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Increasingly, companies faced with takeover bids have begun to employ highly sophisticated tactics to rebuff or promote tender offers. A potential limit to the use of these defensive takeover tactics is section 14(e) of the Williams Act, which prohibits manipulation in connection with tender offers. Professor Weiss discusses the definition of section 14(e) manipulation and whether an arrangement that significantly obstructs the operation of a fair auction market for a target company's shares fits that definition. He focuses on the Sixth Circuit's recent decision in Mobil Corp. v. Marathon Oil Co. *in which the court applied a broad definition of manipulation and held that certain lock-up arrangements favoring one of the bidders were prohibited under section 14(e). Professor Weiss endorses the* Marathon *decision and concludes that the broader definition of manipulation helps clarify the difference between legitimate corporate behavior and actions that serve primarily to provide unwarranted protection to target company managers or unnecessary benefits to favored tender offerors.*

I. INTRODUCTION

Section 14(e) of the Williams Act[1] provides: "It shall be un-

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1. The Williams Act is an investor-protection statute that grew out of a congressional concern for the interests of corporate management whose businesses were likely takeover targets. Piper v. Chris-Craft, Indus., 430 U.S. 1, 39 (1977). It was enacted in 1968, and added § 13(d)-(e), 15 U.S.C. § 78m(d)-(e) (1976 & Supp. IV), and § 14(d)-(f), 15 U.S.C. § 78n(d)-(f) (1976) to the Securities Exchange Act of 1934.

lawful for any person . . . to engage in any fraudulent, deceptive, or manipulative acts or practices, in connection with any tender offer . . . ."[2] In recent years target companies and tender offerors have used increasingly sophisticated tactics to rebuff or promote tender offers.[3] The Sixth Circuit's recent decision in *Mobil Corp. v. Marathon Oil Co.*,[4] holding that certain lock-up[5] arrangements are "manipulative acts" in violation of section 14(e), calls into question the legality of many of these tactics.

This Article discusses whether arrangements designed to ensure the success of a favored bidder or simply to defeat an unwanted tender offer are "manipulative acts or practices" barred by section 14(e).[6] It argues that the critical issue is whether an arrangement significantly obstructs the operation of a fair auction market for a target company's shares. The Article maintains that recent Supreme Court decisions interpreting section 14(e) and other antifraud provisions of the federal securities laws provide substantial support for this approach to interpreting section 14(e).

The Article first discusses the definition of section 14(e) manipulation. The recent *Marathon* decision provides the basis for this discussion. The Article then explores the implications of this proposed definition in takeover situations in which bidders or targets are employing tactics such as lock-ups, two-tier bids, asset or stock sales, defensive acquisitions, and indemnification agreements.The Article emphasizes *Marathon* because it is the first case subsequent to *Santa Fe Industries, Inc. v. Green*[7] to raise squarely the question of whether section 14(e) bars only what might best be termed classic market manipulation, such as simultaneous purchases and sales of securities at different prices, or whether it

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2. 15 U.S.C. § 78n(e) (1976).

3. *See* Fraidin & Franco, *Lock-Up Arrangements*, 14 REV. SEC. REG. 82 (1981); Nathan, *Lock-Ups and Leg-Ups: The Search for Security in the Acquisitions Market Place*, 13th ANN. INST. ON SEC. REG. 13 (Practicing Law Inst. 1981). Fraidin and Franco discuss the strategy underlying the use of lock-up arrangements: "[Lock-up] arrangements do not necessarily insure the success of a transaction or prevent another bidder from successfully challenging it. Rather, a lock-up arrangement merely increases a bidder's likelihood of success and creates barriers (which can generally be overcome) to a competing bidder." Fraidin & Franco, *supra*, at 821.

4. 669 F.2d 366 (6th Cir. 1981).

5. A lock-up is a device that places one bidder in a competitively advantageous position to ensure that a bidder's tender offer will succeed.

6. For an analysis of different types of arrangements, see *infra* text accompanying notes 191-220.

7. 430 U.S. 462 (1977).

prohibits certain other arrangements as well.[8] Prior to *Santa Fe,* two federal district courts had enjoined as manipulative defensive arrangements employed in connection with tender offers, but both courts based their conclusions on the notion that section 14(e) embodies a federal fiduciary standard[9] — a rationale that would not appear to survive *Sante Fe.*[10]

In addition to discussing how courts should interpret section 14(e), and endorsing the result reached in *Marathon,*[11] this Article criticizes philosophically, if not as a matter of law, recent decisions of the Second,[12] Third,[13] and Seventh[14] Circuits rejecting state law challenges to the utilization by target companies of various defensive tactics to fend off unwelcome takeover bids. This Article also enters the broader debate currently raging over the economic effects of tender offers and defensive arrangements employed against those offers.[15] Indeed, the Article strives to examine these issues that usually are discussed in the context of economic theory and state law doctrine, from the perspective of federal law. The Article concludes that section 14(e)'s ban against manipulation provides a

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8. "[Marathon] stands, at least for the time being, as the most authoritative decision available on the legality of target-granted lock-up devices . . . ." Nathan, *Novel Legal Questions Explored,* Nat'l L.J., March 29, 1982, at 30.

9. *See* Applied Digital Data Systems v. Milgo Electronic Corp., 425 F. Supp. 1145 (S.D.N.Y. 1977); Royal Indus. v. Monogram Indus. [1976-1977 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 95,863 (C.D. Cal. 1976).

10. *See* Consolidated Amusement Co. v. Rugoff, [1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,584 (S.D.N.Y. 1978) (commenting on impact of *Santa Fe* and holding fraudulent defensive scheme to be in violation of state law).

11. The *Marathon* decision has received much criticism. *See, e.g.,* Marshall Field & Co. v. Icahn, [Current Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 98,616 (S.D.N.Y. 1982) (expressing doubt that *Marathon* is good law in Second Circuit). For a discussion of *Marathon,* see Bialkin, *Court Casts Cloud Over Option Tract in Takeovers,* Legal Times of Washington, Jan. 11, 1982, at 19; Ferrara & Phillips, *supra* note 5; and Herzel & Collins, *Limits on Takeover Defenses,* Nat'l L.J., Mar. 29, 1982, at 25; Nathan, *supra* note 8. For an analysis of the decision's implications, *see, e.g.,* Fraidin & Franco, *supra* note 3; Hochman, *The Marathon Case,* 14 REV. SEC. REG. 827 (1981); Hochman, *A Hostile Tender Offer: Does It Suspend Rules?,* Nat'l L.J., Mar. 29, 1981, at 25.

12. Treadway Cos. v. Care Corp., 638 F.2d 357 (2d Cir. 1980); Crouse-Hinds Co. v. Internorth, Inc., 634 F.2d 690 (2d Cir. 1980).

13. Johnson v. Trueblood, 629 F.2d 287 (3d Cir. 1980).

14. Panter v. Marshall Field & Co., 646 F.2d 271 (7th Cir. 1981).

15. *See, e.g.,* Bebchuk, *The Case for Facilitating Competing Tender Offers,* 95 HARV. L. REV. 1028 (1982); Easterbrook & Fischel, *The Proper Role of a Target's Management in Responding to a Tender Offer,* 94 HARV. L. REV. 1161 (1981); Easterbrook & Fischel, *Takeover Bids, Defensive Tactics, and Shareholders' Welfare,* 36 BUS. LAW. 1733 (1981); Gilson, *A Structural Approach to Corporations: The Case Against Defensive Tactics in Tender Offers,* 33 STAN. L. REV. 819 (1981); Lipton, *Takeover Bids in the Target's Boardroom: An Update After One Year,* 36 BUS. LAW. 1017 (1981); Lipton, *Takeover Bids in the Target's Boardroom,* 35 BUS. LAW. 101 (1979).

particularly constructive approach to distinguishing between legitimate corporate bebavior and actions that serve primarily to provide unwarranted protection to target company managers or unnecessary benefits to favored tender offerors.

II. Defining Section 14(e) Manipulation

A. *The Contest for Marathon*

Marathon is a medium-size, primarily domestic, oil company.[16] The company was an attractive takeover target largely because of its extensive domestic crude oil reserves, including a forty-eight percent interest in the Yates field in Texas, the largest oil field in the continental United States.[17]

On October 30, 1981, Mobil, a large multinational oil company[18] that traditionally has suffered from a shortage of crude oil reserves, announced a cash tender offer of $85 per share for up to forty million shares of Marathon common stock, or just over two-thirds of the 58,685,906 Marathon shares issued and outstanding. Mobil also stated its intention to acquire the balance of Marathon in a merger if the tender offer was successful. The Marathon board of directors concluded that Mobil's $85 per share was "grossly inadequate from a financial point of view," and that the tender offer and proposed merger presented antitrust problems.[19] Consequently, the board decided to oppose the offer and filed an antitrust suit alleging that a merger between Mobil and Marathon would violate section 7 of the Clayton Act.[20] The Marathon board

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16. Marathon had total sales of $8 billion and net income of $379 million in 1980. By comparison, Exxon, the largest industrial company in the world, had total sales of $103 billion and net income of $5.65 billion. Marathon Oil Co. v. Mobil Corp., 669 F.2d 378, 380 (6th Cir. 1981), *cert. denied*, 102 S. Ct. 1490 (1982).

17. The Yates field has produced oil for more than fifty years and petroleum engineers expect the field to continue producing for another ninety years. Marathon's 48% interest in the oil field is the largest interest held by any oil company. The *Marathon* court appropriately referred to it as Marathon's "crown jewel." Mobil Corp. v. Marathon Oil Co., 669 F.2d 366, 367-68 (6th Cir. 1981).

18. Mobil is the second largest industrial company in the world with sales at $63.7 billion and net income of $3.27 billion. Marathon Oil Co. v. Mobil Corp., 669 F.2d 378, 380 (6th Cir. 1981), *cert. denied*, 102 S. Ct. 149 (1982).

19. Mobil Corp. v. Marathon Oil Co., [1981-1982 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 98,375, at 92,262 (S.D. Ohio 1981), *rev'd*, 669 F.2d 366 (6th Cir. 1981).

20. 15 U.S.C. § 18 (1976 & Supp. IV). Section 7 provides in part as follows: "No person . . . shall acquire . . . stock . . . where in any line of commerce . . . in any section of the country, the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly." *Id.* (Supp. IV).

also directed its investment banker to locate a "white knight"[21]—a more attractive merger partner—prepared to pay a higher price for Marathon.

Marathon's defensive tactics were successful. A United States district court, acting on the antitrust claim, issued first a temporary restraining order and then a preliminary injunction barring Mobil from consummating the purchase of any Marathon shares.[22] Marathon's investment banker located three potential white knights, and Marathon entered into negotiations with all three. These negotiations culminated on November 18, 1981, when United States Steel Corporation (USS) made a four-part package offer to Marathon which it required Marathon to accept or reject that day. USS offered to make a cash tender offer of $125 per share for 30 million shares of Marathon stock, which represented fifty-one percent of the outstanding shares, and to acquire the remainder of Marathon in a subsequent merger in which USS would issue a debenture with an estimated market value of $80 to $85 for each share of Marathon stock. USS conditioned its offer on Marathon's granting two options to USS—an irrevocable option to purchase 10 million authorized but unissued shares of Marathon common stock for $90 per share and an option, exercisable only if the USS tender offer failed and a third party gained control of Marathon, to purchase Marathon's forty-eight percent interest in the Yates oil field for $2.8 billion.[23]

The Marathon board of directors, "faced with a difficult decision and little time in which to make it,"[24] concluded that the USS tender and merger offers were superior to the still-pending offers by Mobil. The directors also determined that the exercise price of the stock option, which was higher than Mobil's offer and the then-current trading price of Marathon stock, was fair to Marathon shareholders and that the exercise price of the Yates field option was reasonable.[25] Consequently, rather than run the risk of allowing the USS offer to expire, the directors voted unanimously, with two absentees, to accept USS's offer and to grant USS the

21. Mobil Corp. v. Marathon Oil Co., 669 F.2d 366, 368 (6th Cir. 1981).

22. Marathon Oil Co. v. Mobil Corp., 530 F. Supp. 315 (N.D. Ohio), *aff'd* 669 F.2d 378 (6th Cir. 1981), *cert. denied*, 102 S. Ct. 1490 (1982).

23. Mobil Corp. v. Marathon Oil Co., 669 F.2d at 367.

24. Mobil Corp. v. Marathon Oil Co., [1981-1982 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 98,375, at 92,268 (S.D. Ohio Dec. 7, 1981), *rev'd*, 669 F.2d 366 (6th Cir. 1981), *cert. denied*, 102 S. Ct. 1490 (1982).

25. *Id.*

two options.[26] Marathon and USS executed the merger and the stock option and Yates field option agreements before the end of the day.

