Section 14(e) of the Williams Act: Formulated Lock-ups Are Not Manipulative Acts in Connection with a Tender Offer - Mobil Corp. v. Marathon Oil Co. Runs Out of Gas

William T. Lewis

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SECTION 14(e) OF THE WILLIAMS ACT: FORMULATED
LOCK-UPS ARE NOT MANIPULATIVE ACTS IN
CONNECTION WITH A TENDER OFFER—MOBIL CORP.
v. MARATHON OIL CO. RUNS OUT OF GAS

I. INTRODUCTION

The cash tender offer emerged on the corporate scene in the early 1960's to expedite the takeover process by circumventing the excessive regulation in the field of conventional mergers. Initially, the tender offer was viewed solely as an unethical tool used by "corporate raiders." However, with the passage of the Williams Act in 1968, the modern tender offer evolved into a respectable means of corporate acquisition. To avoid being acquired in an unwanted takeover attempt, "target" corporations began to develop an array of defensive techniques to fend off unwanted solicitations. These tactics

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1. The cash tender offer normally consists of a bid by an individual or group to buy shares of a company, generally offering a premium price. Those accepting the offer are said to tender their shares for purchase. The offeror obligates himself to purchase all or a specified portion of the shares tendered, provided certain conditions are met. H.R. REP. NO. 1711, 90th CONG., 2d Sess. 1 (1968), reprinted in 1968 U.S. CODE CONG. & AD. NEWS 2811 [hereinafter cited as 1968 HOUSE REPORT].

2. In connection with tender offers, a number of colloquialisms have been developed by specialists in the field to describe the participants and processes involved:
   a. Takeover process: the act of one corporation or group of individuals acquiring control over another corporation.
   b. Target corporation: the corporation whose stock is the subject of the tender offer.
   c. Aggressor: the corporation or group of individuals making the unsolicited tender offer; also known as a "raider."
   d. White Knight: a third party corporation or group of individuals who is sympathetic to the present management of the target and enters into an agreement or bidding contest in an attempt to defeat a hostile bid.

3. See supra note 2.


6. See supra note 2.

7. Among the defensive tactics used by incumbent management to thwart unsolicited
were designed to avoid direct competition with the “aggressor” corporation for the support of the shareholders. By thwarting the aggressor’s ability to make the offer, target management can paternalistically protect shareholders from being “lulled” into tendering their offers at their inception, or shortly thereafter, are the following:

a. Litigation: the target corporation may institute litigation focusing primarily on inadequate disclosure by the aggressor, as required by the securities law, or on antitrust grounds, asserting that the combination would substantially reduce competition. See, e.g., Panter v. Marshall Field & Co., 646 F.2d 271 (7th Cir. 1981), cert. denied, 454 U.S. 1092 (1981).

b. Target Share Repurchases: this strategy is used to reduce the number of shares available to the aggressor by buying-out disgruntled shareholders who are more likely to sell; such repurchases are also helpful in raising the price for the remaining shares by increasing demand. See, e.g., Nathan and Sobel, Corporate Stock Repurchases in the Context of Unsolicited Takeover Bids, 35 Bus. LAW. 1545 (1980). The Williams Act § 13(e), 15 U.S.C. § 78 m(e) (1968), requires disclosure of the purposes of issuer repurchase under certain circumstances.

c. Increase Dividends: an increase in dividend payments boosts shareholder satisfaction with existing management as well as increases the value of the stock, forcing the aggressor to raise his price.


e. Amend Corporate Charter: incumbent management may seek to make any takeover more time consuming, such as by staggering the election of the board of directors or by increasing the minimum number of shares needed to effect any post-acquisition merger. See Comment, Antitakeover Maneuvers: Developments in Defense Tactics and Target Actions for Injunctive Relief, 35 Sw. L.J. 617, 623-25 (1981).

f. Contract Clauses: the target can make a takeover financially prohibitive in post-acquisition costs by conditioning major loans to become due and payable should the target be acquired by a third party. Similarly, long term employment contracts with existing management can be used. See id. at 623.

g. Enlist the Aid of a White Knight: the target may reach an agreement with a “friendly” third party and arrange a defensive merger of the target with the friendly third party. See, e.g., Piper v. Chris-Craft Indus., Inc., 430 U.S. 1 (1977).


