 798-99.

86. See *Interco*, 551 A.2d at 799-800 (employing poison pill to prevent shareholders from choosing to accept noncoercive offer is inconsistent with traditional corporate gov-

Recently, in *Interco* and *Pillsbury*, the Delaware Chancery Court ordered the boards to redeem the rights plan to allow shareholders to decide on an all-cash, all-shares offer.<sup>87</sup> The *Interco* court found it significant that the redemption question arose at the end-stage of the takeover battle.<sup>88</sup> The battle was at its end-stage because the court concluded that the rights plan was no longer being used to force the bidder to increase its offer nor was it needed to give the board time to respond to the offer.<sup>89</sup> Both the *Interco* and *Pillsbury* boards, based on valuation studies conducted by their financial advisers, had concluded that the offers were inadequate,<sup>90</sup> and, as an alternative, proposed a financial restructuring of

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ernance notions and threatens the legitimacy and authority of corporation law); *Pillsbury*, 558 A.2d at 1060 n.10 (court cites *Conoco Inc. v. Seagram Co.*, 517 F. Supp. 1299, 1303 (S.D.N.Y. 1981) which stated:

the Board of Directors are under a duty to exercise their best business judgment with respect to . . . tender offers. They may be right; they may know what is best for the corporation, but their judgment is not conclusive upon the shareholders. What is sometimes lost sight of in these tender offer controversies is that the shareholders, not the directors, have the right of franchise with respect to the shares owned by them; "stockholders, once informed of the facts, have a right to make their own decisions in matters pertaining to their economic self-interest . . ."

*Id.* (citation omitted); see also *Southdown, Inc. v. Moore McCormack Resources, Inc.*, 686 F. Supp. 595, 596, 605 (S.D. Tex. 1988) (ordering board to redeem rights plan because owners of target corporation should have the opportunity to exercise their own business judgment concerning the offer). Non-redemption cases have also expressed this view. See *Norlin Corp. v. Rooney, Pace Inc.*, 744 F.2d 255, 258 (2d Cir. 1984) (same); *Minstar Acquiring Corp. v. AMF Inc.*, 621 F. Supp. 1252, 1260 n.6 (S.D.N.Y. 1985) (same); *AC Acquisitions v. Anderson, Clayton & Co.*, 519 A.2d 103, 112-13 (Del. Ch. 1986) (precursor of *Interco* shareholder choice doctrine); see also Gilson, *supra* note 79, at 869 (defensive tactics should not preempt shareholder decisions); Note, *Shareholder Rights Plans—Do They Render Shareholders Defenseless Against Their Own Management?*, 12 Del. J. Corp. L. 991, 1005-06 (1987) (plan interferes with private transactions between bidders and shareholders).

87. See *Pillsbury*, 558 A.2d at 1060; *Interco*, 551 A.2d at 790-91; see also *Southdown*, 686 F. Supp. at 596 (district court, applying Delaware law, ordered redemption of rights plan).

88. See *City Capital Assocs. v. Interco Inc.*, 551 A.2d 787, 790 (Del. Ch. 1988).

89. See *id.* at 790, 800 n.17 (bidder's offers had come to the top of their range).

In *Pillsbury*, the bidder initially filed suit seeking to have the rights redeemed before the end-stage was reached. See *Grand Metro. PLC v. The Pillsbury Co.*, No. 10317 (Del. Ch. Nov. 7, 1988) (LEXIS, States library, Del file). The bidder argued that sufficient time had passed and the target had not proposed any alternative transaction to shareholders. The court, however, stated that the target may explore its alternatives indefinitely and that in the meantime the board does not breach its fiduciary duties by refusing to redeem the rights. The court noted the independence of the directors (who concluded that the offer was inadequate), the absence of any significant challenge to the board's good faith and the board's consideration of the merits of the offer at a lengthy meeting where it received written opinions from two investment bankers stating that the offer was inadequate. The court also stated that a "just say no" defense may not be appropriate when the offer is an all-cash, all-shares offer.

90. See *Interco*, 551 A.2d at 792. *Interco's* advisers concluded that the company had a value in the \$74.00 to \$87.00 range. See *id.* The bidder ultimately raised its offer to \$74.00 and indicated a willingness to negotiate a higher price. See *id.* at 794. The target's

the corporation.<sup>91</sup> Although the target boards acted in good faith and were fully informed when concluding that the offers were inadequate, the courts held that the rights plan could not be used to prevent the shareholders from choosing between the tender offers and the boards' restructuring plans.<sup>92</sup> The bidders' all-cash, all-shares offers posed a threat solely to the shareholders' economic interests and unlike two-tiered offers were not considered coercive.<sup>93</sup> Therefore, because the contests had reached the end-stage—the rights plans were no longer being used to negotiate an increase in the offer, to conduct an auction, or to implement

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advisers termed the \$74.00 to \$87.00 calculation as a "reference range," but the court found the "reference range" concept deliberately unclear. *See id.* at 792.

Generally, a board supports its decision to reject a tender offer by terming it inadequate. *See Chazen, Fairness from a Financial Point of View in Acquisitions of Public Companies: Is "Third-Party Sale Value" the Appropriate Standard?*, 36 Bus. Law. 1439, 1454 (1981). Inadequacy means that the target reasonably believes that it has a substantial chance of obtaining or generating higher value for shareholders. *See id.* Inadequacy does not, however, mean that the offer is unfair. *See id.* In *Interco*, the target stated that the "reference range" is an indication of the company's intrinsic value which helps determine the adequacy or inadequacy of an offer. *See Appellants' Opening Brief at 15, City Capital Assocs. v. Interco Inc.*, 551 A.2d 787 (Del. Ch. 1988) (No. 10105); *see also infra* note 109. The view that an offer below the company's intrinsic value is inadequate is in accordance with Delaware precedent. *See Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 181 (Del. 1986) (offer grossly inadequate so board acted reasonably in protecting shareholders from takeover at a price below company's intrinsic value); *Smith v. Van Gorkom*, 488 A.2d 858, 876 (Del. 1985) (finding breach of duty of care because board was not informed of company's intrinsic value).

91. *See Interco*, 551 A.2d at 793-94. The restructuring consisted of a cash dividend, debentures, convertible preferred stock and a remaining equity interest in the company (stub interest) which was estimated to trade at a certain value. *See id.* The board's bankers valued the package at \$76.00 per share. The financing for the restructuring was to come from the sale of certain assets representing approximately one-half of the company's gross sales and from \$2.025 billion in loans. *See id.*

The alternative plan in *Pillsbury*, consisting primarily of the spin-off of Burger King and the sale of certain assets and ultimately the whole company within the next few years, was speculated to be deliberately vague in order to distinguish it from the *Interco* precedent. *See Gibson & Smith, Doughboy's Defeat: How Pillsbury Failed to Act Decisively in Bid to Repel Grand Met*, Wall St. J., Dec. 19, 1988, at A1, col. 6. The target, however, did not escape the *Interco* precedent by withholding its alternative plan. Some commentators, however, view the *Pillsbury* decision as actually a test and rejection of the "just say no" defense. *See id.*; Yablon, *Poison Pills and Litigation Uncertainty*, 1989 Duke L.J. 54, 77 (1989).

92. *See Interco*, 551 A.2d at 798. The *Interco* court doubted whether the target's proposed restructuring was worth more than the tender offer. *See id.* at 799. The court, therefore, concluded that a reasonable shareholder could prefer the tender offer over the restructuring. *See id.* The *Pillsbury* court, however, stated that the real threat to shareholders is the possibility of the company's stock price dropping to the pre-offer level if the rights are not redeemed. *See Pillsbury*, 558 A.2d at 1058.

Surprisingly, the *Interco* court declined to enjoin the restructuring because it found it to be a reasonable response to the threat of an inadequate offer. *See Interco*, 551 A.2d at 800-01. Thus, the court would have permitted the target to undergo significant structural changes which might have imperiled the bidder from completing its transaction. *See id.* But *see Pillsbury*, 558 A.2d at 1061-62 (court ordered redemption of rights and enjoined proposed restructuring).