Mobil filed suit shortly thereafter to enjoin the USS tender offer, the stock option, and the Yates field option on the grounds that USS, Marathon, and Marathon's directors had acted in violation of section 14(e) of the Williams Act and various provisions of Ohio law.[27] Mobil also raised its cash tender offer bid to $126 per share for up to thirty million shares of Marathon and stated that if its offer were successful, it would acquire the remainder of Marathon through a merger in which it would issue Mobil debentures with a value of $90 for each remaining Marathon share.[28] Mobil, however, conditioned its revised offer upon the cancellation or judicial invalidation of the stock option and the Yates field option.[29]

The district court denied Mobil's request for a preliminary injunction.[30] The court found that USS and Marathon had not engaged in deception, and that Mobil's contention that the grant of the stock option and the Yates field option was fraudulent or manipulative failed to state a cause of action under section 14(e).[31] To support this latter holding, the court relied on the statement in *Santa Fe Industries, Inc. v. Green*[32] that " 'once full and fair disclosure has occurred, fairness of the terms of the transaction is at most a tangential concern of the statute.' "[33] The Court held Mobil's claim was simply that the terms of the options were unfair.[34]

The court also rejected Mobil's state law claims, including the allegation that the Marathon directors had breached their fiduciary duty to Marathon by granting USS the stock and Yates field options.[35] The court held that the directors had met their burden

26. *Id.*

27. Mobil Corp. v. Marathon Oil Co., 669 F.2d at 368. Mobil contended that the agreement by the Marathon board to the USS offer constituted a breach of fiduciary duty, that the agreement violated the Ohio requirement that shareholders approve the sale of substantially all of a corporation's assets, and that the grant of the options served no corporate purpose. *Id.*

28. *Id.* at 369.

29. *Id.*

30. Mobil Corp. v. Marathon Oil Corp., [1981-1982 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 98,375 (S.D. Ohio Dec. 7, 1981), *rev'd*, 669 F.2d 366 (6th Cir. 1981), *cert. denied*, 102 S. Ct. 1490 (1982).

31. Mobil Corp. v. Marathon Oil Co., 669 F.2d at 370.

32. 430 U.S. 462 (1977). *See infra* notes 108-50 and accompanying text.

33. Mobil Corp. v. Marathon Oil Co., [1981-1982 Transfer Binder] FED. SEC. L. REP. (CCH) at 92,282 (quoting Santa Fe Indus., Inc. v. Green, 430 U.S. 462, 478 (1977)).

34. *Id.* at 92,281.

35. *See supra* note 27. The court held that Marathon's directors had the burden of

of proving "that both options were fair with respect to their valuation."[36] Moreover, the court found that the grant of the options served the "reasonable corporate purpose" of obtaining "the best possible deal for Marathon shareholders in the face of an inevitable takeover."[37] Thus, the court concluded that the defendant directors had "borne their burden of showing fairness, corporate purpose, and good faith."[38]

On appeal the Sixth Circuit reversed.[39] The court addressed only Mobil's claim that the Yates field option violated section 14(e). It concluded that the two options individually and collectively were manipulative.[40]

The court's argument in support of its conclusion was as follows. First, manipulation, as defined by the Supreme Court, concerns "affecting . . . the market for, or price of, securities by *artificial* means, i.e., means unrelated to the natural forces of supply and demand."[41] Second, lock-up options of the type granted to USS "not only artificially affect, but for all practical purposes completely block, normal healthy market activity . . . ."[42] Mobil had shown that the two options created an artificial price ceiling in the tender offer market for Marathon common share.[43] Specifically, the Yates field option served only "to deter . . . other potential tender offerors from competing with USS in an auction for control of

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proving the options were fair since the directors were perpetuating themselves in office by granting the options. Mobil Corp. v. Marathon Oil Co., [1981-1982 Transfer Binder] FED. SEC. L. REP. (CCH) at 92,281. In reaching this conclusion the district court seemed to reject implicitly the Seventh Circuit's argument in Panter v. Marshall Field & Co., 646 F.2d 271 (7th Cir. 1981), that the interest of outside directors of a target corporation in perpetuating their control is not sufficient to remove decisions which have that effect from the coverage of the business judgment rule. *See infra* notes 160-67 and accompanying text. *Panter* is distinguishable on the ground that a majority of the Marshall Field directors were outsiders, while half of the Marathon directors were insiders. The district court, however, did not articulate this distinction.

36. Mobil Corp. v. Marathon Oil Co., [1981-1982 Transfer Binder] FED. SEC. L. REP. (CCH) at 92,285.

37. *Id.*

38. *Id.*

39. Mobil Corp. v. Marathon Oil Co., 669 F.2d 366 (6th Cir. 1981), *cert. denied,* 102 S. Ct. 1490 (1982).

40. *Id.* at 374. The court sua sponte raised and analyzed the issue whether, in light of Piper v. Chris-Craft Indus., 430 U.S. 1 (1977), *see infra* notes 179—189 and accompanying text, Mobil had standing to maintain an implied cause of action to enforce section 14(e). *See* Mobil Corp. v. Marathon Oil Co., 669 F.2d at 370-73.

41. 669 F.2d at 374 (emphasis in original) (citing Ernst & Ernst v. Hochfelder, 425 U.S. 185, 195 (1976)).

42. *Id.*

43. *Id.* at 375.

Marathon . . . . [T]he stock option was large enough . . . to serve as an artificial and significant deterrent to competitive bidding for a controlling block of Marathon share."[44] Since "[t]he purpose of the Williams Act, protection of target shareholders, requires that Mobil and any other interested bidder be permitted an equal opportunity to compete in the marketplace and persuade the Marathon shareholders to sell their shares to them,"[45] the Sixth Circuit concluded that the two options should be cancelled and that USS should keep its bid open for a reasonable time to allow Mobil and other potential offerors to bid for Marathon shares in a market free of the effects of USS's manipulative conduct.[46]The court expressly noted that it was not disturbing "the district court's finding of good faith and loyalty by the Marathon directors."[47] The court directed its mandate concerning relief at USS for "demanding and obtaining the options, as well as any manipulative conduct by the Marathon directors."[48] "The Williams Act protects the target shareholders regardless of who did the manipulating."[49]

The Sixth Circuit clearly was correct in concluding that USS, by receiving the two options, was in a preferred position to compete for control of Marathon, and that consequently the potential for competitive bidding for Marathon was reduced significantly. Since USS possessed the Yates field option, it was the only bidder that could acquire Marathon complete with its Yates field interest. Moreover, the conditional nature of the option—it was exercisable only if USS did not succeed in its tender offer *and* some other person obtained control of Marathon—indicates that the purpose of the option was the deterrence of competing bids. Similarly, the

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44. *Id.* USS viewed the options as a means of gaining an advantage in the contest for Marathon rather than as serving some essential independent business purpose, since USS stated in its tender offer that the offer was not conditioned on the options' validity. *See* Appellant's Brief at 41, Mobil Corp. v. Marathon Oil Co., 669 F.2d 366 (6th Cir. 1981), *cert. denied*, 102 S. Ct. 1490 (1982).

45. 669 F.2d at 376.

46. On the same day the Sixth Circuit affirmed the preliminary injunction issued by the district court in Marathon Oil Co. v. Mobil Corp., 530 F. Supp. 315 (N.D. Ohio 1981), *aff'd*, 669 F.2d 378 (6th Cir. 1981), *cert. denied*, 102 S. Ct. 1490 (1982), which blocked tbe proposed acquisition by Mobil on antitrust grounds. Marathon Oil Co. v. Mobil Corp., 669 F.2d 378 (6th Cir. 1981), *cert. denied*, 102 S. Ct. 1490 (1982). Thus, Mobil was unable to reenter the contest for Marathon despite prevailing on the Williams Act claim. Judge Merritt, who authored the decision, dissented in *Mobil Corp. v. Marathon Oil Co.* on the ground that, in light of the court's disposition of the antitrust case, Mobil's Williams Act claims were moot. 669 F.2d at 378 (Merritt, J., dissenting).

47. 669 F.2d at 377.

48. *Id.*

49. *Id.*

stock option gave USS a significant advantage in a contest for control of Marathon without serving any other legitimate purpose. If USS succeeded in its tender offer, and subsequently acquired the remainder of Marathon, it would have no need for the option nor any reason to exercise it. USS would exercise the option only if another bidder entered the contest for Marathon. Consider the situation in which a second bidder wanted to acquire a fifty-one percent interest in Marathon for $125 per share—the amount bid by USS. With the option USS could obtain a fifty-one percent interest by spending $4.025 billion—$90 per share for the ten million optioned shares and $125 each for an additional twenty-five million shares. The competing bidder, however, must spend $4.375 billion—$125 per share for 35 million shares or $350 million which is 8.7% more to obtain a fifty-one percent interest.[50] In addition, USS's advantage would increase, in both absolute and relative terms, with each increase in the bid price. For example, if bidding reached the $140 per share level, USS could obtain control of Marathon for $4.4 billion, while a competitor would have to pay $4.9 billion, which is $500 million, or 11.4%, more.[51]

B. *Interpreting Section 14(e)*

The critical issue addressed in *Marathon* was whether arrangements such as the two options granted by Marathon to USS are "manipulative acts or practices" within the meaning of section 14(e). The *Marathon* court dealt with this issue by analyzing how the options affected the tender offer market for Marathon shares. Consideration of the relevant statutory language, the purposes of the Williams Act, and the policy considerations discussed by the Supreme Court in *Santa Fe,* however, is necessary to determine whether the result reached in *Marathon* was correct.

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50. In a contest for control a competitive bidder would have to assume that USS would exercise its option. Consequently, the number of shares representing a 51% interest in Marathon would increase from approximately 30 million to approximately 35 million.

51. Viewed from a different perspective, if a competitor was prepared to pay $4.9 billion for a 51% interest in Marathon, and USS was prepared to pay only $4.65 billion, USS would still prevail in a bidding contest. The competitor would be prepared to pay no more than $140 per share for the 35 million shares it would need. USS, on the other hand, could purchase 10 million shares for $900 million, and could then afford to pay up to $150 per share for an additional 25 million shares while still remaining within its lower overall price ceiling.

1. The Statutory Language

Although the Supreme Court never has dealt with the prohibition against "manipulative acts or practices" in section 14(e), the Court recently discussed the meaning of "manipulation" in section 10(b) of the Securities Exchange Act of 1934. The Court in *Ernst & Ernst v. Hochfelder*[52] considered whether the language of section 10(b) suggests that scienter is a necessary element of a private cause of action for damages implied under that section. The Court stated that manipulation "is and was virtually a term of art when used in connection with securities markets. It connotes intentional or willful conduct designed to deceive or defraud investors by controlling or artificially affecting the price of securities."[53] In *Santa Fe Industries, Inc. v. Green,*[54] the Court expanded on its view of manipulation: "The term [manipulation] refers generally to practices, such as wash sales, matched orders, or rigged prices, that are intended to mislead investors by artificially affecting market activity."[55]

Neither *Ernst & Ernst* nor *Santa Fe* is dispositive of what constitutes manipulation for purposes of section 14(e). The Court's statements in these cases do not make clear whether deception is a necessary element of a manipulative act or practice or whether artificial impact on market activity is the sole critical indicium of manipulation. The Eighth Circuit's opinion in *Cargill, Inc. v. Hardin*[56] is instructive in attempting to resolve this ambiguity. *Cargill,* which was brought under the Commodity Exchange Act, is one of the few cases decided prior to *Marathon* to turn on the question of how a court should interpret a statutory prohibition against manipulation.[57] The *Cargill* court reviewed the definitions of manipulation utilized by courts in other contexts.[58] The court noted that courts consistently have defined manipulation in a practical manner designed to accomplish the objectives of the statute in ques-

52. 425 U.S. 185 (1976).

53. *Id.* at 199. The Court said that this connotation of intent or willfulness supported the view that scienter was a necessary element of a cause of action under section 10(b). *Id.* at 201.

54. 430 U.S. 462 (1977).

55. *Id.* at 476.

56. 452 F.2d 1154 (8th Cir. 1971), *cert. denied,* 406 U.S. 932 (1972).

57. The issue in *Cargill* was whether "manipulation under the Commodity Exchange Act must include the commission of an 'uneconomic act.'" 452 F.2d at 1163. The court concluded that a showing of an uneconomic act was not required.

58. *Id.*

tion.[59] Although "[t]he methods and techniques of manipulation are limited only by the ingenuity of man,"[60] the court concluded that the conduct which courts have held to be manipulative has had two essential characteristics: (1) the conduct has been intentional, and (2) the conduct has resulted in a price "which does not reflect basic forces of supply and demand."[61] Thus, *Cargill* suggests that the critical component of manipulation is artificial impact on market activity and that a manipulative scheme does not necessarily depend upon deception. Congress' use of the disjunctive in section 14(e), which bars "fraudulent, deceptive, *or* manipulative acts or practices,"[62] also suggests that "deceptive" acts and "manipulative" acts are different kinds of behavior. Moreover, the statement of the *Santa Fe* Court that "nondisclosure is *usually* essential to the success of a manipulative scheme"[63] implies recognition that some manipulative schemes do not involve deception.[64]

A more important reason why the statements concerning manipulation in *Ernst & Ernst* and *Santa Fe* do not determine what constitutes manipulation for purposes of section 14(e) is the context in which those cases arose—alleged violations of section 10(b) of the 1934 Act. Section 10(b) is part of a statutory scheme for the regulation of securities trading. By contrast, section 14(e) of the Williams Act is directed specifically at the regulation of tender offers. The *Ernst & Ernst* Court itself stated that both the legislative history and the statutory context of a particular measure must be considered when interpreting statutory language.[65] The Supreme Court has noted repeatedly that similar or identical words in different federal securities statutes may properly be interpreted to have different meanings if the history of the legislation in question and the statutory context so require. For example, the Court, when considering the meaning of the terms "purchase" and "sale" in section 16(b) of the 1934 Act,[66] has stated that "[w]here alternative constructions of the terms of § 16(b) are possible, those terms are to be given the construction that best serves the congressional

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59. *Id.*
60. *Id.*
61. *Id.*
62. 15 U.S.C. § 78n(e) (1976) (emphasis added).
63. Sante Fe Indus., Inc. v. Green, 430 U.S. 462, 477 (1976) (emphasis added); *see supra* text accompanying note 55.
64. *See also* Ernst & Ernst v. Hochfelder, 425 U.S. 185, 199 (1976) (manipulation concerns conduct designed to "deceive *or* defraud investors") (emphasis added).
65. *Id.* at 200-01.
66. 15 U.S.C. § 78p(b) (1976).

purpose . . . ."[67] Utilizing this purpose-oriented approach to statutory construction, the Court has concluded that an exchange of stock pursuant to a merger agreement does not constitute a "sale" in a section 16(b) case,[68] even though four years earlier, in a case brought under section 10(b) of the 1934 Act, the Court had held an exchange of stock pursuant to a merger agreement to constitute a "purchase or sale."[69]

Thus, two conclusions relevant to a definition of manipulation derive from the language of section 14(e). First, an approach to defining "manipulative acts or practices" that stresses artificial impact on market activity is more consistent with previous judicial definitions of manipulation than an approach that requires proof of deception. Second, the correctness of an artificial impact or market activity approach turns less on the language of the statute—which clearly is amenable to a number of interpretations—and more upon whether that approach advances the purposes of the Williams Act.