8. See supra note 2.

9. Rather than competing directly with the aggressor, target management have concentrated their efforts at preventing the offer at its inception, thus eliminating the possibility of an incorrect decision by the shareholders. In this manner, target management need not convince shareholders that the existing board was doing a superior job. Also, by preventing a hostile offer, target management can avoid a shareholder comparison of the present value of the target’s anticipated future returns with the premium being offered by the aggressor. See Gilson, A Structural Approach to Corporations: The Case Against Defensive Tactics in Tender Offers, 33 STAN. L. REV. 819, 819-21 (1981).
shares to the aggressor. A relatively recent development in the defensive arsenal of management is the use of the "formulated lock-up."

The lock-up is broadly defined as an arrangement, in connection with the proposed acquisition of a publicly held business, that gives the proposed acquiror an advantage in acquiring the target over other bidders. Lock-ups may take the form of stock options for authorized but unissued shares, options to purchase principal assets, or other types of arrangements in which the "white knight" receives a preferred position in any competitive bidding for the target. These lock-ups are frequently used as a first step toward a defensive merger or a competing tender offer. Lock-ups are often extracted from the target as a condition before the white knight will enter into the picture. At other times, offers of lock-ups are used by targets to entice a hesitant white knight into entering a competitive bidding contest with the aggressor.

The use of lock-ups by target corporations has been recognized as a situation wrought with inherent conflict of interest by target directors. Even though incumbent management generates some minimal business purpose for the lock-up, shareholders have recognized that often director action is influenced more by a desire to preserve the directors' own positions of power and influence than by any genuine intent to act in the shareholders' best interest. As such, there is a genuine need for shareholders to have some recourse against directors for actions taken by the board contrary to the shareholders' best interest. The implementation of lock-ups by target corporations has produced litigation involving both the federal securities law and state corporation law.

This comment discusses the use of lock-ups in tender offers, beginning with a general review of state fiduciary law and specific focus on lock-ups in the context of state corporation law. It then focuses on the impact of federal securities law on the use of lock-ups by examining the legislative history, regulatory action, and judicial interpretation of the Securities Exchange Act and the Williams Act. Finally, the comment proposes that federal law be expanded to include a federal fiduciary duty.

11. See supra note 2.
II. FIDUCIARY DUTY

A. State Law Controlling

Questions concerning violations of the directors’ fiduciary duties to shareholders are examined under applicable state law. There is no fiduciary requirement for directors to either endorse or oppose a tender offer. However, once a position is taken, any disclosure made by the target’s board of directors must comply with the requirements of the federal securities law. This common law countenance of target silence concerning a tender offer has been modified by Securities and Exchange Commission Rule 14e-2 which requires the target board of directors to communicate with the shareholders concerning the merits of any tender offer.

In an unfriendly offer, incumbent management generally will not remain silent, but will take affirmative steps to defeat the offer. Although there has been some question and commentary regarding management’s right to oppose an unsolicited offer, the better view

13. "Corporations are creatures of state law, and investors commit their funds to corporate directors on the understanding that, except where federal law expressly requires certain responsibilities of directors with respect to shareholders, state law will govern the internal affairs of the corporation.” Cort v. Ash, 422 U.S. 66, 84 (1975). See 3 A. FLETCHER, CORPORATIONS § 990 n.16 (1965).
14. Broffe v. Horton, 172 F.2d 489 (2d Cir. 1949). However, there may be a duty for directors to oppose a tender offer if they believe that the aggressor will loot or misuse corporate assets. See Northwest Indus., Inc. v. B.F. Goodrich Co., 301 F. Supp. 706 (N.D. Ill. 1969).
16. Hereinafter cited as S.E.C.
17. 17 C.F.R. § 240.14e-2 (1983). Position of subject company with respect to a tender offer:

a. Position of subject company. As a means reasonably designed to prevent fraudulent, deceptive or manipulative acts or practices within the meaning of section 14(e) of the Act, the subject company, no later than 10 business days from the date the tender offer is first published or sent or given, shall publish, send or give to security holders a statement disclosing that the subject company:
   1. Recommends acceptance or rejection of the bidder’s tender offer;
   2. Expresses no opinion and is remaining neutral toward the bidder’s tender offer; or
   3. Is unable to take a position with respect to the bidder’s tender offer.
   Such statement shall also include the reason(s) for the position (including the inability to take a position) disclosed therein.