93. *See Pillsbury*, 558 A.2d at 1060; *City Capital Assocs. v. Interco Inc.*, 551 A.2d 787, 798 (Del. Ch. 1988).



an alternative transaction—the rights were ordered redeemed to allow the shareholders to decide.<sup>94</sup>

The *Interco* and *Pillsbury* redemption requirement applies when the board proposes an alternative transaction. It is unclear, however, whether the Delaware courts would allow a board to “just say no” to a tender offer based on price inadequacy and the board’s confidence in the long-term potential of the corporation. Recently, the Delaware Chancery Court in *TW Services, Inc. v. SWT Acquisition Corp.*,<sup>95</sup> noted that *Interco* and *Pillsbury* did not address whether a rights plan must be redeemed when the board does not propose an alternative transaction, but instead decides to continue its long-term business plans.<sup>96</sup> *Interco*, *Pillsbury* and other Delaware Chancery decisions, however, have certainly implied that a “just say no” defense would not be looked upon favorably.<sup>97</sup>

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94. See *Pillsbury*, 558 A.2d at 1060; *Interco*, 551 A.2d at 798; see also *Southdown, Inc. v. Moore McCormack Resources, Inc.*, 686 F. Supp. 595 (S.D. Tex. 1988). In *Southdown*, the court ordered the target board to redeem its rights plan in the face of an all-cash, all-shares tender offer and enjoined the target’s recapitalization. *Southdown*, 686 F. Supp. at 596. The court concluded that the plan was no longer being used for a legitimate purpose. *Id.* at 602. In *Southdown*, however, unlike *Interco*, the board’s recapitalization plan was strictly intended to make the company unattractive to a buyer and not to provide shareholders with value. *Id.* at 599-600. Moreover, the court concluded that the board had no basis for calling the tender offer inadequate. *Id.* at 603.

95. [Current Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,334 (Del. Ch. Mar. 2, 1989).

96. See *TW Services*, [Current Binder] Fed. Sec. L. Rep. (CCH) at 92,180; *Interco*, 551 A.2d at 798 n.13. In *TW Services*, Chancellor Allen, who served as chancellor in *Interco*, characterized the redemption issue as the conflict between the board’s duty to protect the shareholders’ long-term interests and the duty to maximize shareholders’ current short-term interests. See *TW Services*, Fed. Sec. L. Rep. (CCH) at 92,178. Chancellor Allen stated that the board maximizes short-term interests by entering a *Revlon* auction mode and that this mode exists when the board proposes a recapitalization because of its similarity to the sale of the company. See *id.* at 92,180. The issue, however, which was not addressed in either *Interco* or *Pillsbury* is whether a board must maximize shareholders’ short-term value when it desires to continue managing the corporation in a long-term mode. See *id.* The court in *TW Services* avoided this issue by holding that the bidder’s tender offer, conditioned upon board approval, was an invitation to negotiate a merger and not the usual tender offer. Therefore, the court did not apply the *Unocal* test, but rather used the traditional business judgment rule which allows the board to decline the invitation to merge provided it acts in the good faith pursuit of a legitimate corporate purpose. See *id.* at 92,182.

97. See *Pillsbury*, 558 A.2d at 1060; *Grand Metro. PLC v. The Pillsbury Co.*, No. 10317 (Del. Ch. Nov. 7, 1988) (LEXIS, States library, Del file); *Interco*, 551 A.2d at 797-98; see also *MAI Basic Four, Inc. v. Prime Computer, Inc.*, [1988-1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,179, at 91,634-35 (Del. Ch. Dec. 20, 1988) (denying request to redeem rights plan because offer was pending for a short time and suggesting that it would not deny shareholders the opportunity to make their own investment decision concerning the offer). But see *Meyers, Showdown in Delaware: The Battle to Shape Takeover Law*, Institutional Investor, Feb. 1989, at 77 (indicating that the Delaware Supreme Court may disagree with the chancery court’s reasoning on this matter).

The use of a rights plan to reject a tender offer was also questioned in the recent battle for control of Time, Inc. See *Paramount Communications, Inc. v. Time, Inc.*, [Current Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,514, at 93,265 (Del. Ch. July 14, 1989), *aff’d*, *Literary Partners, L.P. v. Time, Inc.*, Nos. 279, 283, 284 (Del. July 24, 1989) (LEXIS,

## II. THE INTERACTION OF A BOARD'S FIDUCIARY DUTIES AND THE TENDER OFFER PROCESS

### A. *The Threat Posed by Inadequate All-Cash, All-Shares Tender Offers*

Traditional fiduciary principles require that the board protect the shareholders and the corporation from threatened harm.<sup>98</sup> The board fulfills this duty during a takeover attempt by considering, among other things, the financial adequacy of a tender offer.<sup>99</sup> Courts, therefore, have not considered it a breach of fiduciary duty when a board rejects and defends against a tender offer because the offer is inadequate.<sup>100</sup>

For example, in *Pogostin v. Rice*,<sup>101</sup> the stockholders brought a derivative suit charging that the board wrongfully rejected a tender offer.<sup>102</sup> The Delaware Supreme Court held that the board's refusal to accept a premium tender offer was not a *prima facie* breach of fiduciary duty.<sup>103</sup> Moreover, the court stated that a principle requiring a board to accept any offer which includes a premium over the prevailing market price would "rob corporate boards of all discretion, forcing them to choose between accepting any tender offer . . . or facing the likelihood of personal liability if they reject it."<sup>104</sup> Thus, the court concluded that a board

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States library, Del file). In *Time*, the Delaware Chancery Court held that Time's restructuring of its acquisition agreement with Warner Communications was a reasonable response to the threat posed by Paramount's hostile tender offer for Time. *See id.* at 93,283-84. The court stated that a target board has the right to manage the corporation in a long-term mode "pursuant to a preexisting business plan." *See id.* Nevertheless, the chancery court noted that different considerations may exist when the board rejects a tender offer simply by refusing to redeem a rights plan. *See id.* at 93,284 n.22.

98. *See supra* notes 45-49 and accompanying text. *See also* *Ivanhoe Partners v. Newmont Mining Corp.*, 535 A.2d 1334, 1337-38 (Del. 1987) (board has both power and duty to oppose threatening tender offers).

99. *See Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 955 (Del. 1985); *see also* *Northwest Indus., Inc. v. B.F. Goodrich Co.*, 301 F. Supp. 706, 712-13 (N.D. Ill. 1969) (management has responsibility to oppose offers which, in its best judgment, are detrimental to corporation and its shareholders); Block & Miller, *The Responsibilities and Obligations of Corporate Directors in Takeover Contests*, 11 Sec. Reg. L.J. 44, 47 (1983) (board may legitimately consider offer undesirable because offer is inadequate); Lipton, *supra* note 18, at 101-02 (board may reject tender offer if it concludes that it is inadequate). *But see* Gelfond & Sebastian, *Reevaluating the Duties of Target Management in a Hostile Tender Offer*, 60 B.U.L. Rev. 403, 440-41 (1980) (price inadequacy alone should not be a proper motivation for defensive tactics because shareholders are capable of determining value of stock).

100. *See Panter v. Marshall Field & Co.*, 646 F.2d 271, 296 (7th Cir.), *cert. denied*, 454 U.S. 1092 (1981); *Treadway Cos. v. Care Corp.*, 638 F.2d 357, 381 (2d Cir. 1980); *Anaconda Co. v. Crane Co.*, 411 F. Supp. 1210, 1215 (S.D.N.Y. 1975); *see also* *GAF Corp. v. Union Carbide Corp.*, 624 F. Supp. 1016, 1035 (S.D.N.Y. 1985) (board's decision to reject inadequate offer was a reasonable and informed exercise of board's business judgment); *Pogostin v. Rice*, 480 A.2d 619, 627 (Del. 1984) (informed decision to reject takeover proposal is not *prima facie* breach of fiduciary duty).

101. 480 A.2d 619 (Del. 1984).

102. *Id.* at 622.

103. *Id.* at 627.

104. *Id.* The court added that "[t]o put directors to such a Hobson's choice would be

has the right to reject a tender offer which it deems inadequate as long as it carefully informs itself of the company's value before acting.<sup>105</sup>

While *Pogostin* holds that a board may reject an inadequate tender offer, *Smith v. Van Gorkom*<sup>106</sup> strongly suggests that a board has a duty to ensure that the company is not sold for an inadequate price. In *Van Gorkom* the board agreed to a merger at a substantial premium over the prevailing market price.<sup>107</sup> Although the merger was subsequently approved by a majority of the shareholders, the Delaware Supreme Court held the board liable for breaching its duty of care in approving the sale.<sup>108</sup> The court found that the board failed to ascertain the company's intrinsic value<sup>109</sup> and hastily agreed to sell the company for an inadequate price.<sup>110</sup> *Van Gorkom*, therefore, goes beyond *Pogostin* because it obligates the board to refrain from selling the company for a price below the company's intrinsic value.<sup>111</sup>

Nevertheless, both *Interco* and *Pillsbury* rejected the argument that price inadequacy is a sufficient *Unocal* threat to justify refusing to redeem

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the antithesis of the principles upon which a proper exercise of business judgment is demanded of them. The ultimate loss would, of course, be upon the shareholders." *Id.*

105. See *id.*; see also *Northwest Indus., Inc. v. B.F. Goodrich Co.*, 301 F. Supp. 706, 712-13 (N.D. Ill. 1969) (if board is informed and scrupulously fair in considering tender offer, it may take any step not forbidden by law to prevent takeover).