2. The Purpose of the Williams Act

Both the Williams Act and the 1934 Act share the goal of investor protection, but the Williams Act provides protection in a specialized context. The 1934 Act is directed at investors in trading markets; the Williams Act is concerned only with the impact of

67. Kern County Land Co. v. Occidental Petroleum Corp., 411 U.S. 582, 595 (1973) (quoting Reliance Electric Co. v. Emerson Electric Co., 404 U.S. 418, 424 (1972)).

68. Kern County Land Co. v. Occidental Petroleum Corp., 411 U.S. 582, 600 (1973).

69. SEC v. National Securities, Inc., 393 U.S. 453 (1969) (interpretation consistent with purposes of § 10(b), even though Court acknowledged that under "no sale doctrine" of SEC Rule 133, transaction would not have constituted "sale" for purposes of 1933 Act).

In Aaron v. SEC, 446 U.S. 680 (1980) one issue was whether the SEC is required to prove scienter in an action to enjoin a violation of § 10(b). The Court in Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976) had held that scienter was a necessary element of a private action for damages under § 10(b). *See supra* note 53 and accompanying text. In SEC v. Capital Gains Research Bureau, 375 U.S. 180 (1963) the Supreme Court held that scienter is not a necessary element of an action brought by the SEC to enjoin an alleged violation of § 206(2) of the Investment Advisers Act of 1940, 15 U.S.C. § 80b-6 (1976), which bans any act or practice of an investment adviser that "operates as a fraud or deceit upon any client or prospective client." *Id.* § 80b-6(2). The *Aaron* Court reconciled these two seemingly conflicting decisions by noting that the two different statutory schemes served different purposes. Proof of scienter is consistent with the purpose of § 10(b), which is to bar fraudulent transactions in securities markets, but does not advance the objectives of the Investment Advisers Act, which establishes a fiduciary relationship between investment advisers and their clients. Since *Aaron* concerned enforcement of § 10(b), the Court concluded that *Ernst & Ernst*'s interpretation of the meaning and purpose of § 10(b) was controlling. Aaron v. SEC, 446 U.S. 680, 695 (1980).

tender offers on investors. Thus, the Supreme Court in *Piper v. Chris-Craft Industries*[70] stated: "The legislative history thus shows that the sole purpose of the Williams Act was the protection of investors who are confronted with a tender offer."[71]

Moreover, Congress used different means in the two acts to effectuate their different investor protection goals. The 1934 Act protects investors by regulating trading markets,[72] requiring disclosure,[73] and prohibiting deception and classic kinds of market manipulation.[74] The Williams Act employs a three-pronged approach to protect investors. First, tender offerors are required to make extensive disclosures about themselves, the source of their financing, and their plans for the target company.[75] Second, the Williams Act provides specific substantive benefits to tendering shareholders, including rights to withdraw tendered shares, to participate pro rata in offers for less than all of a company's shares, and to receive the highest price that a tender offeror pays for a target company's shares.[76] Last, although the Williams Act identifies no specific arrangements as deceptive or manipulative, all "fraudulent, deceptive, or manipulative acts or practices" are prohibited, not just in connection with purchases and sales of securities,[77] but "in connection with any tender offer or request or invitation for tenders, or any solicitation of security holders in opposition to or in favor of any such offer, request, or invitation."[78]

No provision of the Williams Act explicitly characterizes lock-up options or other specific practices as manipulative. Additionally, no specific discussion of what arrangements are manipulative under section 14(e) exists in the legislative history. This is not surprising. When Congress adopted the Williams Act, it was concerned primarily with tender offerors' high-pressure tactics.[79]

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70. 430 U.S. 1 (1977).

71. *Id.* at 35.

72. *See, e.g.*, Securities Exchange Act of 1934, §§ 6, 7, 8, 11, 15, 17, 19, 15 U.S.C. §§ 78(f), (g), (h), (k), (o), (q), (s) (1976).

73. *See, e.g.*, Securities Exchange Act of 1934, §§ 12-13, 15 U.S.C. §§ 78(l)-(m) (1976).

74. *See, e.g.*, Securities Exchange Act of 1934, §§ 9, 10, 15 U.S.C. §§ 78(i), (j) (1976).

75. *See* Securities Exchange Act of 1934, § 12, 15 U.S.C. § 78(l) (1976).

76. Piper v. Chris-Craft Indus., 430 U.S. 1, 23 (1977).

77. Section 10(h)'s prohibition against manipulation supplements the specific prohibitions against identified manipulative practices included in 15 U.S.C. § 78(j) (1976). In addition, § 10(b) regulates conduct only in connection with purchases and sales of securities. *See* Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723 (1975).

78. 15 U.S.C. § 78n(e) (1976). The Court in *Piper* characterized § 14(e) as additive to the disclosure and substantive provisions of the Williams Act. 430 U.S. at 24.

79. *See, e.g.*, 113 CONG. REC. 857-58 (1967) (statement of Sen. Kuchel, cosponsor of

Neither offerors nor target companies had begun to use the sophisticated tactics that have since become common in takeover battles.[80] Consequently, Congress realistically could not have foreseen the wide utilization of lock-ups and other defensive tactics that did not appear until many years after the adoption of the Williams Act. Nevertheless, a close reading of the Williams Act, along with a review of the legislative purpose and testimony before Congress during the consideration of the measure,[81] strongly indicates that the section 14(e) prohibition on manipulative acts should apply to any arrangements that artificially impair the tender offer market for a company's shares.

a. *The Benefits of a Fair Auction Market*

Protecting the rights of all potential bidders to compete on equal terms in the market for a target company's shares advances the purposes of the Williams Act. Maintenance of open competition in the auction market clearly benefits target company shareholders by ensuring that they receive the best possible price for their shares. "[A] rule of auctioneering increases premiums [paid to target shareholders] in all acquisitions, unfriendly or negotiated, through merger or takeover, whether management is loyal or self-serving."[82]

The Seventh Circuit in *MITE Corp. v. Dixon*[83] recently relied upon a similar rationale in striking down the Illinois antitakeover statute.[84] The court concluded that the Illinois statute was unconstitutional because it provided target company management with a weapon against takeover bids and thus, upset the balance estab-

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bill).

80. Hayes & Taussig, *Tactics of Cash Takeover Bids,* HARV. BUS. REV., Mar.-Apr. 1967, at 135 contains the most comprehensive catalog of offensive and defensive tactics used in connection with tender offers during the years before the Williams Act was passed. The only practice that the authors characterized as manipulative was the open market purchase by a target company of its shares to raise their price above the amount bid by the tender offeror. *Id.* at 145.

81. *See infra* text accompanying notes 90-102.

82. Bebchuk, *supra* note 15, at 1045. Bebchuk adds that a rule protecting target management's ability to act as an auctioneer promotes the interests of the shareholders and society if management also is denied the power to obstruct bids it does not favor. *Id.* at 1054. *Cf.* Billard v. Rockwell Int'l Corp., [Current] FED. SEC. L. REP. (CCH) ¶ 98,733, at 93,700 (2d Cir. June 30, 1982) (noting that under ordinary circumstances a tender offer does not "freeze" the price of target company stock because other market participants are free to top the original tender offer).

83. 633 F.2d 486 (7th Cir. 1980), *aff'd sub nom.* Edgar v. MITE Corp., 102 S. Ct. 2629 (1982).

84. ILL. ANN. STAT. ch. 121½ §§ 137.51-.70 (Smith-Hurd Supp. 1982-83).

lished by the Williams Act. Noting the strong link between Congress' concern for protecting investors who face tender offers and the preservation of a competitive and unimpeded auction market for target company shares, the Seventh Circuit concluded: "[M]aintenance of an equitable balance between the contending sides is perceived as a principal means of investor protection . . . . [I]n its concern for investors, Congress was necessarily committed to maintaining, where appropriate, the basic capability of offerors to make successful tender offers . . . ."[85]

On appeal, the Supreme Court supported this characterization.[86] Justice Wbite, writing for a plurality of the Court, stated:

> [I]t is . . . crystal clear that a major aspect of the [Williams Act's] effort to protect the investor was to avoid favoring either management or the takeover bidder. . . . We, therefore, agree with the Court of Appeals that Congress sought to protect the investor not only by furnishing him with the necessary information *but also by withholding from management or the bidder any undue advantage that could frustrate the exercise of an informed choice.*[87]

Similarly, in the portion of his opinion in which he spoke for a majority of the Court, Justice White noted the three detrimental effects of the Illinois act. First, the Illinois statute deprived sharebolders of an opportunity to sell their shares at a premium.[88] Second, the statute hindered the efficient allocation of economic resources.[89] Last, the statute reduced the incentive of management to perform well.[90] The Court, Justice White continued, was unprepared to disagree with the Seventh Circuit's conclusion that "the possible benefits of the potential delays required by the [Illinois] Act may be outweighed by the increased risk that the tender offer will fail due to defensive tactics employed by incumbent management."[91] Because the statute imposed these substantial burdens on interstate commerce, and created only limited local benefits, it was

85. MITE Corp. v. Dixon, 633 F.2d at 496. *See also* Kennecott v. Smith, 637 F.2d 181, 189-90(3d Cir. 1980)(holding New Jersey takeover law unconstitutional for similar reasons).

86. Edgar v. MITE Corp., 102 S. Ct. 2629 (1982).

87. *Id.* at 2636-37 (emphasis added). Justice White also noted that Congress did not intend to discourage takeover bids. *Id.* at 2636. Shareholders often receive a premium over the market price because of competitive bidding for their shares. *Id.* at 2636 n.9. Chief Justice Burger and Justice Blackmun joined this portion of Justice White's opinion, which endorsed the Seventh Circuit's supremacy clause rationale. *Id.* at 2633. Only Justice Stevens expressed any explicit misgivings about this portion of Justice White's opinion. *Id.* at 2644. (Stevens, J., concurring).

88. *Id.* at 2642.

89. *Id.*

90. *Id.*

91. *Id.*

unconstitutional under the Commerce Clause.

b. Congressional Support of Shareholder Decisionmaking

The Williams Act reflects Congress' fundamental belief that target company shareholders are capable of acting in their own interests if they are provided with adequate information relevant to a tender offer and given a reasonable period of time within which to decide what to do.[92] Prior to adoption of the Williams Act, shareholders were "pawn[s] in a form of industrial warfare,"[93] vulnerable to tender offers designed to force them to decide quickly whether to sell all or part of their shares, and to the self-serving conduct of target company managements.[94] Although Congress was concerned primarily with the tactics of tender offerors, it nonetheless took pains to note that target company shareholders often benefit from tender offers and that the bill "avoids tipping the balance of regulation either in favor of management or in favor of the person making the takeover bid."[95]

The Supreme Court pointed out in *Piper* that Congress implemented a "policy of neutrality"[96] to ensure that legitimate takeover bids by offerors prepared to make full disclosure would not be discouraged.[97] A policy of neutrality does not necessarily subsume a rule prohibiting one person from impeding another's access to the tender offer market. This type of prohibition, however, is con-

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92. At the hearings on the Bill SEC Chairman Manuel Cohen stated that the purpose of the measure was "to provide the investor, the person who is required to make a decision, an opportunity to examine and to assess the relevant factors and to reach a decision without being pressured and without being subjected to unwarranted techniques which are designed to prevent that from happening." *Full Disclosure of Corporate Equity Ownership in Corporate Takeover Bids: Hearings on S. 510 Before the Subcomm. on Securities of the Senate Comm. on Banking and Currency*, 90th Cong., 1st Sess. 15 (1967) [hereinafter cited as *Hearings*].

93. Piper v. Chris-Craft Indus., 430 U.S. 1, 30 (1977) (quoting *Hearings*, *supra* note 92, at 17 (testimony of Manuel Cohen)).

94. Before the enactment of the Williams Act offerors could limit the time tbat an offer would be available, require that tenders be irrevocable, or specify that if shareholders oversubscribed the offer, then the offeror would purchase the first sbares tendered. These terms caused shareholders to tender quickly or risk losing the opportunity to realize the tender offer price. For a discussion of tactics used by target managements, see Hayes & Taussig, *supra* note 80.