b. Material change. If any material change occurs in the disclosure required by paragraph (a) of this section, the subject company shall promptly publish, send or give a statement disclosing such material change to security holders.
is that management has not only a right, but a duty to defend against an offer it feels is not in the shareholders' best interest. 19

B. Business Judgment Rule

Historically, shareholder suits claiming breach of state fiduciary law have been decided under the business judgment rule. The rule prohibits judicial interference with the decisions of a board of directors so long as those decisions are made in good faith and neither fraud nor overreaching is present. 20 The traditional rationale for the rule has been that the courts, unlike business professionals, are not competent to evaluate the numerous variables considered by the board in reaching a decision. 21

To enjoy the judicial deference of the business judgment rule, the board of directors must show that some judgment was exercised. To satisfy the showing for this de minimus scrutiny, the courts require the board of directors to evaluate the merits of any hostile offer in good faith and determine that the offer is not in the shareholders' best interest. 22 Once the board has fully and fairly evaluated the merits of the offer and concluded that the terms are inadequate or otherwise not in the shareholders' best interest, the board may take whatever steps are legally available to oppose it. 23

Since the business judgment rule developed under state corporation law, the scope and extent of the judicial scrutiny will vary from state to state. 24 Unlike the ordinary decisions of the board of direc-


20. See generally Panter v. Marshall Field & Co., 646 F.2d at 293; Treadway Cos. v. Care Corp., 638 F.2d 357, 381 (2d Cir. 1980); Crouse-Hinds Co. v. InterNorth, Inc., 634 F.2d 690, 701-03 (2d Cir. 1980).


24. Compare Panter v. Marshall Field & Co., 646 F.2d at 293 (in the absence of a showing of bad faith on the part of the directors or a gross abuse of discretion, the courts will not interfere with the business judgment of the directors) and Sinclair Oil Corp. v. Levien, 280 A.2d 717, 720 (Del. 1971) ("[a] board of directors enjoys the presumption of sound business judgment, and its decisions will not be disturbed if they can be attributed to any rational business purpose") with Klaus v. Hi-Shear Corp., 528 F.2d 225 (9th Cir. 1975) and Jones v. H.F. Ahmanson & Co., 1 Cal. 3d 93, 94, 460 P.2d 464, 81 Cal. Rptr. 592 (1969) (transac-
tors and management, target responses to hostile tender offers create an inherent conflict of interest when the aggressor has expressed a desire to replace existing management. The majority of the courts addressing the issue have held, however, that this conflict of interest is not sufficient to warrant judicial interference with management's decisions. These courts have conceded that management's desire to maintain control may be a motive in defending against a takeover. But, to shift the burden of proof to the defendant directors to justify their actions, those challenging the directors' actions must make a factual showing that the impermissible motive predominated in the decision to oppose. That is, absent a showing of fraud, bad faith, gross overreaching or abuse of discretion on the part of the directors, the courts will not interfere with the board's business judgment.

This conflict of interest, and its ability to taint management's discretion, has been recognized by courts and commentators. Courts have applied various standards to minimize the impact of the conflict. Some courts have examined the incumbent board's actions in light of the number of "independent" directors involved in reaching the decision to oppose, while other courts have shifted the burden to the directors to establish a compelling business purpose in transactions affecting control. However, these courts remain in the minority.

C. Fiduciary Duties and the Formulated Lock-Up

Like other defensive tactics, the use of formulated lock-ups inevitably leads to allegations of fiduciary breaches, on the part of directors, for authorizing transactions having no business purpose other
than for defeating the offer. The response of the target board has typically been that without the issuance of the lock-up, no competing bid would have been made against the "inadequate" offer by the aggressor. Moreover, the directors generally contend that the business judgment rule insulates their actions from judicial scrutiny.

When the price offered in the lock-up is near the fair market value of the stock or assets, courts have been reluctant to find a breach of duty. Instead, the courts have generally found that such transactions fall within the purview of the business judgment rule. Just as they must demonstrate with other defensive tactics that enjoy judicial deference under the business judgment rule, directors are generally required to show that some modicum of judgment was exercised in the context of a lock-up. Some courts, in addressing lock-up situations, have distinguished between lock-ups involving target stock and lock-ups involving target assets. The distinction is legitimate because, although similar, the types of investigations that must be done by the directors to satisfy their fiduciary burden are different.