The *Pillsbury* court refused to apply *Pogostin* in the context of a request to redeem a rights plan. See *Grand Metro. Pub. Ltd. v. The Pillsbury Co.*, 558 A.2d 1049, 1059 (Del. Ch. 1988). The court reasoned that *Pogostin* was decided before the formulation of the *Unocal* test and before the approval of the rights plan in *Moran*. See *id.* The *Pillsbury* court, however, failed to recognize that *Moran* also relied on pre-*Unocal* cases, including *Pogostin*, when discussing the board's fiduciary duties in adopting and implementing a rights plan. See *Moran v. Household Int'l, Inc.*, 500 A.2d 1346, 1357 (Del. 1985). Presumably then, cases decided under traditional fiduciary principles are relevant in applying the *Unocal* test.

106. 488 A.2d 858 (Del. 1985).

107. See *id.* at 866-70. The company's CEO initially proposed a \$55.00 per share sale to a takeover specialist during a period when the company's stock price traded in the \$38.00 to \$29.00 range. *Id.* at 866 & n.5.

108. *Id.* at 893.

109. See *id.* at 875-77. The traditional definition of intrinsic value emphasizes the role of different factors: the value justified by assets, earnings, dividends, definite prospects and the factor of management. See S. Cottle, R. Murray, & F. Block, *Graham and Dodd's Security Analysis* 41-50 (5th ed. 1988). In essence, the intrinsic value of a firm is its economic value as a going concern, taking into account all of its characteristics, the nature of its business and the investment environment. See *id.*; see also Lowenstein, *supra* note 81, at 275 (intrinsic value reflects the price that a private buyer would pay if, in a freely negotiated transaction, with access to all material information, he were buying the enterprise as a whole).

110. *Id.* at 874.

111. Although *Van Gorkom* involved a merger, and therefore the board had a defined statutory role, its significance has been noted in tender offer decisions. See *Gelco Corp. v. Coniston Partners*, 652 F. Supp. 829, 849-50 (D. Minn. 1986), *aff'd in part, vacated in part*, 811 F.2d 414 (8th Cir. 1987); *Mills Acquisition Co. v. Macmillan, Inc.*, [Current Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,401, at 92,596 (Del. May 3, 1989). Moreover, *Unocal* clearly established that the board has an active role in matters concerning fundamental corporate change, including tender offers. See *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 954 & n.8.

a rights plan.<sup>112</sup> In reaching these decisions, both courts failed to recognize the implications of minimizing the threat of price inadequacy and failed to consider the court's decision in *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*,<sup>113</sup> which characterized price inadequacy as a *Unocal* threat.<sup>114</sup> In *Revlon*, the Delaware Supreme Court held that the adoption of a rights plan was a reasonable response to the threat of a hostile takeover at a price below the company's intrinsic value.<sup>115</sup> The court found that the board acted in good faith and upon reasonable investigation, and did not breach its fiduciary duties in concluding that the all-cash, all-shares offer was grossly inadequate and a threat to the corporate enterprise.<sup>116</sup> *Revlon* indicates that a rights plan is an appropriate

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112. See *Grand Metro. Pub. Ltd. v. The Pillsbury Co.*, 558 A.2d 1049, 1057-58 (Del. Ch. 1988); *City Capital Assocs. v. Interco Inc.*, 551 A.2d 787, 798 (Del. Ch. 1988) (inadequate offer is threat in sense that target may be able to negotiate higher price, but shareholders must be permitted to choose at some point).

113. 506 A.2d 173 (Del. 1986).

114. See *id.* at 181. Moreover, the court in *Unocal* stated that the inadequacy of price offered is a concern which a board may consider in determining the effect of a bid on the corporate enterprise. See *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 955 (Del. 1985). Although *Unocal* involved the threat of a two-tiered offer, the court did not preclude characterizing inadequate all-cash, all-shares offers as a threat to the corporate enterprise. See *id.* at 956. The court stated that the lower court "specifically found that the 'directors' decision [to oppose the Mesa tender offer] was made in the good faith belief that the Mesa tender offer is inadequate.' Given our standard of review . . . we are satisfied that Unocal's board has met its burden of proof." *Id.* at 958 (citations omitted). The decision appears to indicate that the inadequacy of the offer by itself is a sufficient threat to the corporation and its shareholders. See *id.*; Note, *supra* note 67, at 1329 (*Unocal* court concluded that opposing an inadequate tender offer is valid business purpose); see also *Desert Partners, L.P. v. USG Corp.*, 686 F. Supp. 1289, 1299 & n.21 (N.D. Ill. 1988) (target board reasonably perceived price of tender offer as threat to corporation); *Robert M. Bass Group, Inc. v. Evans*, 552 A.2d 1227, 1240 (Del. Ch. 1988) (argument that an inadequate offer represents threat is plausible); *Ivanhoe Partners v. Newmont Mining Corp.*, 535 A.2d 1334, 1342-43 (Del. 1987) (focusing on threat of two-tiered offer, but also indicating that price inadequacy is independent threat to corporation and shareholders). In *Evans*, however, the court stated that the tender offer was not a threat because the offer was subject to negotiation. See *Evans*, 552 A.2d at 1240. Other courts, however, have clearly stated that a board does not have a duty to negotiate. See *Amanda Acquisition Corp. v. Universal Foods Corp.*, 708 F. Supp. 984, 1013 (E.D. Wis.), *aff'd on other grounds*, 877 F.2d 496 (7th Cir. 1989); *Desert Partners*, 686 F. Supp. at 1300; *Ivanhoe Partners*, 535 A.2d at 1344-45; see also *BNS Inc. v. Koppers Co.*, 683 F. Supp. 458, 476 (D. Del. 1988) (target's duty to negotiate is questionable).

115. See *Revlon*, 506 A.2d at 181. The issue of the board's use of the rights plan was mooted by the board's resolution to redeem the rights in connection with any offers equal to or above a certain price. See *id.*

116. See *id.* The court also upheld an exchange offer designed to thwart a hostile takeover, concluding that this was a reasonable response to the threat of a grossly inadequate offer. See *id.* See also McBride, *Conflicting Claims Remain an Issue in Delaware Cases*, Nat'l L.J., Feb. 20, 1989, at S14, col. 4 (noting that *Pillsbury* court, in citing *Revlon*, indicates that board may refuse to redeem rights if offer is grossly inadequate). Although *Revlon* used the term "grossly inadequate," it is not clear whether the court meant that only grossly inadequate offers are threats. Courts have not always made the distinction. See *BNS Inc. v. Koppers Co.*, 683 F. Supp. 458, 474-75 (D. Del. 1988); *Gelco Corp. v. Coniston Partners*, 652 F. Supp. 829, 849 (D. Minn. 1986), *aff'd in part, vacated in part*, 811 F.2d 414 (8th Cir. 1987).

defensive measure against the threat of inadequate tender offers. It is inconsistent, therefore, to assert that a board may adopt a rights plan to protect shareholders from an inadequate all-cash, all-shares offer, but then must redeem the plan even though an inadequate tender offer is made.

Some federal courts have also held that an inadequate all-cash, all-shares offer does represent a threat under *Unocal*, and that the refusal to redeem rights is a reasonable response.<sup>117</sup> In *Gelco Corp. v. Coniston Partners*,<sup>118</sup> the bidder made an all-cash, all-shares offer that the board, after meeting with its financial advisers, concluded was inadequate.<sup>119</sup> The court held that the board's refusal to redeem the rights plan was a reasonable response to the threat of an inadequate tender offer.<sup>120</sup> The court also recognized that the board has a fiduciary duty to adopt defensive measures to defeat a takeover attempt which is contrary to the best interests of the corporation and its shareholders.<sup>121</sup>

Recently, a Wisconsin federal district court in *Amanda Acquisition Corp. v. Universal Foods Corp.*,<sup>122</sup> allowed a board to "just say no" to an all-cash, all-shares tender offer.<sup>123</sup> The target argued that its desire to remain independent was justified by the company's bright prospects and by the inadequacy of the tender offer.<sup>124</sup> The court held that the offer's

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117. See *BNS*, 683 F. Supp. at 475; *Gelco*, 652 F. Supp. at 849-50; *Nomad Acquisition Corp. v. Damon Corp.*, [1988-1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,040, at 90,872 (Del. Ch. Sept. 16, 1988).