95. Rondeau v. Mosinee Paper Co., 422 U.S. 49, 58 (1975). *See* House Comm. on Foreign Commerce, Disclosure of Corporate Equity Ownership, H.R. Rep. No. 1711, 90th Cong., 2d Sess. 5 (1968) [hereinafter cited as House Report]; Senate Comm. on Banking & Currency, Full Disclosure of Corporate Equity Ownership and in Corporate Takeover Bids, S. Rep. No. 550, 90th Cong., 2d Sess. 3 (1967).

96. Piper v. Chris-Craft Indus., 430 U.S. at 29.

97. *Id.*

sistent with a policy of neutrality. A policy of neutrality and a prohibition against impeding access to the tender offer market exist to ensure that target shareholders are able to make informed choices. The policy of neutrality achieves this objective by not favoring any party in a tender offer situation. The prohibition against impeding access to the tender offer market promotes an informed choice by eliminating barriers to the presentation of the choice to shareholders.[98]

Similarly, the Supreme Court in *Rondeau v. Mosinee Paper Co.*[99] noted that the primary purpose of the Williams Act is to address what the Senate committee had described as the "dilemma" faced by target shareholders.[100] One aspect of this dilemma is that a shareholder facing a tender offer "may wait to see if a better offer develops, but if he tenders late, he runs the risk that none of his shares will be taken."[101] This situation represents a "dilemma" only if one believes that a shareholder should have a reasonable opportunity to receive and consider competing tender offers.

Judge Edward Weinfeld, in a recent decision denying a motion by Conoco to enjoin one offeror, Seagram Co., from making a tender offer for Conoco in competition with a tender offer from a second offeror, Du Pont, articulated the philosophy underlying congressional enactment of the Williams Act:

> 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 shares owned by them . . . . [T]he shareholders now have the choice of acting upon the existing outstanding offers of Du Pont and Seagram . . . . The Directors are free to continue by proper legal means to express to the shareholders their objection and hostility to the Seagram proposal, but they are not free to deny them their right to pass upon this offer or any other offer for the purchase of their shares.[102]

98. Senator Harrison Williams, the principal sponsor of the legislation, outlined the primary goal of the legislation: "The purpose of this bill is to require full and fair disclosure for the benefit of stockholders while at the same time providing the offeror and management equal opportunity to fairly present their case." 113 CONG. REC. 854-55 (1967) (remarks of Sen. Williams). *See also supra* note 92 (similar remarks of SEC Chairman Cohen).

In colloquy with Senator Jacob Javits, who asked if the Bill was intended to condemn tender offers, since "[s]ometimes stockholders do very well because of tenders, especially competitive tenders," 113 CONG. REC. 24,665 (1967) (remarks of Sen. Javits), Senator Williams responded: "There is no intention . . . to prohibit tender offers. As a matter of fact, I think [the Bill] migbt encourage them," *id.* (remarks of Sen. Williams).

99. 422 U.S. 49 (1975).

100. *Id.* at 60.

101. *Id.* at 58 n.8.

102. Conoco, Inc. v. Seagram Co., 517 F. Supp. 1299, 1303 (S.D.N.Y. 1981) (making a tender offer for Conoco in competition with a tender offer from Du Pont, which the Conoco management favored).

c. *The Relevance of the Act's Substantive Provisions*

The substantive provisions of the Williams Act dealing with withdrawal rights and rights to receive the best price paid furnish additional support for the view that courts should interpret section 14(e) to bar as manipulative any actions that significantly impede participation by a potential bidder in the tender offer market for a target company's shares. By regulating the conditions under which a company may make a tender offer, the Williams Act provides target shareholders with the opportunity to receive and evaluate competitive bids. Thus, arrangements that limit competition subvert the intent of Congress in enacting these provisions.

Section 14(d)(5) provides that for seven days after a tender offer is made, tendering shareholders shall have the right to withdraw shares they have tendered.[103] The House committee report explains that this provision "would give shareholders who tender their shares immediately after the offer is made a short period within which to reconsider."[104] A shareholder will reconsider his decision to tender his shares to the original offeror in light of additional information provided by target company management or others, or he will reevaluate his decision because another bidder has made a more attractive offer for his shares. Given these possibilities, Congress' decision to grant withdrawal rights suggests a desire to provide a target company shareholder with an opportunity to accept the most attractive and timely offer.[105]

Section 14(d)(7),[106] the best price provision, also ensures that target shareholders receive the full benefit of free market competition for their shares. The provision benefits shareholders both when an offeror increases his bid because it has not attracted the desired number of shares—even when a shareholder was prepared to accept a lower price—and when an offeror increases his bid to compete with another offer. Under 14(d)(7) all shareholders have a right to receive the price that is the product of supply and demand in a competitive auction market. Allowing an offeror or a target

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103. 15 U.S.C. § 78n(d)(5) (1976).

104. House Report, *supra* note 95, at 10.

105. SEC Regulation 14D provides that shareholders may withdraw shares for 15 business days after an offer is made, and that if a competitive offer is made, these rights are extended to 10 business days from the date of that offer, unless the shares already have been purchased. This rule recognizes the value to target shareholders of being able to receive and consider competing offers. The rule does not promote competitive offers, but it does ensure that shareholders have adequate time to consider them. SEC Act Release No. 33-6158.

106. 15 U.S.C. § 78n(d)(7) (1976).

company to limit competition would frustrate this objective.

In sum, both the legislative history and the structure of the Williams Act demonstrate a congressional intent to ensure that target company shareholders obtain the benefits generated by the existence of an open and competitive auction market for their shares. Although Congress did not consider explicitly all tactics that would deprive shareholders of the benefits of that market, it did enact a comprehensive antifraud provision in section 14(e). "No doubt Congress meant to prohibit the full range of ingenious devices that might be used to manipulate . . . [the tender offer market]."[107] Thus, the Sixth Circuit's holding that the options granted by Marathon to USS were manipulative[108] seems to be consistent not only with the language of the Williams Act, but also with the purposes that Congress intended the Williams Act to serve, since those options placed USS in a preferred position to compete for control of Marathon and were designed to discourage other bidders. Indeed, if those options cannot be characterized as manipulative, the door would be open to a variety of arrangements to rig the tender offer market—a possibility that the Congress which passed the Williams Act surely would not have endorsed.

3. The Relevance of *Santa Fe*

The Article so far does not consider the significance of the Supreme Court's decision in *Santa Fe Industries v. Green.*[109] Several commentators, along with the district court in *Marathon,* have contended that *Santa Fe* precludes a holding that the options granted to USS violated section 14(e).[110] The Sixth Circuit, however, summarily disposed of this argument, terming it "erroneous" and adding only that "*Santa Fe* involved a claim under section 10(b)."[111] A fuller consideration of *Santa Fe* is required. Interpreting section 14(e) to prohibit lock-ups and various other arrangements may be compatible with the statutory language and advance the purpose of the Williams Act, but section 14(e) could be defined to prohibit only classic manipulative maneuvers—such as simultaneous purchases and sales of target company stock—without strip-

107. Santa Fe Indus., Inc. v. Green, 430 U.S. 462, 477 (1977) (discussing § 10(b) of the 1934 Act prohibition against manipulation of securities prices).

108. Mobil Corp. v. Marathon Oil Co., 669 F.2d 366 (6th Cir. 1981).

109. 430 U.S. 462 (1977).

110. *See* Bialkin, *supra* note 11, at 19; Herzel & Colling, *supra* note 11, at 25; Nathan, *supra* note 8, at 25.

111. Mobil Corp. v. Marathon Oil Co., 669 F.2d 366, 373 (6th Cir. 1981).

ping the statutory language of all meaning. Thus, if *Santa Fe* suggests that the term manipulative in section 14(e) should be defined narrowly, then a restrictive approach probably is required.[112] In that event, one also would conclude that the Sixth Circuit reached an incorrect result in *Marathon.*

A close analysis reveals that *Santa Fe* does not require a restrictive interpretation of section 14(e).[113] The case arose when Santa Fe Industries, which had acquired ninety-five percent of the stock of Kirby Lumber, eliminated the remaining shareholders of Kirby by effecting a short-form merger in compliance with the Delaware merger statute. Minority shareholders brought suit against Santa Fe Industries, claiming that the merger was fraudulent and manipulative, in violation of section 10(b) of the 1934 Act and SEC rule 10b-5, because the merger was designed solely to eliminate the minority shareholders of Kirby and was consummated at a grossly inadequate price.[114] The district court dismissed the complaint, concluding that since defendants had made full and fair disclosure to the minority shareholders, the merger transaction was beyond the purview of rule 10b-5.[115] The Second Circuit reversed, holding that even without any misrepresentation or nondisclosure of relevant facts, the defendants had violated rule 10b-5 if they had effected a merger without any corporate purpose at an inadequate price.[116]

The case presented two questions to the Supreme Court: whether an allegation of deception or manipulation was necessary to a valid claim under rule 10b-5 and, if it was, whether defendants' alleged conduct was deceptive or manipulative. The Court answered the first question summarily, holding that section 10(b) and rule 10b-5 reach only conduct that is manipulative or deceptive. " 'When a statute speaks so specifically in terms of manipula-

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112. Indeed the Supreme Court in *Santa Fe* limited the definition of manipulation for purposes of § 10(b) to this type of conduct. *See supra* text accompanying note 107. For an example of such classic manipulation in the context of a tender offer, see Crane Co. v. Westinghouse Air Brake Co., 419 F.2d 787 (2d Cir. 1969).

113. The policy considerations in part IV of *Santa Fe* seem to support the Court's circumscription of the meaning of manipulation under § 10(b). *See infra* text accompanying note 116.

114. Santa Fe Indus., Inc. v. Green, 430 U.S. at 467.

115. Green v. Santa Fe Indus., Inc., 391 F. Supp. 849 (S.D.N.Y. 1975), *aff'd in part and rev'd and remanded in part,* 533 F.2d 1283 (2d Cir. 1976), *rev'd,* 430 U.S. 462 (1977).

116. Green v. Santa Fe Indus., Inc., 533 F.2d 1283 (2d Cir. 1976), *rev'd,* 430 U.S. 462 (1977).

Judge Mansfield, in a concurring opinion, argued that defendants' conduct was manipulative under § 10(b). 533 F.2d at 1294 (Mansfield, J., concurring).

tion and deception, . . . and when its history reflects no more expansive intent, we are quite unwilling to extend the scope of the statute. . . .' "[117] Clearly, said the Court, defendants' conduct was not deceptive since defendants had furnished the minority shareholders with all relevant information.[118]

The Court also concluded that defendants' conduct was not manipulative. But the Court supported this conclusion largely by reiterating that the defendants' conduct should not be considered manipulative because the term "manipulative" in section 10(b) should not be interpreted to outlaw this kind of conduct. It stated:

> [Manipulation] refers generally to practices, such as wash sales, matched orders, or rigged prices, that are intended to mislead investors by artificially affecting market activity. . . . [W]e do not think Congress would have chosen this "term of art" if it had meant to bring within the scope of § 10(b) instances of corporate mismanagement such as this, in which the essence of the complaint is that shareholders were treated unfairly by a fiduciary.[119]

The Court then set forth in part IV of its opinion policy considerations to support its conclusions.[120] These policy considerations are most relevant to the question of how the courts should interpret section 14(e).

The *Santa Fe* Court's first policy consideration was that the "fundamental purpose" of the 1934 Act is to implement a "philosophy of full disclosure,"[121] and not to ensure the fairness of any particular transaction. Thus, the Court was "reluctant to recognize a cause of action . . . to serve what is 'at best a subsidiary purpose' of the federal legislation."[122] By contrast, the purpose of the Williams Act is to protect investors faced with a tender offer. The Williams Act attempts to achieve its objectives by a combination of mandatory disclosure and substantive regulation.[123] As noted above, prohibition of tactics such as lock-ups serves to protect investors' interests by promoting competition in the tender offer market.[124] Thus, the prohibition serves the primary purpose of the legislation.

The second consideration the Court relied upon in part IV of *Santa Fe* was "whether 'the cause of action [is] one traditionally

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117. 430 U.S. at 473 (quoting Ernst & Ernst v. Hochfelder, 425 U.S. 185, 214 (1976)).
118. 430 U.S. at 474.
119. *Id.* at 476-77.
120. Part IV immediately followed the discussion of manipulation.
121. 430 U.S. at 478. *See supra* text accompanying note 117.
122. 430 U.S. at 478.
123. *See supra* text accompanying notes 70-81.
124. *See supra* notes 70-81 and accompanying text.

relegated to state law . . . .' "[125] In discussing the applicability of state law the Court also noted that "the existence of a particular state-law remedy is not dispositive of the question whether Congress meant to provide a similar federal remedy . . . ."[126] This point is significant because the argument thus far for holding lock-up options and similar arrangements to be manipulative would appear equally applicable to a situation in which the management of a target company, rather than a tender offeror, initiated the arrangement.[127] The relationship of an offeror to target company shareholders does not give rise to fiduciary duties,[128] but state law fiduciary principles regulate the relationship of the target's management to its shareholders. The mere existence, however, of a state law cause of action, directed at an allegedly manipulative arrangement, should not eliminate the possibility of a federal claim directed at the same arrangement.[129] The gravamen of a claim under section 14(e) is manipulation, not mismanagement, and simply because the conduct at issue might constitute mismanagement should not insulate the conduct from review under federal law.[130]

Santa Fe supports this conclusion. The Court relegated the plaintiff in *Santa Fe* to his state court remedies because to uphold a federal cause of action the Court would have had to *override* "es-

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125. 430 U.S. at 478 (quoting Cort v. Ash, 422 U.S. 60, 78 (1975)).