1. **Lock-ups Involving Target Stock**

The price of any treasury stock or authorized, but unissued stock, that is to be sold or otherwise locked-up to a favored bidder must be low enough to entice the bidder to purchase, thus scaring off


32. After an aggressor makes an offer, management generally hires an investment banker to generate a valuation of the shares. This valuation is usually disclosed by target management as indicative of the inadequacy of the aggressor's offer. Such an internal valuation can prove embarrassing to the target and any successful white knight in a back-end merger. Excessive valuation by the investment banker may prove harmful to the target in any statutory appraisal action arising out of the back-end freeze-out. See Bloomenthal, *Lock-ups - Mobil Wins Battle; Loses War*, 4 SEC. & FED. CORP. L. REP. 77 (Feb. 1982). See generally, CAL. CORP. CODE §§ 1300-12 (West 1977 & Supp. 1983) (statutory appraisal rights). "Back-end merger" and "back-end freeze-out" are defined infra at note 37.

33. See Buffalo Forge Co. v. Ampco-Pittsburgh Corp., 638 F.2d 568 (2d Cir. 1981).

34. See Kramer, supra note 31, at 21, col. 1; Whittaker Corp. v. Edgar, 535 F. Supp. 933, 951 (N.D. Ill. 1982).

35. See Treadway Cos. v. Care Corp., 638 F.2d at 383. The sale of an asset, which has the result of making a company less attractive to a tender offeror, can be a proper exercise of the directors' business judgment. Whittaker Corp. v. Edgar, 535 F. Supp. at 951. Therefore, it may be that the issue to focus on in a white knight lock-up transaction is not the directors' opposition to the initial takeover proposal, but the fairness of the transaction facilitated by the lock-up. Kramer, supra note 31, at 21, col. 1.
any hostile bidder by successfully putting a large amount of target stock in friendly hands. At the same time, if the price is too low, shareholder allegations of breach of fiduciary duties will arise. To satisfy state corporation law requirements that the consideration received by a corporation be equal to the stock’s fair value, the purchase price of the shares is usually set at the current market price, or, in the alternative, the purchase price is set at the same price the white knight proposes to make in his public offering.\textsuperscript{36} While pricing the shares at the proposed public offering price may produce a higher original cost, such a capital outlay is only temporary because the white knight will be able to reacquire the funds expended through a back-end merger\textsuperscript{37} of the target corporation into the white knight. The only limitation on the white knight in this friendly acquisition is the number of shares to be covered in the agreement. The stock exchange rules usually restrict this quantity to approximately twenty percent (20\%) of the outstanding shares.\textsuperscript{38} The directors satisfy their fiduciary duty by engaging an investment banker who will render an opinion that the price offered by the white knight is fair,\textsuperscript{39} and certify that the sale would be in the best interest of the corporation.

\section*{2. Lock-ups Involving Target Assets}

In the sale of a principal asset, directors are only required to show that the price was "fair." To this end, target management will generally employ an investment banking firm to generate an appraisal. After receiving a favorable assessment by the appraisers, the courts will defer to the business judgment of the directors.\textsuperscript{40} There is, however, one limitation on the board of directors’ ability to sell principal assets: if the assets are large enough, there may be liability

\begin{footnotes}
\item[36.] Nathan, \textit{supra} note 5, at 23.
\item[37.] A "back-end" or "second-phase" merger arises when an aggressor has obtained a block of stock in excess of the amount required in the corporate charter and by-laws to effect a merger; this amount is typically between 50\% and 80\%. At this point the merger can be authorized solely by the aggressor voting its target stock in favor of the merger. Remaining shareholders are bought out under the merger, usually with some form of stock or debt of the aggressor. Such back-end mergers are subject to shareholder challenges as a "freeze-out" of the minority interests, resulting in shareholder suits seeking to exercise their statutory appraisal rights, if such rights exist.
\item[39.] Directors have a right to rely upon the advice and counsel of experts. Spirt v. Bechtel Co., 232 F.2d 241, 247 (2d Cir. 1956); Whittaker Corp. v. Edgar, 535 F. Supp. at 951.
\item[40.] "The sale of an asset that has the result of making a company less attractive to a tender offeror can be a proper exercise of a board of directors' business judgment." Whittaker Corp. v. Edgar, 535 F. Supp. at 951.
\end{footnotes}
under state law for selling substantially all of the corporation's assets without shareholder approval. Courts only require shareholder approval of a sale when the assets sold are "quantitatively vital to the operation of the corporation," that is, when the sale "strikes at the heart of the corporate existence and purpose." Hence, sales of assets "representing at least twenty-six percent (26%) and possibly as much as fifty percent (50%) of a corporation's total assets have been deemed not a sale of substantially all of the corporation's assets." In the lock-up area, then, it becomes obvious that the sale of an asset as large as a subsidiary may not constitute a "sale of assets" if the vendor is a large conglomerate.