118. 652 F. Supp. 829 (D. Minn. 1986), *aff'd in part, vacated in part*, 811 F.2d 414 (8th Cir. 1987).

119. See *id.* at 849.

120. See *id.* at 849-50. In *BNS*, the court held that the board did not breach its fiduciary duties by refusing to redeem a rights plan in the face of an inadequate all-cash, all-shares tender offer. See *BNS*, 683 F. Supp. at 475. The bidder, much like the bidders in *Interco* and *Pillsbury*, argued that the all-cash offer was not a threat, and that the refusal to redeem the rights plan was unreasonable. See *id.* The court, however, disagreed and stated that "the inadequacy of the offering price does present a threat to the company and its stockholders." *Id.*

121. See *Gelco*, 652 F. Supp. at 849. The court stated that "[d]irectors have not only the right, but a duty, to adopt defensive measures to defeat a takeover attempt contrary to the best interests of the corporation and its shareholders." *Id.*; See also *Nomad Acquisition Corp. v. Damon Corp.*, [1988-1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,040, at 90,872 (Del. Ch. Sept. 16, 1988). In *Nomad*, the board refused to redeem the rights plan in the face of an all-cash, all-shares tender offer. The court held that the board acted reasonably in refusing to redeem the rights because financial advisers valued the company in excess of the tender offer price and because the post tender offer market price was higher than the tender offer. See *id.* Moreover, the court stated that the board has both the duty and the responsibility to oppose inadequate offers even when the offer is all-cash. See *id.*

122. 708 F. Supp. 984 (E.D. Wis.), *aff'd on other grounds*, 877 F.2d 496 (7th Cir. 1989).

123. Because the circuit court affirmed the district court's ruling on the constitutionality of Wisconsin's takeover statute, it found it unnecessary to decide the poison pill redemption issue. See *Amanda Acquisition Corp. v. Universal Foods Corp.*, 877 F.2d 496, 500 (7th Cir. 1989). The circuit court, however, noted that it did not endorse the district court's views concerning the threats of tender offers. See *id.* at 499 n.4.

124. See *Universal Foods*, 708 F. Supp. at 1013-14. The target board stated that it was

inadequacy,<sup>125</sup> its timing,<sup>126</sup> and its threat to the viability of the corporation<sup>127</sup> allowed the board to preclude shareholder choice by refusing to redeem the rights plan.<sup>128</sup> Although the court declined to state that price inadequacy alone justifies precluding shareholder choice,<sup>129</sup> the court

not saying no to the offer, but was instead saying yes to its future prospects. The target's counsel had indicated that one of the principal purposes of the rights plan is to allow a company to remain independent when a proposed tender offer does not reflect the company's present and future value as an ongoing business entity. *See id.* at 1006; *see also* *Nomad Acquisition Corp. v. Damon Corp.*, [1988-1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,040, at 90,869 (Del. Ch. Sept. 16, 1988) (rights plan recommended as means of ensuring that shareholders' receive full value for their shares). The decisions ordering a board to redeem a rights plan conclude that the plans should be used only as a bargaining mechanism for a limited time period or as a defense against two-tiered tender offers. *See Grand Metro. Pub. Ltd. v. The Pillsbury Co.*, 558 A.2d 1049, 1058 (Del. Ch. 1988); *City Capital Assocs. v. Interco Inc.*, 551 A.2d 787, 797-98 (Del. Ch. 1988).

125. *See Universal Foods*, 708 F. Supp. at 1015-16. The board did not obtain an investment banker's opinion as to the adequacy of the offer because it believed that it was familiar enough with the company's business plans to make the inadequacy determination. *See id.* at 1010. The bidder argued that the board's failure to obtain an opinion was a breach of its fiduciary duty of care. *See id.* at 1013. The court disagreed and concluded that the board properly "ascertained from their own knowledge and experiences that the offer was inadequate in light of the future prospects of the company." *Id.* The court, however, indicated its discomfort with a board determination and stated that an opinion may be necessary if the bidder raised its offer. *See id.* at 1016.

126. *See id.* at 1014, 1015-16. The court concluded that the timing of the offer represented a threat to the shareholders given the increased earnings and potential of the corporation. *Id.* at 1014.

127. *See id.* at 1015. The court found that there was a threat to the corporation itself and to other constituencies (customers, suppliers, employees) because of the high level of debt contemplated in the offer. *See id.*; *see also infra* note 130. The court also concluded that the offer represented a threat because of the complexity and possibly misleading nature of the financing arrangement. *See Universal Foods*, 708 F. Supp. at 1015.

128. *See id.* at 1015-16. The court in *Universal Foods* recognized that shareholder choice is not mandated when there is a valid threat to shareholders. *See id.* Courts have approved defensive measures which preclude shareholder choice when offer represents threat to corporation and shareholders. *See, e.g.,* *Ivanhoe Partners v. Newmont Mining Corp.*, 535 A.2d 1334, 1345 (Del. 1987) (upheld dividend distribution and standstill agreement as part of defensive plan to defeat tender offer); *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 958-59 (Del. 1985) (upheld company's self-tender, which excluded bidder, to defeat tender offer).

Critics, however, argue that the rights plan improperly alters the governing structure of the corporation because it allows the board to preclude shareholder choice. *See* Note, *supra* note 86, at 1005-06; Note, *supra* note 4, at 189-90. *Moran*, however, rejected the argument that the rights plan significantly changes the corporate structure because of the board's ability to redeem the rights plan and its fiduciary obligations. *See Moran v. Household Int'l, Inc.*, 500 A.2d 1346, 1354 (Del. 1985).

129. *See Amanda Acquisition Corp. v. Universal Foods Corp.*, 708 F. Supp. 984, 1014-15 (E.D. Wis.), *aff'd on other grounds*, 877 F.2d 496 (7th Cir. 1989). The court stated: Applying the *Unocal* standards, I am unable to conclude that a board may in all instances preclude shareholder choice solely on the basis of its own perception of the inadequacy of the offer. If no other threat is posed to the corporation and shareholders, a board must at some point allow shareholders to choose between the offer and some alternative. Whether the alternative is to remain independent and reap the future benefits with the company . . . or a financial restructuring . . . or an auction . . . the shareholders must at some point be allowed to choose.

*Id.*

gave directors more latitude in rejecting inadequate tender offers. First, the court adopted the view that threats to corporate viability are significant in considering a tender offer.<sup>130</sup> Second, the court recognized that a board does not have to auction itself to the first bidder, especially when shareholders are just beginning to benefit from the company's improving financial position.<sup>131</sup>

The view that a board should not reject a tender offer solely because of price inadequacy is consistent with the Efficient Capital Market Hypothesis ("ECMH").<sup>132</sup> The ECMH contends that the stock market accurately reflects a company's value, and therefore any offer above prevailing market value is adequate by definition.<sup>133</sup> In reality, however,

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130. See *id.* at 1015. In *Universal Foods*, the court found the highly leveraged nature of the offer and its effect on the long-term viability of the corporation, its customers, suppliers and employees to be a valid corporate issue, worthy of board consideration. See *id.* One commentator states that if a board may consider the interests of the corporate enterprise, particularly its long-term viability after the completion of the tender offer, it is easier to justify the board's power to preclude shareholder choice. See McBride, *supra* note 116, at S14, col. 2. The author notes that *Interco* and *Pillsbury* addressed the issue of enterprise interests in conflicting ways. *Interco* indicated that in an all-cash, all-shares offer the primary threat is to shareholder interests, not enterprise interests. See *City Capital Assocs. v. Interco Inc.*, 551 A.2d 787, 797 (Del. Ch. 1988); see also *TW Services, Inc. v. SWT Acquisition Corp.*, [Current Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,334, at 92,179 (Del. Ch. Mar. 2, 1989) (long run interests of shareholders and other corporate constituencies not relevant in all-cash, all-shares tender offer situation because shareholders will be completely bought out). It is unclear, however, whether *Pillsbury* rejected the use of enterprise interests to evaluate a threat in all-cash, all-shares offers or simply found that none existed in that particular case. See McBride, *supra* note 116, at S14, col. 3.