126. 430 U.S. at 478.

127. Managers of a target company should have no more latitude under federal law to manipulate the tender offer market than a tender offeror. Thus, although the *Marathon* court emphasized that USS had demanded the options, the court's rationale should apply also to a grant of options by Marathon.

128. *See* Chiarella v. United States, 445 U.S. 222 (1980). Consequently, under state law USS seemingly would be free to attach whatever conditions it wished to its offer to the Marathon board, even if those conditions were designed to rig the tender offer market for Marathon shares. *See* Bialkin, *supra* note 11, at 19 ("The 6th Circuit opinion, therefore, stands for the novel proposition that . . . a party may not condition its willingness to offer an increased bid by extracting some concession from the target designed to make it less attractive to a competing bidder."). *Id.*

129. Since the options were of considerable value, Marathon's management could not have given them to USS, if USS had been prepared to make its offer without receiving the options. A gift of this kind would lack a legitimate business purpose and thus would be prohibited.

130. *See, e.g.,* Goldberg v. Meridor, 567 F.2d 209 (2d Cir. 1977) (breach of fiduciary duty in connection with securities transaction violates rule 10b-5 when the defendant effects the transaction with material deception), *cert. denied,* 434 U.S. 1069 (1978). *Cf.* Santa Fe Indus., Inc. v. Green, 430 U.S. at 475 n.15. (citing with favor lower court decisions holding the breaches of fiduciary duty which included deception constitute violations of rule 10b-5). The violation of the federal interest in preventing deception or manipulation, not the breach of fiduciary duty, gives rise to the federal cause of action.

tablished state policies of corporate regulation."[131] Plaintiffs' claim in *Santa Fe* was that defendants had violated section 10(b) and SEC rule 10b-5 by effectuating a short-form merger, pursuant to Delaware law, solely to eliminate minority shareholders at a grossly inadequate price. The plaintiffs further claimed that the Delaware appraisal statute,[132] which entitles dissatisfied minority shareholders to a judicial determination of the fair value of their shares, did not provide them with an adequate remedy. To find a violation of federal law, the Court would have had to agree that the state appraisal remedy was inadequate.[133] If it did not agree, the plaintiffs' federal claim would fail because the plaintiffs would not have been damaged by the defendants' conduct.

The problems that acceptance of the plaintiffs' theory would have created led the Court to reject it. "The reasoning behind a holding that the . . . [Delaware appraisal statute did not provide an adequate remedy] could not be easily contained."[134] This approach inevitably would draw federal courts into passing on the adequacy of all state law regulation of corporate fiduciaries' involvement in securities transactions. Eventually federal fiduciary principles would emerge that would, to some extent at least, conflict with state fiduciary standards.[135] This prospect led the Court to conclude: "Absent a clear indication of Congressional intent, we are reluctant to federalize the substantial portion of the law of corporations that deals with transactions in securities, particularly where established state policies of corporate regulation would be overridden."[136]

Interpreting section 14(e) to bar lock-ups and other arrangements that have similar effects would not cause comparable federalism problems nor would it open the floodgates to federal usurpation of state regulation of corporate fiduciaries' behavior.[137] The court, in *Marathon,* based its finding of manipulation, for example, not upon any perceived inadequacy in state law remedies available to Mobil or to Marathon's shareholders, but on the manner in which the two options impinged on the interest of Marathon's

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131. 430 U.S. at 479.

132. DEL. CODE ANN. tit. 8, § 262 (Supp. 1980).

133. *See* Green v. Santa Fe Indus., Inc., 533 F.2d 1283, 1304-09 (2d Cir. 1976) (Moore, J., dissenting), *rev'd,* 430 U.S. 462 (1977).

134. 430 U.S. at 478.

135. *Id.* at 478-79.

136. *Id.* at 479.

137. *See infra* text accompanying notes 150-66.

shareholders in the maintenance of an open auction market for their shares.[138]

Further, the *Marathon* court's declaration that the options were manipulative would not have conflicted with or overridden state law, even if the court had found that the Marathon directors, in the exercise of their reasonable business judgment, had initiated the offer to grant the options to USS. As the *Santa Fe* Court noted, both federal and state regulation may concurrently govern certain conduct.[139] Concurrent regulation of the conduct of corporate officials in securities transactions is particularly common. The federal courts consistently have interpreted the federal securities laws in a manner designed to achieve their (federal) objectives, even when a liberal interpretation would have the effect of limiting the range of business judgments that corporate managers can make. For example, the courts have not allowed corporate managers to justify decisions to issue false or misleading statements in securities transactions on the grounds that those decisions were reasonable business judgments.[140] Thus, if Marathon had given material, nonpublic information to USS during their negotiations, and if USS and Marathon then had agreed that they would not disclose that information despite the USS tender offer for Marathon shares, both USS and Marathon would be engaged in deceptive conduct in violation of sections 10(b) and 14(e). Although the Marathon board's decision to keep the information secret might be a reasonable business judgment, this finding would not be dispositive of the federal securities law claims. Similarly, a board decision to grant lock-up options to an offeror, though possibly a reasonable business judgment, should not be immune to a claim of manipulation.

Finally, the policy considerations espoused in part IV of *Santa Fe* may be less pertinent to the interpretation of section 14(e) than to the interpretation of section 10(b) because of the divergent purposes of the 1934 Act and the Williams Act. The *Santa Fe* Court suggested it would have been more willing to impinge

138. 669 F.2d at 374-76.

139. *See supra* text accompanying note 134.

140. *See* Elkind v. Liggett & Myers, Inc., 635 F.2d 156, 163-64 (2d Cir. 1980) ("A company which undertakes to correct errors in reports presented to it for review . . . risks sacrificing a measure of its autonomy . . . ."); SEC v. Texas Gulf Sulfur Co., 401 F.2d 833, 863-64 (2d Cir. 1968), *cert. denied,* 394 U.S. 976 (1969). Of course, even if management acted in a deceptive manner, management's good faith may be relevant to whether it acted with scienter. *See* Adams v. Standard Knitting Mills, Inc., 623 F.2d 422 (6th Cir.), *cert. denied,* 449 U.S. 1067 (1980).

upon—or even override—state corporation law if Congress had indicated some intent to preempt state law when it passed the 1934 Act.[141] Congress, according to the Court, limited the 1934 Act to ensuring full disclosure.[142] The Williams Act, however, is not limited to disclosure and explicitly preempts state substantive law in a number of respects.[143] Moreover, the emphasis of the Williams Act on protecting target company shareholders' ability to decide how to respond to tender offers, although consistent with the approach that state courts once employed when dealing with contests for corporate control, contrasts sharply with the approach to these contests that state courts were using at the time of the adoption of the Williams Act. Thus, federal courts may not need to be concerned about interpreting the Williams Act in a manner that is philosophically inconsistent with state law regulation of corporate fiduciaries' behavior in contests for corporate control.

A brief review of leading cases reveals the trend of state law regulation of contests for corporate control. The 1907 case of *Elliott v. Baker*[144] is illustrative of the approach state courts first used when dealing with contests for control. In *Elliott* two factions were contending for control of the Elliott Company. One faction, led by Elliott, acquired a majority of the outstanding stock. The other, led by Nickerson, controlled a majority of the directors. The Nickerson group, on learning of the threat the Elliott group posed to their control, convened the board and approved the issuance of a sufficient number of previously authorized shares to a friend of the Nickerson group to ensure continued control of the board by the group. Elliott brought suit to cancel these shares. The Massachusetts Supreme Judicial Court held that issuance of stock to retain control is "not a fair exercise in good faith of the power with which [the directors] are clothed" and affirmed the cancellation of the shares.[145] Although the directors may have believed that their action was in the best interests of the corporation, the court stated that a stock issuance absent convincing evidence that the company needed to raise funds was invalid.[146] Moreover, the court held that

141. The Court stated that the absence of any "clear indication" of contrary congressional intent to override state law supported this conclusion. Santa Fe Indus., Inc. v. Green, 430 U.S. at 479.

142. *Id.* at 477-78.

143. *See supra* text accompanying notes 103-06.

144. 194 Mass. 518, 80 N.E. 450 (1907).

145. *Id.* at 523, 80 N.E. at 452.

146. The court disregarded the minutes that the directors had drafted in advance of the meeting in an attempt to justify their actions. The court focused instead upon the cir-

a showing that the stock was sold for a fair price would not change the result.[147] Because of the contest for control, the board was obligated to sell shares to the highest bidder rather than accepting a price that would "ordinarily [be] a fair one,"[148] even if the company needed additional capital.

The courts gradually retreated from the shareholder-oriented, market-oriented approach exemplified by *Elliott*. The court in *Hall v. Trans-Lux Daylight Screen Corp.*[149] held that directors may use corporate resources to campaign for reelection in proxy contests concerning questions of corporate policy.[150] Similarly, the First Circuit held that directors who face a challenge to their control may issue stock for any fair consideration if the sole or primary motive for issuing the stock is not protecting control.[151] The court in *Kors v. Carey*[152] upheld a directors' decision to repurchase stock at a premium over the market price from a raider who

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cumstances surrounding the sale of the stock and concluded that the primary motive underlying the sale was to ensure continued control of the board by the Nickerson group. *Id.* at 522, 80 N.E. at 451-52.

147. *Id.*

148. *Id.* at 522, 80 N.E. at 452. The court stated the price, "although ordinarily a fair one, was not so much as could have been obtained if the directors had taken advantage of the contest for control of the corporation." *Id.* The directors' failure to obtain a higher price called into question their good faith. The court in Luther v. C. J. Luther Co., 118 Wis. 112, 94 N.W. 69 (1903) had reached a similar result four years earlier:

> Nothing can be more fallacious in corporate or in popular government than the argument that because they honestly believe their policy right, and another dangerous, they [the directors] may rightfully invade the field of suffrage upon which policy rests, and disenfranchise, in whole or in part, those who disagree with them.

Id. at 124, 94 N.W. at 73.

149. 20 Del. Ch. 78, 171 A. 226 (1934).

150. The court's reasoning in this case illustrates the process by which shareholders' role in the corporate structure was diminished while the role of directors was enhanced. The court equated directors' *obligation* to provide shareholders with information about transactions that require both board and shareholder approval with directors' *authority* to use corporate funds to urge shareholders to approve such transactions. Acknowledging the difficulty of distinguishing proxy contests concerning issues of policy from contests concerning only issues of personality, the court nevertheless extended its rationale and concluded that directors also could use corporate funds to urge shareholders to reelect them in proxy contests that involved questions of corporate policy. *Id.* at 84, 171 A. at 228.

151. McPhail v. L. S. Starrett Co., 257 F.2d 388 (1st Cir. 1958). The court concluded that the primary purpose of the challenged stock issuance was to provide an incentive for employees, not to neutralize a raider. *Id.* at 394. The court in dicta, however, added that the directors legitimately could have taken action directed at "frustrating a raid . . . ." *Id.* at 396. In the context of *McPhail*, the court's statement had some validity since the board reasonably believed that the raider intended to manipulate the target company's affairs to serve his personal ends. *Id.* at 394-95. The court's statement, however, was susceptible to application in other contexts in which the interests of shareholders were not in jeopardy.

152. 39 Del. Ch. 47, 158 A.2d 136 (1960).

threatened to change established corporate policies on the grounds that the repurchase was authorized by law and served the useful purpose of avoiding a costly proxy fight.[153]

These decisions set the stage for *Cheff v. Mathes*,[154] a 1964 decision by the Delaware Supreme Court that is the most definitive state court statement of directors' obligations when faced with a threat to their control. In *Cheff* a shareholder of the Holland Furnace Company challenged the repurchase by Holland of a large block of its stock from Motor Products Company. Arnold Maremont, who controlled Motor Products, had told Holland's directors that if Holland did not purchase his Holland stock at a premium above the market price, he would seek control of Holland.[155] Noting that one effect of the repurchase was to protect the Holland directors' control, the court held that the directors had the burden of proving that the repurchase was "primarily in the corporate interest."[156] In *Cheff*, however, the board that authorized the repurchase had a majority of nonmanagement directors. The court held that these "directors satisfy their burden by showing good faith and reasonable investigation; the directors will not be penalized for an honest mistake of judgment . . . ."[157] In effect, the court placed decisions that have the result of protecting incumbent management's control, when made by outside directors, under the protective umbrella of the business judgment rule.[158] The court abandoned the earlier view that contests for control should be decided by shareholders acting in accord with market forces.[159]

From this perspective, one can view the Williams Act as representing a congressional choice, not to eliminate target company managements from any role in the tender offer process, but at least

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153. The court relied upon *Hall* and *McPhail* to support this conclusion.

154. 41 Del. Ch. 494, 199 A.2d 548 (Sup. Ct. 1964).

155. *Id.* at 501, 199 A.2d at 551.

156. *Id.* at 504, 199 A.2d at 554. The court relied upon an earlier ruling in Bennett v. Propp, 41 Del. Ch. 14, 187 A.2d 405 (Sup. Ct. 1962) holding that directors must prove that the terms of a defensive transaction are fair.