Judicial interpretation of the business judgment rule has given directors a virtual free rein. The board need not be concerned with potential liability to shareholders so long as some business rationale for the transaction has been demonstrated. Due largely to this judicial deference, recent litigation has focused on lock-ups as a violation of the antimanipulation provisions of the Williams Act.

III. FEDERAL SECURITIES LAW

A. The 1934 Act

The fundamental purpose of the 1934 Securities Exchange Act was to "substitute a philosophy of full disclosure for the philosophy of caveat emptor . . ." By requiring full disclosure, Congress sought to put the investing public on the same footing as corporate insiders by equalizing the information available to both. The

41. See, e.g., OHIO REV. CODE § 1701.76 (Page 1953); CAL. CORP. CODE §§ 1000-1002 (West 1982).
44. The 1934 Securities Exchange Act [hereinafter cited as the 1934 Act] is concerned primarily with the regulation of securities in the secondary markets; that is, securities traded through interstate commerce, as in the over-the-counter market, or securities traded on any facility of any national exchange. See preamble of Pub. L. No. 73-291. In contrast, the 1933 Securities Act is generally concerned with regulating initial stock distributions from the issuer, through the underwriters and selling groups, and ultimately to the investing public. See generally 1933 Securities Act. The Williams Act is an amendment of the 1934 Act.
45. Santa Fe Indus., Inc. v. Green, 430 U.S. 462, 467 (1977) (citations omitted). See Affiliated Ute Citizens v. United States, 406 U.S. 128, 151 (1972). See also 1968 HOUSE REPORT, supra note 1 ("[Williams Act] designed to require full and fair disclosure for the benefit of investors while at the same time providing the offeror and management equal opportunity to fairly present their case").
46. See Note, supra note 7, at 637.
second principal concern of the 1934 Act was the prohibition of manipulative practices. Historically, the courts have emphasized the disclosure purpose of the 1934 Act; however, increasing attention is now being paid to the substantive antimanipulation provisions. There is no explicit definition of the term "manipulation" contained in the 1934 Act; therefore, its meaning must be gleaned from both the practices explicitly prohibited and the judicial pronouncements of the term.

The two sections of the 1934 Act specifically addressing the term "manipulation" are section 9,\(^{47}\) prohibiting manipulation of securities prices, and section 10,\(^{48}\) regulating the use of manipulative and deceptive devices. After satisfying the jurisdictional requirements,\(^{49}\) the S.E.C. is empowered by section 9 "to issue regulations concerning pegging . . . [and] option . . . orders" as is necessary or appropriate in the public interest or for the protection of investors.\(^{50}\) Section 10 regulates short sales and stop-loss orders\(^{51}\) as well as prohibits such manipulative or deceptive devices as determined by the S.E.C. To date, neither the Congress, the courts, nor the commentators have developed a clear consensus on the definition of "manipulation."\(^{52}\) It is against this backdrop of the prior interpretation of "manipulation" that the tender offer antimanipulation language of the Williams Act must be examined.

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48. Id. § 78j.
49. The jurisdictional threshold of § 9 and § 10 requires that the offending act be committed "by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange . . . ." R. Jennings & H. Marsh, Securities Regulation, Cases and Materials, 779 (5th ed. 1982).
50. Note, supra note 7, at 638. A "pegging" transaction is one wherein the price of a security is fixed, stabilized, or otherwise prevented from declining. 15 U.S.C. § 78i(a)(b). An "option" is a privilege existing in a person, for which he has paid money, which gives him an irrevocable right to purchase (a "call" option), or to sell (a "put" option), or to purchase and sell (a "straddle" option). Id. § 78i(b).
51. A "shortsale" is a transaction wherein a vendor sells shares that he does not yet own or control, such shares typically being borrowed from a brokerage house to be replaced by the vendor in the future. Id. § 78j(a). A "stop-loss" order is an order given to a stock broker to buy or sell certain securities when the market price reaches a specified level. Id. § 78j(a).
52. "The term 'manipulation' was intended to apply to those activities occurring within the market itself which intentionally distort the market's appraisal of value." Note, supra note 7, at 639. The term "manipulation" is "virtually a term of art when used in connection with [the] securities market . . . refer[ring] generally to practices, such as wash sales, matched orders, or rigged prices, that are intended to mislead investors by artificially affecting market activity." Santa Fe Indus., Inc. v. Green, 430 U.S. at 476. Manipulation "connotes intentional or willful conduct designed to deceive or defraud investors by controlling or artificially affecting the price of securities." Ernst & Ernst v. Hockfelder, 425 U.S. 185, 199 (1976).
B. The Williams Act