131. See *Universal Foods*, 708 F. Supp. at 1013.

132. See Lowenstein, *supra* note 81, at 269-70. The ECMH holds that competition between sophisticated investors enables the stock market to reflect the fundamental value of the businesses and assets underlying the stocks traded on the market. See *id.* According to the ECMH, the market is information efficient in that "[a]ll relevant publicly available information is analyzed by thousands of investors and any new data . . . is quickly noticed, digested and then incorporated in the price of the stock." *Id.* Because stock prices would reflect all currently available information, investors would be wasting their time by trying to beat the market through careful stock selection. See *id.*

Tender offers are considered a useful device in an efficient market because corporate performance is mirrored in stock prices and management has an incentive to be efficient. See Easterbrook & Fischel, *supra* note 18, at 1165-74; Fischel, *Efficient Capital Market Theory, the Market for Corporate Control, and the Regulation of Cash Tender Offers*, 57 Tex. L. Rev. 1, 9 (1978). Moreover, the combination of an efficient market and tender offers creates "a market for corporate control" because it constrains managerial inefficiency, self-dealing and reduces agency costs. See Manne, *Mergers and the Market for Corporate Control*, 73 J. Pol. Econ. 110 (1965). Thus, defensive measures, such as the refusal to redeem a rights plan, which deprive shareholders of the opportunity to decide on tender offers, are harmful to shareholders and contrary to traditional corporate governance theories. See Easterbrook & Fischel, *supra* note 18, at 1166; Gilson, *supra* note 79, at 845-48.

133. See Easterbrook & Fischel, *supra* note 18, at 1166-67; see also Andre, *Tender Offers for Corporate Control: A Critical Analysis and Proposals for Reform*, 12 Del. J. Corp. L. 865, 871 (1987) (ECMH suggests impossibility of reaping profits by acquiring firms whose stock is underpriced because no firm is worth more than its market price). According to the ECMH a bidder would offer a premium, and attempt a takeover, only if it thought that it could profit by the takeover. If market prices conform closely to long run

the market may not be perfectly efficient. Although the ECMH has been accepted by some commentators,<sup>134</sup> others have questioned whether the market's pricing mechanism is always efficient.<sup>135</sup>

The market may not consistently reflect a corporation's intrinsic value,<sup>136</sup> and therefore a premium offer would not definitively establish that the offer is adequate.<sup>137</sup> Consequently, shareholders must be capable of analyzing information about the company in order to decide whether to accept an offer. Shareholders, however, are generally passive investors and do not have the information or expertise to make a price adequacy determination.<sup>138</sup> On the other hand, the board is in the best position to evaluate whether a premium offer is adequate.<sup>139</sup> The board is better informed than the shareholders as to the company's worth, future prospects and plans, and is more capable of determining whether the company should remain independent.<sup>140</sup> Moreover, the board is more

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stock values, then the primary opportunity for profit would be those situations in which the superior managerial skills of the acquiring firm could put the undermanaged resources of the target to better use. See Jarrell & Bradley, *The Economic Effects of Federal and State Regulations of Cash Tender Offers*, 23 J. Law & Econ. 371, 380-81 (1980). In addition, potential synergy gains arising from the combination of two complementary lines of businesses may lead to a takeover. See R. Clark, *Corporate Law* 535-36 (1986) (Professor Clark, however, states that potential acquirers would resort to friendly merger rather than tender offer); see also Lowenstein, *supra* note 81, at 274 n.103 (other factors such as synergy gains do not account for the remarkable growth in takeover bids or the character of particular targets).

134. See, e.g., Easterbrook & Fischel, *supra* note 18, at 1165; Fama, *Efficient Capital Markets: A Review of Theory and Empirical Work*, 25 J. Fin. 383, 389-91 (1970); Fischel, *supra* note 132, at 9; Gilson, *supra* note 79, at 838.

135. See Lowenstein, *supra* note 81, at 273-74. Professor Lowenstein states that "whatever the market's long-run tendencies toward efficiency may be, they are only that—tendencies. The market is not perfectly efficient for all stocks at all times." *Id.* at 274; see also S. Cottle, R. Murray & F. Block, *supra* note 109, at 23-27 (despite gains in market efficiency, anomalies exist which challenge the accuracy of the market's pricing mechanism); Summers, *Does The Stock Market Rationally Reflect Fundamental Values?*, 41 J. Fin. 591, 592 (1986) (existing evidence insufficient to establish that financial markets are efficient in reflecting fundamental values). The stock market crash of 1987 also casts doubt over the efficient market theory. See Farrell, *The 'Efficient Market' was a Good Idea—And Then Came the Crash*, Bus. Wk., Feb. 22, 1988, at 140.

136. See *supra* note 109.

137. See *Gelco Corp. v. Coniston Partners*, 652 F. Supp. 829, 849-50 (D. Minn. 1986), *aff'd in part, vacated in part*, 811 F.2d 414 (8th Cir. 1987); *Smith v. Van Gorkom*, 488 A.2d 858, 875-76 (Del. 1985).

138. See *Dynamics Corp. of America v. CTS Corp.*, 794 F.2d 250, 254 (7th Cir. 1986), *rev'd on other grounds*, 481 U.S. 69 (1987).

139. Indeed, in *Van Gorkom* the board was found liable for not informing itself of the company's value before agreeing to a premium merger offer. See *Van Gorkom*, 488 A.2d at 875-76. Moreover, Delaware law has clearly recognized that the board's statutory duty to manage the affairs of the corporation is fully applicable in the takeover context. See *Ivanhoe Partners v. Newmont Mining Corp.*, 535 A.2d 1334, 1341 (Del. 1987); *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 179 (Del. 1986); *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 954 (Del. 1985).

140. See Steinbrink, *Management's Response to the Takeover Attempt*, 28 Case W. Res. 882, 891 (1978); see also Yablon, *supra* note 91, at 88 (recognizing board's unique insights into company's future prospects).



sensitive to the likelihood that the bidder is seeking to acquire control of the company at the cheapest possible price.<sup>141</sup> Thus, the decision to accept or reject a tender offer must be made by the board.<sup>142</sup>

### B. *The Coercive Effects of All-Cash, All-Shares Tender Offers*

Both the *Interco* and *Pillsbury* courts concluded that an all-cash, all-shares tender offer is noncoercive.<sup>143</sup> Under this view, even if the target board reasonably considers the offer inadequate, shareholders are not at

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141. See Lowenstein, *supra* note 81, at 274-75 (takeover game is uneven, stock market produces a number of attractively priced takeover candidates, and bidder, focusing on intrinsic value, is looking more towards value of resources than to expected changes in stock prices); see also Shipman, *The Case for Reasonable State Regulation of Corporate Takeovers: Some Observations Concerning the Ohio Experience*, 57 U. Cin. L. Rev. 507, 508, 537 (1988) (hostile offerors naturally wish to stampede shareholders into selling shares quickly and at cheapest possible price); O'Connell, *supra* note 6, at 38, col. 1 (board must review offers because prospective acquirers attempt to gain control as inexpensively as possible).

142. Some commentators, however, argue that undervalued stocks can remain undervalued. Thus, shareholders may not mind being exploited by an inadequate offer because of the attractiveness of a premium offer. See Andre, *supra* note 133, at 872; Coffee, *Regulating the Market for Corporate Control: A Critical Assessment of the Tender Offer's Role in Corporate Governance*, 84 Colum. L. Rev. 1145, 1172-73 (1984). These commentators, however, do not address whether bidders would start lowering their bids if they knew management could not reject their offer.

The Kraft takeover is a recent example of how bidders can sometimes make what is considered to be a very generous offer, but not necessarily their best offer. Kraft's board initially characterized Philip Morris's hostile tender offer as inadequate, even though Philip Morris offered a 50 percent premium over the prevailing market price. See Freedman & Gibson, *Philip Morris Cos. Is Bidding \$90 a Share For Kraft Inc. in \$11 Billion Tender Offer*, Wall St. J., Oct. 18, 1988, at A3, col. 3. Kraft used its rights plan to resist the offer and proposed an alternative transaction to its shareholders. Philip Morris eventually raised its initial bid to \$106.00 per share and won the takeover battle. See Freedman & Gibson, *Kraft Accepts Philip Morris's Sweetened Offer Totalling \$13.1 Billion, or \$106.00 a Share in Cash*, Wall St. J., Oct. 31, 1988, at A3, col. 1. Thus, despite making a generous offer, Philip Morris felt the deal was still attractive at a price 18 percent higher than its original offer. Kraft's shareholders were certainly better off, but it is uncertain whether Philip Morris would have increased its bid if it knew that Kraft could not reject the offer.