157. Cheff v. Mathes, 41 Del. Ch. at 506, 199 A.2d at 555.

158. The decision afforded the directors the protection of what might be termed the weak form of the business judgment rule—they were required to show good faith and reasonable investigation. The strong form does not allow any challenge to a decision to which any reasonable purpose can be attributed, unless a shareholder can show that the directors had a conflict of interest. *See, e.g.*, Schlensky v. Wrigley, 99 Ill. App. 2d 173, 237 N.E.2d 776 (1968) (dismissing complaint which included allegations that challenged decision was motivated by both controlling shareholder's idiosyncratic beliefs and directors' concern for long-run economic interests of corporation).

159. *See* Gilson, *supra* note 15, at 824-31.

to attempt to ensure that target company shareholders are in a position to decide who will prevail in a tender offer contest. The proposed approach to defining manipulation is consistent with that choice.

III. The Implications of the Proposed Approach to Defining Manipulation

Federal court decisions that embrace the definition of manipulation utilized by the *Marathon* court would have some exceedingly important practical implications. Persons interested in challenging lock-ups and other defensive tactics that are employed in tender offer battles likely would base their claims on section 14(e). Moreover, parties challenging these tactics would be more likely to prevail on their claims than they would if they brought suit under state law since the proposed approach questions the lawfulness under section 14(e) of several arrangements, in addition to lock-up options, now being utilized to defend against hostile tender offers or to promote the success of friendly offers.

A. *Challenges Under Federal Law*

In recent years, most parties challenging the defensive tactics used by corporate management to defend against a hostile tender offer have done so under state law.[160] The decisions dealing with these challenges are "something less than a seamless web,"[161] but the trend clearly has been in the direction of granting corporate managers increasing lattitude to use corporate resources to resist unwanted takeover bids. This trend was evident as early as 1969, when a federal district court, in an opinion rejecting a challenge to a defensive acquisition made by a target company, remarked: "[M]anagement has the responsibility to oppose [tender] offers

160. Management, however, frequently has challenged tender offers under § 14(e) by characterizing them as deceptive.

161. Treadway Cos. v. Care Corp., 638 F.2d 357, 382 (2d Cir. 1980). For example, in Condec Corp. v. Lunkenheimer Co., 43 Del. Ch. 353, 230 A.2d 769 (1967) Condec brought a suit to cancel issuance of 75,000 shares of Lunkeheimer stock to a white knight. The court held that Lunkenheimer's investigation of Condec was minimal and did not justify management's resistance to a takeover, even though in Cheff v. Mathes, 41 Del. Ch. 494, 199 A.2d 548 (1964), *see supra* text accompanying notes 154-59, the court upheld the defendant directors' decision, which was based on a similarly cursory investigation. One possible basis for distinguishing the two cases is that *Condec* was a suit for injunctive relief, not damages. Delaware courts have been inclined to scrutinize management's decisions more closely in suits for injunctive relief. *See, e.g.,* Gimbel v. Signal Cos., 316 A.2d 599 (Del. Ch.), *aff'd,* 316 A.2d 619 (Del. 1974); *see also infra* text accompanying notes 192-97.

which, in its best judgment, are detrimental to the company or its stockholders."[162] Three recent federal appellate decisions applying state law highlight this movement. Taken together, these decisions strongly suggest that plaintiffs in cases brought under state law have minimal prospects of success.

In *Treadway Cos. v. Care Corp.*[163] a target corporation's directors issued stock to a white knight to eliminate the ability of another offeror, which held about one-third of the target corporation's shares, to block a merger of the target company and the white knight. The Second Circuit held that all but one of the target company's directors were entitled to the protection of the business judgment rule; since those directors would lose their directorships if the merger with the white knight were consummated, they had no pecuniary interest in the defensive transaction.[164] The court's reasoning implies that all decisions which favor white knights will be insulated from close judicial scrutiny by the business judgment rule if target company directors also expect to lose their positions if a white knight prevails.

In *Crouse-Hinds Co. v. Internorth, Inc.*[165] Internorth made a tender offer for Crouse-Hinds conditioned on the rejection by Crouse-Hinds' shareholders of a previously announced merger between Crouse-Hinds and Belden, Inc. Crouse-Hinds and Belden subsequently negotiated an exchange agreement, the sole function of which appeared to be to pressure the Crouse-Hinds shareholders into approving the Belden merger.[166] Internorth sought to enjoin

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162. Northwest Indus. v. B. F. Goodrich Co., 301 F. Supp. 706, 712 (N.D. Ill. 1969) (dictum). The court concluded that the challenged defensive acquisition represented a reasonable business decision by the target board. *See* Cummings v. United Artists Theatre Circuit, Inc., 237 Md. 1, 204 A.2d 795 (1964).

163. 638 F.2d 357 (2d Cir. 1980).

164. *Id.* at 383-84. The court failed to consider that one clear effect of the transaction was to dilute the voting power in the target that the first offeror had acquired legitimately. *Compare id.* at 383 n.48, *with* Condec Corp. v. Lunkenheimer Co., 43 Del. Ch. 353, 230 A.2d 769 (1976). *See supra* note 161 and Schnell v. Chris-Craft Indus., 285 A.2d 437 (Del. 1971) (disallowing change in annual meeting date that disadvantaged dissident shareholders, even though change was accomplished in strict conformity with statutory requirements).

165. 634 F.2d 690 (2d Cir. 1980).

166. *Id.* at 695-97. Under the exchange agreement Belden shareholders received exactly what they would have received in the merger. Thus, any Belden shareholder exchanging shares presumably would have voted for the merger, so the agreement did not increase the likelihood that the Belden shareholders would approve the merger. The Crouse-Hinds shares received could not be voted at the Crouse-Hinds shareholders meeting on the merger. Thus, the exchange agreement would not directly affect that vote. The exchange agreement, however, included "standstill" provisions that made a vote against the merger economically unattractive to Crouse-Hinds shareholders. *Id.* at 694.

implementation of the exchange agreement. The Second Circuit held that since the merger of Crouse-Hinds and Belden had been announced before Internorth's tender offer, the Crouse-Hinds directors' decision to enter into the exchange agreement was motivated by a desire to pursue the merger and not a desire to maintain their control of Crouse-Hinds. Consequently, the business judgment rule protected that decision.[167] In reaching this conclusion the court ignored the fact that promoting the merger of Crouse-Hinds and Belden effectively defeated the Internorth tender offer. Crouse-Hinds exemplifies the increasing reluctance of courts to overturn defensive transactions on state law grounds, except when those transactions are motivated by a blatant desire to protect control.[168]

Finally, the Seventh Circuit in *Panter v. Marshall Field & Co.*[169] upheld a district court's dismissal of claims that the directors of Marshall Field had approved a number of questionable expansions of Marshall Field's business primarily to create antitrust obstacles to a tender offer that Carter Hawley Hale had announced that it planned to make to acquire Marshall Field. Although the rationale of the opinion is not clear, the court seemed to hold that whenever some rational business purpose is attributable to nonemployee directors' decisions that have the effect of protecting control, the courts will allow no further inquiry. The theory is that the interests of outside directors in maintaining their directorships is not sufficient, as a matter of law, to remove their decisions from the protection of the business judgment rule.[170]

The impact of these three decisions[171] upon the tender offer

167. *Id.* at 703-04.

168. Contrast the Second Circuit's willingness to embrace target managements' characterizations of the facts in *Treadway* and *Crouse-Hinds* with the Massachusetts court's skepticism in Elliott v. Baker, 114 Mass. 518, 80 N.E. 450 (1907), *see supra* note 142.

169. 646 F.2d 271 (7th Cir. 1981).

170. The dissent read the majority opinion in this fashion. *See id.* at 299-304 (Cudahy, J., dissenting). The majority may have relied upon the language of Cheff v. Mathes, 41 Del. Ch. 494, 199 A.2d 548 (Sup. Ct. 1964), *see supra* text accompanying note 123, and concluded that the plaintiff had shown that a majority of the Marshall Field board had acted in good faith and after reasonable inquiry. 646 F.2d at 293-98. If so, those directors would have met the burden of justifying the defensive transactions being challenged.

171. A fourth recent federal appellate decision, Johnson v. Trueblood, 629 F.2d 287 (3d Cir. 1980), also has attracted considerable attention. The case concerned review of a trial judge's charge to the jury regarding management actions that protect control. The charge, based upon Delaware law, was ambiguous. The cbarge stated that the business judgment rule did not apply when management had taken an action solely or primarily to protect control. The court, however, continued and said that the rule does apply if the directors' action "can be attributed to a rational business purpose." *Id.* at 292. This statement

process is clear. Commentators and practitioners have read them as endorsing use of ever more agressive and innovative defensive tactics,[172] and instances of the use of these tactics have increased.

The suggested approach to interpreting section 14(e), as exemplified by the result in *Marathon,* implements the philosophy of the Williams Act of protecting target shareholders' rights to sell their shares in an open and competitive auction market, and represents a constructive counterweight to this trend. Professor Gilson has argued convincingly: "The market for corporate control is the principal constraint on management self-dealing in important situations, and the tender offer is the only displacement mechanism which has the potential to effectuate that constraint . . . . Thus, the corporate structure requires that tender offerors have unrestricted access to target shareholders".[173]

Further, the suggested approach to defining manipulation likely will lead to more effective regulation of target company behavior than the state law standard recommended by Professor Gilson, which is that "no action shall be taken by the target company which could interfere with the success of . . . [a tender] offer or result in the shareholders of the target company being denied the opportunity to tender their shares . . . ."[174] A court attempting to apply Professor Gilson's standard is apt to conclude that the standard cannot mean what it says. "The very fact that the director wants to enhance corporate profits is in part attributable to his desire to keep shareholders satisfied so they will not oust him."[175] A director, however, surely is not barred from attempting to manage his corporation profitably because it has become the target of a tender offer. Thus, the courts must distinguish between the actions of directors that represent legitimate profit seeking and have the incidental effect of interfering with a pending tender offer, and those actions that are designed to defeat a tender offer. The courts

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shifts the focus away from the directors' motives to possible justifications for their actions. The plaintiff, however, did not attack the charge on this basis, but on the ground that an action was improper whenever protecting control was "a" motive for directors' actions. *Id.* The court correctly rejected this claim.

172. *See, e.g.,* Fleischer, *Tender Offers: Defenses, Responses, and Planning,* 88-2 to 88-26; Lipton, *Update, supra* note 15. *But cf.* Crane Co. v. Harsco Corp., 511 F. Supp. 294 (D. Del. 1981) (target company repurchase of its own stock probably improper under state law, but injunction denied).

173. Gilson, *supra* note 15, at 844-45.

174. *Id.* at 879.

175. Johnson v. Trueblood, 629 F.2d at 292.

likely will conclude that the test utilized in *Cheff v. Mathes*[176] provides the most convenient means for making this distinction, and also furnishes a well-tested standard—the business judgment rule—for evaluating the propriety of directorial actions that are not directed primarily at protecting control.[177] Indeed, one can envision a court utilizing this line of reasoning when applying Professor Gilson's standard to a board's decisions in a situation identical to that presented by *Panter v. Marshall Field & Co.*, a case that Professor Gilson clearly believes was decided wrongly,[178] and reaching a result identical to the one reached by the Seventh Circuit.

The Article details below how the suggested approach to defining manipulation would regulate defensive arrangements more effectively. First, however, the Article considers questions relating to standing and relief.

B. *Standing and Relief*

The Sixth Circuit in *Marathon* held that Mobil had standing to maintain a private cause of action for injunctive relief under section 14(e),[179] even though Mobil would not have had standing to sue for damages under *Piper*, which held a defeated tender offeror could not maintain a suit for damages under section 14(e).[180] The court supported this conclusion with pragmatic arguments relating to the differences between suits for equitable relief and suits for damages.[181] *Piper* provides some support for the Sixth Circuit's

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176. 41 Del. Ch. 494, 199 A.2d 548 (Sup. Ct. 1964).

177. See Johnson v. Trueblood, 629 F.2d 287 (3d Cir. 1980) in which the court explained why the Delaware courts have utilized a version of the business judgment rule to evaluate the propriety of management actions taken in response to challenges to their control of a corporation. *Id.* at 292-93. Professor Gilson's defense of his proposed standard does not address effectively this interpretive problem. *See* Gilson, *supra* note 15, at 881-82.

178. Gilson, *supra* note 15, at 830 n.43. One can envision a court reasoning that Marshall Field's board merely made expansion decisions that were consistent with their desire to manage Marshall Field properly, and that the business judgment rule protected those decisions. That those decisions led Carter Hawley Hale to desist from making a tender offer was merely an incidental, and legally irrelevant, consequence of this use by the board of its inherent authority to manage the business. *Cf. infra* text accompanying notes 206-10.

179. Mobil Corp. v. Marathon Oil Co., 669 F.2d 366, 370-73 (6th Cir. 1981), *cert. denied*, 102 S. Ct. 1490 (1982).

180. 430 U.S. 1 (1977).

181. In determining whether Mobil had an implied private cause of action under section 14(e), the Court utilized the four-part test in Cort v. Ash, 422 U.S. 66 (1975). The *Cort* test consists of these factors: (1) whether plaintiff is "one of the class for whose *especial* benefit the statute was enacted" (emphasis by the Court); (2) whether any indication exists that the legislature intended—explicitly or implicitly—to create the remedy or to deny it;

conclusion.[182] Moreover, most lower federal courts are inclined to allow tender offerors to maintain suits for equitable relief.[183] In addition, target company shareholders probably can maintain suits under section 14(e) for equitable relief and damages.[184] Furthermore, the SEC has standing both to seek injunctions against violations of section 14(e),[185] and to issue rules under section 14(e) specifying that certain acts and practices are manipulative and, hence, unlawful.[186] Thus, if the proposed definition of manipulation is adopted, parties with substantial relevant interests likely will challenge most allegedly manipulative arrangements.

Courts should limit application of the Williams Act to suits in which the plaintiff seeks equitable relief. Most arrangements that constitute manipulation in connection with a tender offer take on their manipulative character partly because they are overt—they must be revealed to potential bidders to have their desired effect. This characteristic makes equitable relief particularly appropriate because if a court determines that an arrangement is manipulative, it readily can remedy the situation by restoring the status quo ante.[187]

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(3) whether the existence of a private remedy is consistent with the underlying purpose of the legislative scheme; and (4) whether the cause of action is traditionally relegated to state law. *Id.* at 78 (emphasis in original).

The *Marathon* Court found that under the *Cort* test Mobil had an implied cause of action. In addition, the court also found four "special circumstances" in the case that justified Mobil's action: (1) Because the action was in the form of a preliminary injunction, the case was at a stage when relief could best be given; (2) Mobil had large amounts of data about Marathon; (3) Because the relief sought by Mobil was injunctive, the Court may structure a remedy on a case-by-case basis; and (4) Mobil's tender offer is still outstanding and the firm may renew its efforts to take over Marathon. Mobil Corp. v. Marathon Oil Co., 669 F.2d at 372-73. The Court's summary of the "four special circumstances" relevant to the standing issue is more persuasive than its analysis of the *Cort* elements.

182. *See* Piper v. Chris-Craft Indus., 430 U.S. at 42.

183. *See* Whittaker Corp. v. Edgar, [1981-1982 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 98,483 (N.D. Ill. Jan. 28, 1982), *aff'd sub nom.* Whittaker v. Brunswick Corp., No. 82—1305 (7th Cir. 1982); LTV Corp. v. Grumann Corp., 526 F. Supp. 106 (E.D.N.Y. 1981); Crane Co. v. Harsco Corp., 511 F. Supp. 294 (D. Del. 1981); Weeks Dredging & Contracting, Inc. v. American Dredging Co., 451 F. Supp. 468 (E.D. Pa. 1978); Humana, Inc. v. American Medicorp, Inc., 445 F. Supp. 613 (S.D.N.Y. 1977).

184. The analysis in *Piper* supports this conclusion. *See* 430 U.S. at 46. *See also* Merrill, Lynch, Pierce, Fenner & Smith, Inc. v. Curran, 102 S. Ct. 1825 (1982) (defrauded investors can maintain an implied private cause of action for damages under the Commodity Exchange Act).

185. 15 U.S.C. § 78u (1976 & Supp. IV).

186. 15 U.S.C. § 78n(e) (1976).

187. For example, in *Marathon* the court required USS to keep its tender offer open for a reasonable time after the two options were invalidated and to give Marathon shareholders additional time in which to withdraw their shares and to tender them to another

Further, allowing suits for damages could pose serious problems. Lawyers representing target company shareholders—the only persons who might have standing to sue for damages—might delay bringing suit until after a manipulative arrangement has had its desired effect, in the hope that the money damages available would generate a larger fee than would a successful suit for equitable relief.[188] But courts may be tempted to alter their approach to defining manipulation to avoid the prospect of draconian damage awards against merely malfeasant directors.[189] The result could be a body of law as doctrinally unsatisfactory as is the current body of state law dealing with defensive tactics.

A possible solution is to deny target company shareholders an implied cause of action for damages under section 14(e). Courts, however, may find it difficult to distinguish satisfactorily between a shareholder's right to sue for damages and a shareholder's right to seek equitable relief.[190] A more promising approach would be one that focused upon causation. The amount of damages caused by an allegedly manipulative arrangement usually will be highly speculative. Whether a manipulative arrangement deters anybody from making a tender offer is often unclear. Moreover, would the offer have succeeded—and at what price?[191] Faced with such uncertainties, the courts should decline to award damages in suits claiming manipulation on the ground that plaintiff has not proven causation.[192] The prospect of these rulings should dampen target com-

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offeror if one appeared after the options were withdrawn. Mobil Corp. v. Marathon Oil Co., 669 F.2d at 377-78.

188. Attorney's fees are available in suits for equitable relief, Bosch v. Meeker Coop. Light & Power Ass'n, 257 Minn. 362, 101 N.W. 2d 423 (1960), but the "salvage value" theory of awarding fees still tends to influence courts. *See* Mowrey, *Attorney Fees in Securities Class Action and Derivative Suits*, 3 J. Corp. L. 267 (1978). As a practical matter, attorneys who frequently represent plaintiffs in derivative and class actions prefer to pursue suits that potentially involve recovery of substantial damages.

189. Principles of Corporate Governance and Structure: Restatement and Recommendations § 7.06 (Tent. Draft No. 1 1982) "[A] close reading of cases, particularly those involving outside directors, suggests that courts have protected directors from disproportionate liability through flexible interpretations of legal doctrines, such as proximate causation and negligence."); *see supra* note 168.

190. The sharply conflicting approaches taken by the majority and the four dissenting Justices in Merrill Lynch, Pierce, Fenner & Smith v. Curran, 102 S. Ct. 1825 (1982), illustrate the doctrinal confusion in this area.

191. After the court in *Marathon* ruled that the two lock-up options were illegal, no other bidders appeared and USS successfully completed its tender offer. *See* Radol v. Thomas, 6 Fed. Sec. L. Rep. [CCH] ¶ 98,693, at 93,454 (S.D. Ohio March 16, 1982). Mobil could not pursue its tender offer hecause of the antitrust problems it raised. *See supra* note 46.

192. *See* Crane Co. v. American Standard, Inc., 439 F. Supp. 945, 955-58 (S.D.N.Y.

pany shareholders' interest in pursuing suits for damages and increase the prospect that they will attempt to protect their interests by seeking equitable relief.

C. *A Taxonomy of Defensive Tactics*

This Article has demonstrated that an act or practice intended or designed to interfere with the operation of the forces of supply and demand in the tender offer market is manipulative for purposes of section 14(e).[193] Arrangements have these effects when they block a potential offeror or seller from entering the market or when they place one offeror or seller in a preferred position vis-à-vis all others. The Article also suggests that a federal court cannot decide properly that an arrangement constitutes unlawful manipulation under section 14(e) merely because the court deems the arrangement to be unfair. The emphasis of *Santa Fe* upon the need to avoid interpreting the federal securities laws in a fashion that flatly overrides state law probably is as applicable to section 14(e) as it is to section 10(b).[194]

Only since *Marathon* have courts begun to analyze tender offer arrangements regularly to determine whether they are manipulative; predicting how they will react to specific fact situations in the future is a venture fraught with peril. Nonetheless, litigated cases furnish enough information about arrangements that have

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1977), *aff'd on other grounds*, 603 F.2d 244 (2d Cir. 1979) (holding Crane had not proven that manipulative purchases and sales of target company stock had caused it any damage).

193. Intent is a critical component of manipulation. The Supreme Court stated in *Ernst & Ernst* that use of the word "manipulative" in section 10(b) clearly evinces a congressional intent to proscribe only "knowing or intentional misconduct." Ernst & Ernst v. Hochfelder, 425 U.S. at 197 (1976). This conclusion would appear to be equally applicable to section 14(e). The Eighth Circuit concluded in Cargill, Inc. v. Hardin, 452 F.2d 1154 (8th Cir. 1971) that courts consistently have found manipulative conduct was intended to affect artificially market forces. *See supra* text accompanying notes 58-64. Moreover, since a large number of corporate decisions may have the effect of deterring one tender offeror or favoring another, an intent test is needed to discriminate between the improper and the legitimate activities of target companies. The courts are almost certain to read an intent test into any standard proposed to regulate the activities of target companies during the pendency of a tender offer.

194. Some commentators argue that the Williams Act creates a "federal fiduciary principle" in the tender offer area. *See, e.g.*, Lynch & Steinberg, *The Legitimacy of Defensive Tactics in Tender Offers*, 64 CORNELL L. REV. 901, 913 (1979). Several courts, however, have held that target company management does not violate § 14(e) merely because it acts for the purpose of protecting its position if its actions were not deceptive or manipulative. *See, e.g.*, *In re* Sunshine Mining Co. Sec. Litig., 496 F. Supp. 9, 11 (S.D.N.Y. 1979); Bucher v. Shumway [1979-1980 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 97,142 (S.D.N.Y. Oct. 11, 1979), *aff'd*, 622 F.2d 572 (2d Cir.), *cert. denied*, 449 U.S. 841 (1980).

been utilized to allow an effort at classification of arrangements and the reconciliation of decided cases.

1. Two-Tier Offers

A two-tier offer is a tender offer for a majority of a target company's shares at a substantial premium over the market price, accompanied by an agreement or statement of intent to acquire the remainder of the target company in a second-step merger at a significantly lower price.[195] Tender offers are two-tiered in this fashion to pressure target company shareholders into tendering their shares, even when they may question the adequacy of the package price or the tender offer price. By not tendering a shareholder risks having all of his shares acquired at the lower, second-stage price.[196] Nonetheless, a court should not classify as manipulative a two-tier offer, at least when target shareholders have the right to seek appraisal of their shares or otherwise to challenge the second-step merger under state law. A two-tier offer would be manipulative only if state-law remedies are inadequate,[197] and under *Santa Fe* a federal court should not premise federal relief upon the unfairness or inadequacy of state law.[198]

2. Defensive Acquisitions

An acquisition by a target company that creates a serious antitrust problem for a tender offeror constitutes an almost insurmountable barrier to consummation of a tender offer.[199] To determine whether an acquisition by a target company is a manipulative

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195. *See* Radol v. Thomas, [Current] FED. SEC. L. REP. (CCH) ¶ 98,693 (S.D. Ohio Mar. 16, 1982).

196. Since § 14(d)(6) requires offerors to accept pro rata only shares that are tendered in the 10 days after an offer is made, use of this tactic places time pressure on target shareholders. The offeror must keep the offer open for 20 business days pursuant to SEC rule 14e-2, but a shareholder who tenders after the first 10 days will not have any of his shares accepted if the offer is oversubscribed during that period. The SEC has proposed that offerors be required to accept pro rata all shares tendered during the withdrawal period to eliminate this timing effect. Rel. No. 18761 [Current] FED. SEC. L. REP. (CCH) ¶ 83,222 (May 25, 1982).

197. If a state statute provides for a target shareholder to seek a fair price for his shares, he can refuse to tender, or dissent from or sue to enjoin the second-step merger and hope that a state court will agree that the price offered is inadequate. *See* Weiss, *The Law of Take Out Mergers: A Historical Perspective*, 56 N.Y.U. L. REV. 624 (1981). A claim by a shareholder that a two-tier offer is manipulative, with these state remedies available to the shareholder, requires a federal court to conclude that the remedies are inadcquate.

198. *See supra* notes 131-40 and accompanying text.

199. *See* Fleischer, *supra* note 170, at 120 ("The most successful show stopper has been the antitrust lawsuit alleging violations of Section 7 of the Clayton Act.").

act or practice, a court should scrutinize the intent of the target company. If the sole or compelling reason for the acquisition is to block or frustrate a tender offer, then the acquisition is properly classified as manipulative under section 14(e) and should be enjoined.[200] Similarly, when a party utilizes an agreement ancillary to an acquisition—such as the exchange agreement in *Crouse-Hinds*[201] —to usurp or interfere with shareholders' ability to evaluate fairly a tender offer, that agreement should be deemed manipulative.[202] By contrast, when a court concludes that an acquisition was motivated by bona fide business considerations, as may have been the case in *Panter v. Marshall Field & Co.*,[203] it should reject a claim of manipulation. The issue in a section 14(e) case will not be whether the directors had a pecuniary interest in the transaction or whether any reasonable purpose can be attributed to the directors' decision, but on the federal question of whether the directors acted with the requisite manipulative intent.

3. Sales of Assets or Stock

Similarly, whether sales by target companies of assets or of stock constitute manipulation would seem to depend upon the intent behind and effect of such sales. If a target company sells some of its assets or issues previously authorized stock in a transaction negotiated at arm's length that the company intends to further some legitimate corporate purpose, then manipulation has not occurred even if the transaction causes a tender offeror to abandon or modify its offer. Section 14(e) should not require a target company to forego commercially attractive transactions simply because a tender offer for its stock is in progress.[204]

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200. *See* Royal Indus. v. Monogram Indus. [1976-1977 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 95,863 (C.D. Cal. Nov. 29, 1976) (pre-*Santa Fe* opinion holding that target company violated § 14(e) by acquiring company engaged in antitrust litigation with tender offeror).

201. *See supra* text accompanying notes 165-68.

202. Crouse-Hind's original agreement to acquire Belden, however, was not manipulative under § 14(e) because it was not motivated by a desire to block a tender offer and was not entered into in connection with a tender offer. *Cf.* David J. Steinberg, Ltd. v. The Children's Place, Inc., No. 6685 (Del. Ch. Jan. 25, 1982) (temporary restraining order issued against cash merger if approved because of vote of shares sold to acquiring company).

203. 646 F.2d 271 (7th Cir. 1981); *see supra* text accompanying notes 169-70.