The Kraft takeover also shows that bidders do not always make tender offers because target management is inefficient. Kraft was viewed as a company on the rise and not the victim of poor management. See Dreyfack, *Kraft, Minus Some Extra Baggage, Is Picking up Speed*, Bus. Wk., Mar. 9, 1987, at 74; see also Freedman & Gibson, *Philip Morris Cos. Is Bidding \$90 a Share For Kraft Inc. in \$11 Billion Tender Offer*, *supra*, at A3, col. 3 (Philip Morris does not intend to replace Kraft's management). Kraft was taken over because it was in excellent financial condition and was a well-established, successful company. Examples such as Kraft rebut the argument that tender offers are needed to prevent the entrenchment of poor management and lend more support to the contention that bidders are in pursuit of a bargain.

143. See *Grand Metro. Pub. Ltd. v. The Pillsbury Co.*, 558 A.2d 1049, 1060 (Del. Ch. 1988); *City Capital Assocs. v. Interco Inc.*, 551 A.2d 787, 796 (Del. Ch. 1988); see also *Robert M. Bass Group, Inc. v. Evans*, 552 A.2d 1227, 1239 (Del. Ch. 1988) ("Takeover bids found to be a threat have typically involved a coercively structured proposal, such as a two tiered, hostile tender offer."). But see *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 181 (Del. 1986) (upheld rights plan as reasonable defensive measure to counter grossly inadequate all-cash, all-shares offer).

risk because they cannot be forced into accepting the offer.<sup>144</sup> This reasoning, however, ignores the argument that all tender offers are somewhat coercive and do not provide for free shareholder choice.<sup>145</sup> Neither *Interco* nor *Pillsbury* considered whether the shareholders tendering into the offers did so because they deemed the offers adequate, or because they succumbed to the pressure to tender present in all tender offers.

Some commentators have noted that the prisoner's dilemma is not limited to two-tiered or partial tender offers, but includes all tender offers, even all-cash, all-shares offers.<sup>146</sup> The prisoner's dilemma occurs because no one shareholder can be sure how other shareholders will act, and must assume that the offer will be successful.<sup>147</sup> The pressure to tender stems from the fear of ending up with minority shares that will generate less value than if the shareholder had tendered to the original offer.<sup>148</sup> Target shareholders, therefore, are pressured into tendering their shares even if they view the offered acquisition price as lower than the value of the target in long-term perspective.<sup>149</sup> Thus, allowing only shareholders to determine the adequacy of an offer will invariably lead to acceptance of the offer because of the coercive effects inherent in all tender offers.

Moreover, a promise of a second step at the same consideration does not alleviate the pressure to tender.<sup>150</sup> There is no guarantee that a sec-

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144. See *Interco*, 551 A.2d at 797-98.

145. See *Radol v. Thomas*, 534 F. Supp. 1302, 1312 (S.D. Ohio 1982).

146. See Bebchuk, *The Pressure to Tender: An Analysis and a Proposed Remedy*, 12 Del. J. Corp. L. 911, 926-27 (1987); Lowenstein, *supra* note 81, at 307; see also L. Solomon, D. Schwartz & J. Bauman, *supra* note 7, at 1057 (recognizing that all tender offers have second step which may lead to coercion); Greene & Junewicz, *A Reappraisal of Current Regulation of Mergers and Acquisitions*, 132 U. Pa. L. Rev. 647, 679-81 (1984) (all tender offers are coercive to some extent); Lipton, *supra* note 18, at 113 (misleading to speak of free shareholder choice, as special dynamics of tender offer is such that shareholders will always tender); Note, *Poison Pill Rights: Toward a Two-Step Analysis of Directors' Fidelity to their Fiduciary Duties*, 56 Geo. Wash. L. Rev. 373, 378 (1988) (tender offer contains an inherent element of coercion).

147. See Bebchuk, *supra* note 146, at 926; Lipton, *supra* note 18, at 113-14; see also Lowenstein, *supra* note 81, at 307 (shareholders pursue a high premium, but cannot communicate with each other or negotiate for better terms).

148. See Bebchuk, *supra* note 146, at 926. Professor Bebchuk states:

The pressure to tender is rooted in the consequences that the shareholder might suffer if he does not tender. Clearly, the assurance that the shareholder will not end up with any minority shares if he *does* tender in no way alleviates his fear that he will end up with low-value minority shares if he *does not* tender. As long as the expected value of minority shares is lower than the bid price, this fear introduces a pressure to tender. This low expected value of minority shares, which arises from the powers that a successful bidder would have upon gaining control, does not depend on whether the successful bidder's offer was partial or for all shares.

*Id.*

149. See Bebchuk, *supra* note 146, at 926; Lowenstein, *supra* note 81, at 307.

150. It is probable that some shareholders will not tender their shares. In order to avoid having the offer termed coercive, bidders usually state that if the offer succeeds there will be a prompt follow-up merger to merge out the non-tendering shareholders for the same consideration and terms offered in the first-step. Therefore, non-tendering

ond step will occur because the bidder may be unwilling or unable to effect the promised second step. For example, the bidder's offer often contains an escape clause which might release it from the second step it promises to take if all shares are not tendered.<sup>151</sup> Or a recurrence of "black Monday" might make it impossible for the bidder to finance the second step. In any event, even if the second step occurs, it occurs in the future, and therefore a rational shareholder would always tender because it is better to receive cash sooner rather than later.<sup>152</sup> Consequently, shareholders are forced into tendering, even in an all-cash, all-shares offer with a promised second step, because there are still risks and disadvantages facing shareholders who do not tender in the first step.<sup>153</sup>

### C. The End-Stage Concept

*Interco* adhered to the view that the board's duty to redeem the rights plan arises at the end-stage of the takeover contest.<sup>154</sup> The end-stage occurs when the rights plan is no longer being used as negotiating leverage or to improve or increase the options available to the target.<sup>155</sup> The advent of the end-stage is usually signaled when the target has formulated and proposed an alternative transaction.<sup>156</sup>

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shareholders will not remain minority shareholders for an indefinite term. See *City Capital Assocs. v. Interco Inc.*, 551 A.2d 787, 796 (Del. Ch. 1988).

151. See *Pillsbury*, 558 A.2d at 1060. Offers typically contain an escape clause which gives the bidder the right to change the terms or amount of consideration in the event economic or market conditions change. See, e.g., *Desert Partners, L.P. v. USG Corp.*, 686 F. Supp. 1289, 1299 (N.D. Ill. 1988); Appellants' Opening Brief at 25, *City Capital Assocs. v. Interco Inc.*, 551 A.2d 787 (Del. Ch. 1988) (No. 10105) ("City Capital states in its Offer to Purchase that even if the tender offer is consummated there may be circumstances in which 'the Purchaser does not consummate a merger or other business combination.'").

152. See Lowenstein, *supra* note 81, at 307; see also *Ivanhoe Partners v. Newmont Mining Corp.*, 535 A.2d 1334, 1339, 1342 (Del. 1987) (court considered an offer coercive despite a promise of a second step for the same consideration offered in the first step).

153. See *Amanda Acquisition Corp. v. Universal Foods Corp.*, 708 F. Supp. 984, 1013 (E.D. Wis.), *aff'd on other grounds*, 877 F.2d 496 (7th Cir. 1989).

The *Pillsbury* court agreed that there may be coercion or risk to the minority who do not tender, but did not think that it was serious enough to deprive the majority of shareholders of the right to accept the offer. See *Pillsbury*, 558 A.2d at 1060. The court noted that there were safeguards that protect against this risk: (1) every shareholder who tendered may have withdrawn any time before the offer closed; (2) the offer did not close until after the opinion was rendered so those who did not tender still had the opportunity to tender; and (3) the bidder was required to use its best efforts to buy on the same terms every share of *Pillsbury* stock held by non-tendering shareholders. See *id.* The court in *Universal Foods* may have found the escape clause more significant because a majority of the shareholders had not tendered into the offer. See *Universal Foods*, 708 F. Supp. at 1014.