204. In GM Sub Corp. v. Liggett Group, Inc., 415 A.2d 473 (Del. 1980) the target company agreed to sell a wholly-owned subsidiary, which the tender offeror apparently viewed as one of the target's most attractive assets, to a third party. The sale, however, occurred after the target company had asked several companies to bid for the subsidiary. Moreover, the price was fair. The court held that by selling the subsidiary the target com-

On the other hand, if a target company issues stock under circumstances that suggest no need to raise capital or issues stock subject to conditions—such as short-term redemption requirements—that suggest the sale serves some other purpose, or sells stock or assets in a transaction negotiated with a white knight before the white knight launches its competitive bid, a court should investigate closely the possibility that the transaction is manipulative. If a court determines that the transaction was designed to artificially influence the tender offer market for the target company's shares, then the court should grant equitable relief designed to annul the manipulative effects of the transaction.[205]

Whittaker Corp. v. Edgar[206] illustrates the difficult questions that courts face when reviewing these transactions. Whittaker made a cash tender offer of $27 per share for forty-nine percent of the stock of Brunswick Corp. and announced its intention to acquire the remainder of Brunswick through a merger in which it would issue debentures valued at $26 to $27 per share for each Brunswick share.[207] Shortly thereafter, Brunswick arranged to sell

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pany's directors did not violate any fiduciary obligation that they owed to the company's shareholders. In this case the sale did not deter the offeror, which continued its offer and eventually acquired the target—and thus the proceeds of the sale of the previously desired subsidiary.

205. The approach recommended by this Article would support the results reached in Applied Digital Data Systems v. Milgo Electronic Corp., 425 F. Supp. 1145 (S.D.N.Y. 1977) (enjoining as manipulative sale of 15.5% of target company's stock to a white knight that nullified the ability of the first offeror to consummate tax-free exchange offer) and Consolidated Amusement Co. v. Rugoff, [1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,584 (S.D.N.Y. Oct. 6, 1978) (enjoining sham sale of securities of target company). *Cf.* Joseph E. Seagram & Sons, Inc. v. Abrams, 510 F. Supp. 860 (S.D.N.Y. 1981) (granting temporary restraining order against implementation of "scorched earth policy" by directors of target company).

A stock sale to an acquiring company prior to a proposed merger would not violate § 14(e) because it would not be "in connection with a tender offer." If, however, the target company or white knight contemplates a three stage transaction—lock-up stock sale, "friendly" tender offer, and clean-up merger—a court should deem manipulative the stock sale designed to deter competing bids from unwanted suitors. *See* Freund & Easton, *The Three-Piece Suitor: An Alternative Approach to Negotiated Corporate Acquisitions*, 34 BUS. LAW. 1679 (1979). Fraiden and Franco maintain that a three stage transaction may lead a potential acquiring company to increase the price it is prepared to offer. *See* Fraiden & Franco, *supra* note 3, at 822-23. A more likely result, however, is that an economically rational offeror will lower its bid if it can put into place arrangements that increase the chance its bid will succeed. *See* Hochman, *The Marathon Case*, *supra* note 11.

206. [1981-1982 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 98,483 (N.D. Ill. Jan. 25, 1982), *aff'd sub nom.* Whittaker v. Brunswick Corp., No. 82-1305 (7tb Cir. 1982).

207. Whittaker first proposed to complete the merger with preferred stock that analysts said would be worth less than $26.50. Wall St. J., Feb. 2, 1982, at 18, col. 8. Whittaker

its Sherwood medical subsidiary—which investors generally viewed as the segment of Brunswick's business that was most attractive to Whittaker—to American Home Products (AHP) for $425 million in a two-step transaction. First, AHP was to make a cash tender offer of $30 for 14,166,666 Brunswick shares—sixty-four percent of the outstanding Brunswick shares—for a total price of $425 million. Then AHP was to purchase Sherwood from Brunswick with the shares it hoped to acquire. If AHP was not able to acquire the desired number of shares, it had the option of paying cash to Brunswick.[208] The court rejected Whittaker's claim that Brunswick's sale of Sherwood was manipulative within the meaning of *Marathon*. The sale did not create an artificial ceiling on the tender offer market for Brunswick shares nor was it "expressly designed solely for the purpose of completely blocking normal, healthy market activity . . . ."[209] The court pointed out that the sale resulted in Brunswick receiving more for Sherwood than the value Whittaker placed on Sherwood. Thus, the transaction "might actually be characterized as part of healthy market activity . . . ."[210]

The court's conclusion that the sale of Sherwood was not manipulative appears reasonable. The arrangement did not deny Brunswick shareholders a choice; they could choose to accept Whittaker's offer, proceed to approve the second-step merger and receive about $27 per share for all of their shares, or they could sell sixty-four percent of their shares to AHP for $30 per share and retain their ownership interest in the remainder of Brunswick's assets.[211] Moreover, Whittaker was not frozen out of the bidding be-

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subsequently offered $30 principal amount 16% debenture for each Brunswick share. Wall St. J., Feb. 11, 1982, at 50, col. 1.

208. Brunswick bad been offered $450 million cash for Sherwood, hut found the AHP offer more attractive because it would not result in income taxable to Brunswick. N.Y. Times, Feb. 12, 1982 at D1, col. 5. Recent changes in the Internal Revenue Code eliminate this tax advantage. N.Y. Times, Sept. 7, 1982, at D1, col. 3.

209. Whittaker Corp. v. Edgar, [1981-1982 Transfer Binder] FED. SEC. L. REP. at 92,832. The court continued: "A sale of a substantial asset by a corporation in the face of a hostile tender offer standing alone is not a violation of section 14(e)." *Id.*

210. *Id.*

211. This choice, however, may have been more ephemeral than real. Brunswick's shareholders faced a "prisoner's dilemma." *See* Gilson, *supra* note 15, at 859-62. While all shareholders would have received about $27 if the two-part Whittaker offer had succeeded, a majority was likely to accept AHP's $30 bid for 64% of the shares. If AHP succeeded, non-tendering shareholders would be left with Brunswick stock valued at $15-$16 per share. The average received by all Brunswick shareholders, under this scenario—which ultimately eventuated—would be less than $25 per share—$30 x .64 = $19.20 plus $16 x .36 = $5.76, or a total of $24.96. Nonetheless, one cannot say accurately that the activities of Bruns-

cause it could have bid more than $425 million for Sherwood, if it had believed that Sherwood was worth a higher price.[212] Brunswick's defense succeeded not because it was manipulative, but because AHP placed a higher value on Sherwood than did Whittaker and because Whittaker did not have access to sufficient funds to increase the cash portion of its offer.[213]

4. Options to Purchase Stock or Assets

The courts generally should view target company decisions to grant options to white knights or third parties somewhat more skeptically than they do outright sales. When the target company grants an option, it generally will receive no more than minimal compensation and will not be able to ensure that the grantee ever will exercise the option, while the grantee often will receive valuable rights without making any substantial commitment of resources. Certain options, such as the options granted in *Marathon,* clearly are manipulative. Other instances are likely to present closer cases.

Marshall Field & Co. v. Icahn[214] illustrates one of these closer situations. Marshall Field faced a possible take-over by the Icahn group, which had acquired about thirty percent of Marshall Field's stock through open market purchases. To counter this possibility, Marshall Field initiated a search for a white knight. Eventually, Marshall Field induced BATUS, Inc. to make a cash tender offer for fifty-one percent of Marshall Field. BATUS and Marshall Field entered into a second-step merger agreement and a number of ancillary agreements in connection with this tender offer. One agreement conferred on BATUS a right of first refusal for the purchase of properties constituting Marshall Field's Chicago Division, good for one year after any termination of the BATUS-Marshall Field merger agreement. The arrangement also allowed BATUS to pay for these properties with Marshall Field stock valued at BATUS's cost.[215] The grant of the first refusal right may be manipulative

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wick's directors in approving this arrangement artificially affected the tender offer market. *But see* Hochman, *A Hostile Tender Offer: Does It Suspend Rules?, supra* note 11, at 25 (criticizing court's opinion on these grounds).

212. The court implied that it would have found that Brunswick engaged in manipulation if Brunswick had rejected an offer from Whittaker to purchase Sherwood for more than AHP offered to pay. *See supra* text accompanying note 200.

213. *See* Wall St. J., March 9, 1982, at 5, col. 1.

214. [Current] FED. SEC. L. REP. (CCH) ¶ 98,616 (S.D.N.Y. March 26, 1982).

215. The only Marshall Field stock BATUS was likely to own was stock it had agreed to purchase directly from Marshall Field. *Id.* at 93,060.

under section 14(e) because it placed BATUS in the preferred position of being the only party that could acquire Marshall Field and then be entirely free to dispose of its Chicago Division properties within one year.[216] The court, however, rejected Icahn's claim that the agreement was manipulative, and pointed out that the first refusal right did not bar sale of the properties nor grant BATUS the right to purchase them for less than fair market value. The court noted that Marshall Field and BATUS had clarified their agreement to ensure that Field could reopen the bidding for any property if BATUS elected to exercise its first refusal right.[217] More importantly, the court concluded that the existence of the first refusal right is "mostly unlikely to dissuade competitors . . . from tendering for control of Field."[218] Thus, the right was distinguishable from the options ruled manipulative in *Marathon* and did not fall within the prohibition of section 14(e).

The court's conclusion in *Marshall Field* is reasonable. Not every arrangement that places one tender offeror in a preferred position is manipulative. Some concept analogous to materiality should enter into the court's calculus: section 14(e) should bar only those arrangements that seem likely to serve as substantial deterrents to competing offers.[219] *Marathon* does not suggest otherwise. Thus, the court's denunciation of *Marathon* in *Marshall Field* was unnecessary as well as faulty.[220]

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216. If the Icahn group gained control of Marshall Field, the group might sell those properties to recover the cost of financing its acquisition of Marshall Field stock. *See* Wall St. J., Feb. 23, 1982, at 48, col. 6.

217. Marshall Field & Co. v. Icahn, [current] FED. SEC. L. REP. at 93,060. Apparently the purchaser would be given an opportunity to raise its offer, at which point BATUS again would have an opportunity to match the offered price.

218. *Id.* When BATUS raised its tender offer to $30 per common share, and then agreed to pay $30 per common share in a second-step merger, the Icahn group dropped its opposition to the BATUS tender offer and merger. BUS. WK., Apr. 12, 1982 at 44.

219. *Cf.* TSC Indus. v. Northway, Inc., 426 U.S. 438 (1976) (under rule 14a-9 an omitted fact is material if a substantial likelihood exists that a reasonable shareholder would consider it important in deciding how to vote).

220. The court statcd:

> Apart from the absence of proof of harm, Icahn's contentions rest on a questionable legal theory. Icahn relies solely on *Mobil Corp. v. Marathon Oil Corp.* [sic] . . . . I doubt that decision represents the law in this circuit. In my view the reasoning of that decision could unduly interfere with the right of company management to combat a takeover attempt tbat it believes in good faith to be barmful to its sbareholders. In my view the securities laws do not bar management from taking [sucb] action . . . .

Marshall Field & Co. v. Icahn, [current] FED. SEC. L. REP. at 93,061.

5. Indemnification

The most common arrangements between target companies and white knights are idemnification arrangements whereby the target company agrees to indemnify the white knight for the losses it may incur if its efforts to gain control of the target company fail. Advocates of these arrangements often justify them as necessary to induce a white knight to enter the contest for control of the target, desirable from the point of view of the target's shareholders, and not dissimilar to indemnification agreements that corporations enter into in a variety of other contexts.[221] A per se rule classifying as manipulative all arrangements designed to place one bidder in a preferred position would bar these indemnification agreements, since only the white knight would be in a position to make a tender offer without bearing the burden of paying another offeror's costs. If, however, section 14(e) bars as manipulative only those arrangements that operate as substantial deterrents to competing bids, then at least it should not proscribe straightforward indemnification agreements.[222] Transaction costs associated with tender offers, while often substantial when viewed in absolute terms, rarely amount to more than a very small proportion of acquisition costs.

A rule allowing indemnification, however, should not become a license for use of other defensive arrangements that arguably serve the purpose of allowing an unsuccessful white knight to recover its transaction costs. In particular, granting a white knight an option to purchase a substantial number of target company shares may have the effect of allowing the white knight to cover its costs if another offeror tops the bid. This alternative, however, is not directly proportional to the costs a white knight is likely to incur and, thus, is likely to have more significant manipulative effects. Therefore, a court should not treat an option grant as an acceptable substitute for a straightforward indemnification arrangement.

IV. Conclusion

Recent Supreme Court decisions support the view that an arrangement designed to interfere significantly with the forces of supply and demand in the tender offer market properly is termed manipulative for purposes of section 14(e). Specifically, *Ernst & Ernst* and *Santa Fe,* as well as the Eighth Circuit's opinion in *Car-*

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221. *See, e.g.,* Fraidin & Franco, *supra* note 3.
222. *See* Hochman, *supra* note 211.

gill, support interpreting the language of section 14(e) to prohibit these arrangements. This interpretation of the statute advances the purposes of the Williams Act as the Court described those purposes in *Piper v. Chris-Craft Industries* and *Rondeau v. Mosinee Paper Co.* Moreover, the policy considerations set out in part IV of *Santa Fe* do not prohibit interpreting section 14(e) in this fashion.

Judicial utilization of the approach to defining manipulation suggested by this Article should have a constructive effect on the tender offer process and on corporate governance generally. By focusing on the need to protect the target company shareholders' right to obtain the benefits of an open, competitive auction market for their shares, the federal courts should be able to block arrangements intended to artificially impede the operation of market forces without unduly constraining target company managements from entering into legitimate business transactions.