154. See *City Capital Assocs. v. Interco Inc.*, 551 A.2d 787, 798 (Del. Ch. 1988).

155. See *id.*; see also *Southdown, Inc. v. Moore McCormack Resources, Inc.*, 686 F. Supp. 595, 603 (S.D. Tex. 1988) (noting that target board was no longer attempting to use poison pill to increase stock price, but not explicitly referring to end-stage).

156. The typical alternative transaction proposed by a target board is recapitalization. The recapitalization often takes the form of a special dividend which is distributed to stockholders in the form of cash and/or securities and is often financed by the sale of

In *Interco*, the court found that the rights plan was being used solely to prevent the target's shareholders from choosing between the tender offer and the target's alternative restructuring plan which the court treated as if it were a competing tender offer or other sale type alternative.<sup>157</sup> The existence of an alternative restructuring plan, however, should not be determinative in deciding whether to order the board to redeem the rights plan.<sup>158</sup> Although an alternative recapitalization may be viewed as competing with a hostile tender offer, it is not, by its nature, a tender offer. Unlike a tender offer, a recapitalization leaves shareholders with a continuing equity interest in the company and allows shareholders to participate in the future economic growth of the company.<sup>159</sup> A restructuring is intended to keep the target independent based on the board's conclusion that the tender offer is inadequate and inferior to the target's short-term or long-term potential.<sup>160</sup> The proposal of an alternative recapitalization, therefore, should not automatically call for redemption of the rights plan because a recapitalization is not a sale of the company.

The end-stage concept or a legal rule requiring shareholder choice when an all-cash, all-shares tender offer is made may further the goals of shareholder democracy,<sup>161</sup> but is beneficial to shareholders only if the bidder has made an adequate tender offer. Ordering a board to redeem rights and allowing shareholder choice when the target board has con-

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certain assets. Shareholders also retain their existing shares which are referred to as "stub" shares. These shares trade at a lower value than the pre-recapitalization shares because their value reflects the distribution of the special dividend and is based on the earnings of a smaller company. See *British Printing & Communication Corp. v. Harcourt Brace Jovanovich, Inc.*, 664 F. Supp. 1519, 1525 (S.D.N.Y. 1987); *Interco*, 551 A.2d at 793-94; *AC Acquisitions Corp. v. Anderson, Clayton & Co.*, 519 A.2d 103, 108-09 (Del. Ch. 1986).

157. See *Interco*, 551 A.2d at 798.

158. In any event, courts have permitted a target board to implement a recapitalization plan without shareholder approval when the board in good faith believes that the restructuring will generate greater value for shareholders. See *Gelco Corp. v. Coniston Partners*, 652 F. Supp. 829, 846 (D. Minn. 1986), *aff'd in part, vacated in part*, 811 F.2d 414 (8th Cir. 1987). Courts, however, have enjoined an alternative transaction when the hostile tender offer has not been declared inadequate by the target board. See *AC Acquisitions*, 519 A.2d at 106-07 (enjoining recapitalization as unreasonable response to adequate tender offer because it precluded shareholders from deciding on a fair offer); see also *Robert M. Bass Group, Inc. v. Evans*, 552 A.2d 1227, 1244 (Del. Ch. 1988) (cannot force shareholders to accept economically inferior transaction while, at the same time, preclude them from considering economically superior one).

159. See *Harcourt Brace Jovanovich*, 664 F. Supp. at 1525; *Gelco*, 652 F. Supp. at 846; *AC Acquisitions*, 519 A.2d at 109.

160. See *id.* at 850; see also *BNS Inc. v. Koppers Co.*, 683 F. Supp. 458, 475 (D. Del. 1988) (indicating that court may not interfere with recapitalization if proposed).

161. The end-stage concept does not preclude the target's shareholders from choosing to accept premium tender offers or prevent bidders from saving shareholders from depressed stock prices. See *Coffee*, *supra* note 142, at 1172. In addition, the end-stage concept recognizes that a tender offer clearly benefits shareholders financially by offering them a premium. See *Edgar v. Mite Corp.*, 457 U.S. 624, 633 n.9 (1982) (in enacting the Williams Act, Congress did not want to deny shareholders opportunity to sell shares for premium over market price).

cluded that an all-cash, all-shares offer is inadequate is harmful to shareholders.

A rights plan is effective because it gives the board bargaining leverage in allowing it to reject inadequate or unfair takeovers.<sup>162</sup> The end-stage approach, however, takes away the board's negotiating leverage. It is questionable whether a bidder will offer shareholders intrinsic value or its best offer if it knows that the board will eventually be ordered to redeem the rights plan.<sup>163</sup> The end-stage approach, therefore, may prevent shareholders from receiving the best possible price for their shares.<sup>164</sup>

### III. THE PROPER COURSE OF CONDUCT

A board should not be required to redeem its rights plan if it has reasonably concluded that an all-cash, all-shares tender offer is inadequate. Courts should not overturn a board's decision not to redeem rights unless it acts in bad faith or is not well informed in determining that the offer is inadequate. Some commentators have argued, however, that a board is incapable of acting impartial and can effectively "paper" a transaction to give it the appearance that it is exercising due care in determining inadequacy.<sup>165</sup> Consequently, courts should pay considerably more attention to the procedures followed by a board, particularly the outside directors,

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162. See *Moran v. Household Int'l, Inc.*, 500 A.2d 1346, 1354-55 (Del. 1985); see also *Desert Partners, L.P. v. USG Corp.*, 686 F. Supp. 1289, 1296 (N.D. Ill. 1988) (pill does not preclude all takeovers, only inadequate or unfair ones); Dawson, Pence & Stone, *supra* note 29, at 426 ("poison pills may effectively deter certain inadequate or otherwise undesirable offers").

163. The end-stage approach places the bidder in command because it alone will determine when to stop bidding. The bidder, however, will have no incentive to increase its offer if it knows it just has to wait out the target's board. See Herzfel, Schmidt & Davis, *Why Corporate Directors Have a Right to Resist Tender Offers*, 3 Corp. L. Rev. 107, 110 (1980) (legal rules requiring board to accept proposed merger would remove a significant element of board's bargaining power); see also Yablon, *supra* note 91, at 90 (suggesting lack of precise legal standards governing redemption may encourage bidders to increase offers).

164. Recently, a study was conducted to determine whether shareholders receive higher takeover premiums when their company has a rights plan. The study concluded that companies protected by a rights plan received takeover premiums 69 percent greater than those received by companies without a rights plan. See Georgeson & Company Inc., *Poison Pill Impact Study I-2* (Mar. 31, 1988). This report, however, was criticized because it did not sufficiently consider whether rights plans prevented some takeovers from occurring. See *id.* Georgeson & Company, Inc. conducted another study to refute the criticism. This study, designed to examine the actual impact of poison pills, concluded that companies with rights plans still outperformed, in terms of the premiums received, companies without rights plans by 9.6 percent. See Georgeson & Company Inc., *Poison Pill Impact Study II 6* (Oct. 31, 1988). Moreover, it found that companies with rights plans were more likely to receive hostile bids. See *id.* at 7. The study was criticized again when another research firm did its own study and concluded that performance was the same between companies with and without rights plans. See Cowan, *Study Asserts 'Poison Pills' Do Not Raise Stock Prices*, N.Y. Times, Jan. 4, 1988, at D4, col. 3.

165. See Note, *supra* note 146, at 397; Note, *supra* note 67, at 1330; see also *City Capital Assocs. v. Interco Inc.*, 551 A.2d 787, 792-93 (Del. Ch. 1988) (expressing concern over board's valuations and reliance on investment banker's opinion).

in concluding that an offer is inadequate.<sup>166</sup> Although this view does not represent a significant change from existing law, it does propose that courts refrain from rubber-stamping boards' inadequacy determinations.<sup>167</sup>

Courts are not equipped to make the actual financial decision that an offer is inadequate,<sup>168</sup> but they may look at the board's methodology in concluding that a given price is inadequate.<sup>169</sup> Particularly, courts should examine the independence and thoroughness of the target's investment bankers and whether the target's outside directors played a significant role in evaluating the offer's merits.<sup>170</sup> Courts should defer to the board's decision to remain independent as long as the conclusion was made under proper circumstances.<sup>171</sup>

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166. See Block & Hoff, *The Duties of Boards to Redeem Poison Pills*, N.Y.L.J., Dec. 15, 1988, at 6, col. 3 (suggests courts may "require the board to make a more particularized showing to justify its determination of financial inadequacy").

167. Professors Gilson and Kraakman, however, recently proposed that in addition to examining certain board procedures, a court should exercise its own independent judgment when determining whether a tender offer represents a threat to shareholders. See Gilson & Kraakman, *supra* note 61, at 270-74.

168. See *Auerbach v. Bennett*, 47 N.Y.2d 619, 630-31, 393 N.E.2d 994, 1000, 419 N.Y.S.2d 920, 926-27 (1979); see also Siegel, *Tender Offer Defensive Tactics: A Proposal for Reform*, 36 Hastings L.J. 377, 394-96 (1985) (courts reluctant to apply intrinsic fairness standard because it requires courts to make investment decision involving fundamental security analysis and involves considerations which business judgment rule was created to avoid). But see *Zapata Corp. v. Maldonado*, 430 A.2d 779, 789 (Del. 1981) (court should apply own independent business judgment in determining whether motion to dismiss derivative suit should be granted); McBride, *supra* note 116, at S14, col. 2 (*Pillsbury* court made own determination that tender offer was adequate).

169. See *Desert Partners, L.P. v. USG Corp.*, 686 F. Supp. 1289, 1299 (N.D. Ill. 1988); *BNS Inc. v. Koppers Co.*, 683 F. Supp. 458, 475-76 (D. Del. 1988); *Anaconda Co. v. Crane Co.*, 411 F. Supp. 1210, 1215 (S.D.N.Y. 1975); *Pogostin v. Rice*, 480 A.2d 619, 627 (Del. 1984). Moreover, courts have not always been reluctant to find that a board acted haphazardly in tender offer situations. See, e.g., *Hanson Trust PLC v. ML SCM Acquisition, Inc.*, 781 F.2d 264, 274-75 (2d Cir. 1986) (applying New York law) (court found that board breached its duty of care in approving lock-up option, stating that where board's "methodologies and procedures" are 'so restricted in scope, so shallow in execution, or otherwise so *pro forma* or halfhearted as to constitute a pretext or sham,' then inquiry into their acts is not shielded by the business judgment rule") (quoting *Auerbach v. Bennett*, 47 N.Y.2d 619, 634, 393 N.E.2d 994, 1002-03, 419 N.Y.S.2d 920, 929 (1979)).

170. Courts have just recently begun criticizing investment bankers for their actions during takeover contests. See *Mills Acquisition Co. v. Macmillan Inc.*, [1988-1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,071 (Del. Ch.), *rev'd*, [Current Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,401 (Del. May 3, 1989); see also Bartlett, *Delaware Courts Get Tough Toward Investment Bankers*, N.Y. Times, May 30, 1989, at D1, col. 1.

171. See *Ivanhoe Partners v. Newmont Mining Corp.*, 535 A.2d 1334, 1339 & n.12 (Del. 1987); see also *BNS Inc. v. Koppers Co.*, 683 F. Supp. 458, 475 (D. Del. 1988) (board rejected offer only after conducting serious review of several relevant factors, including: (i) the board's assessment of the value of the company; and (ii) the advice of its investment banker); *Gelco Corp. v. Coniston Partners*, 652 F. Supp. 829, 849 (D. Minn. 1986) (board devoted a five and one half hour meeting to evaluate the merits of offer and acted to reject offer, based partly on advice from investment banker), *aff'd in part, vacated in part*, 811 F.2d 414 (8th Cir. 1987); *Anaconda Co. v. Crane Co.*, 411 F. Supp. 1210, 1215 (S.D.N.Y. 1975) (reviewing report of company's investment banker and concluding that business man could make a proper business judgment based upon report to

Despite the view that an investment banker's opinion is not always necessary, a board should obtain an independent investment banker's opinion in determining whether a tender offer is adequate.<sup>172</sup> Although there is some possibility of self-serving opinions, the bankers do have their professional reputations to consider and, therefore, arguably provide a necessary monitoring function.<sup>173</sup> In any event, courts are capable of determining when to give less credence to inadequacy opinions. Opinions by bankers that frequently and inexplicably change a company's fairness range during the course of a takeover battle or who have a clear conflict of interest should be discounted.<sup>174</sup>

A board's decision to reject a tender offer because of price inadequacy can be given more weight if it is the decision of a majority of outside independent directors.<sup>175</sup> Outside directors are capable of protecting shareholder interests when they truly remain independent.<sup>176</sup> The board's decision to remain independent should be respected if the outside directors distanced themselves from the management directors and reviewed the offer in a neutral manner.<sup>177</sup> Moreover, courts should recognize that directors, even inside directors, have an incentive to consider a tender offer objectively. A board that rejects an obviously adequate

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reject offer); *MAI Basic Four, Inc. v. Prime Computer, Inc.*, [1988-1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,179, at 91,634 (Del. Ch. Dec. 20, 1988) (finding it significant that company retained two independent outside investment bankers who concluded offer was inadequate).

172. A valuation opinion by an investment adviser is not required as a matter of law. See *Smith v. Van Gorkom*, 488 A.2d 858, 876 (Del. 1985); see also *Amanda Acquisition Corp. v. Universal Foods Corp.*, 708 F. Supp. 984, 1013 (E.D. Wis.) (not requiring investment banker's opinion because board was well-informed concerning the company's value), *aff'd on other grounds*, 877 F.2d 496 (7th Cir. 1989). Nevertheless, boards invariably obtain adequacy opinions since they are counseled by their attorneys to do so and courts seem to expect them. See *Hanson Trust PLC v. ML SCM Acquisition, Inc.*, 781 F.2d 264, 275 (2d Cir. 1986); *Lipton*, *supra* note 18, at 101.

173. See *Gelfond & Sebastian*, *supra* note 99, at 470; see also *Note, Investment Bankers' Fairness Opinions in Corporate Control Transactions*, 96 Yale L.J. 119, 126 (1986) (although investment bankers may have incentive to craft opinions favorable to management, they are outsiders with reputations beyond the client firm and are more difficult to corrupt than inside managers).

174. See *City Capital Assocs. v. Interco Inc.*, 551 A.2d 787, 792-93 (Del. Ch. 1988); *Bartlett*, *supra* note 171, at D2, col. 4; see also *Bebchuk & Kahan, Fairness Opinions: How Fair are They and What Can be Done About it?*, 1989 Duke L.J. 27, 49-53 (1989) (suggesting that courts scrutinize bankers' opinions when conflict of interest exists).

175. See *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 955 (Del. 1985); *Amanda Acquisition Corp. v. Universal Foods Corp.*, 708 F. Supp. 984, 1010-11 (E.D. Wis.), *aff'd on other grounds*, 877 F.2d 496 (7th Cir. 1989); see also *Gelfond & Sebastian*, *supra* note 98, at 468-69 (board may follow recommendation of truly independent directors); *Shipman*, *supra* note 141, at 537 (if disinterested outside directors carefully follow proper methodology, there should be judicial deference).

176. See *Universal Foods*, 708 F. Supp. at 1010-11; see also *Dobrzynski, Taking Charge*, Bus. Wk., July 3, 1989, at 66 (discussing positive shift in board's concern for shareholders).

177. See *Universal Foods*, 708 F. Supp. at 1010-11 (finding it significant that ten independent directors on target's thirteen member board avoided contact with inside management when evaluating offer and clearly did not rubber-stamp management's position).

tender offer will not remain in office for long if the company's stock price falls and remains at its pre-offer level.<sup>178</sup> Either other bidders will surface and threaten the company's independence or shareholders will use the powers of corporate democracy to vote the board out.<sup>179</sup>

#### CONCLUSION

A board should be able to refuse to redeem a rights plan if, in good faith and after reasonable investigation, it concludes that the offer is inadequate. The board has the duty to protect shareholders from harm and an inadequate all-cash, all-shares offer represents such harm. A rights plan forces bidders to offer shareholders full value for their shares. If the board is forced, however, to redeem a rights plan at the end-stage of a takeover contest, then the shareholders' chances of receiving full value will be jeopardized. Thus, instead, courts should focus on the board's inadequacy determination. The courts should not make their own independent conclusions concerning adequacy, but can examine the board's methodology to ensure that the board had a reasonable basis for its decision.

*Anthony Augliera*

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178. See Cohen, *supra* note 6, at B5, col. 1 (board runs risk of losing proxy fight or shareholder suits if their rejection decision based on price is not vindicated by markets).

179. See *Unocal*, 493 A.2d at 959; *Aronson v. Lewis*, 473 A.2d 805, 811 (Del. 1984).