1. History and Legislative Intent

The Williams Act, which amends the 1934 Act, specifically provides for full disclosure of pertinent information to shareholders when control of a corporation is sought by a tender offeror, or when a target corporation repurchases its own stock. This disclosure was intended to be consistent with the disclosure requirements of the 1934 Act. As such, Congress viewed the Williams Act as filling the gap in the securities law by requiring the same disclosures in a cash tender offer as were then required in an exchange tender offer. In drafting the legislation, Congress took great pains to create a regulatory scheme that would maintain neutrality. The goal of the authors was:

[to avoid] tipping the balance of regulation either in favor of management or in favor of the person making the takeover bid. It [was] designed to require full and fair disclosure for the benefit of investors while at the same time providing the offeror and management equal opportunity to fairly present their case.

2. Manipulation In Connection With a Tender Offer

Even though the courts have focused primarily on the disclosure requirements of the Williams Act, substantive provisions do exist. It is these substantive antimanipulation provisions that have been emphasized by plaintiffs in attacking target defensive actions. In determining what acts and practices constitute manipulation in connection with a tender offer, the legislative and judicial history of section 53. The Williams Act, Pub. L. No. 90-439, 82 Stat. 454, (amending 15 U.S.C. §§ 78 m-n (1964)) (as amended by Pub. L. No. 91-567, 84 Stat. 1497) (codified as amended at 15 U.S.C. §§ 78 m(d)-(e), n(d)-(f) (1981)) [hereinafter cited as the Williams Act.]


55. "As a disclosure bill, the [Williams Act] is consistent with the basic philosophy of the federal securities laws that investors should be furnished with all material facts before being asked to make an investment decision. This philosophy has been the keystone of federal regulation for more than thirty years." 1967 Senate Hearings, supra note 5, at 97 (testimony of Ralph Saul, President of the American Stock Exchange).

56. In an exchange tender offer, the aggressor corporation offers some amount of its own stock in exchange for each share of the target corporation that is tendered; in contrast, the cash tender offer involves a payment of cash by the aggressor for each share tendered.

57. The purpose of the bill was to close the gap in an area of the securities law where full disclosure was not yet required. 1967 Senate Hearings, supra note 5, at 1; 1968 HOUSE REPORT, supra note 1, at 2814.

58. 1968 HOUSE REPORT, supra note 1, at 16 (testimony of the Hon. Manuel F. Cohen, Comm'r of the Securities Exchange Comm.).
14(e) of the Williams Act must be critically examined.

a. Congressional History

Like the 1934 Act, the Williams Act contains no explicit definition of the term "manipulative." In addition, the legislative history is conspicuously barren as to the intended meaning of manipulation under section 14(e). At the Congressional hearings, testimony was received expressing the view that strong antimanipulation provisions were needed. Those who testified stated that, in light of the difficulty and expense of proxy fights, strong substantive provisions would provide the only viable mechanism to prevent incumbent management from using unfair defensive tactics to entrench its position of control. However, this view was not endorsed by Congress; rather, the prevailing view was that problems of unfair defensive tactics and entrenched management are better left to state control under the fiduciary laws. The conclusion that the Williams Act was not intended to regulate defensive tactics is buttressed by the dual purposes of the Williams Act mentioned earlier: the requirement of full disclosure sufficient to allow the investor to make an intelligent decision, and the prohibition of manipulative devices designed to distort the market price of shares to a level unrelated to natural supply and demand.

The inference that Congress did not intend to regulate defensive tactics is further supported by a negative implication arising from

59. Section 14(e) provides:
It shall be unlawful for any person to make any untrue statement of a material fact or omit to state any material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading, or to engage in any fraudulent, deceptive, or manipulative acts or practices, 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. The Commission shall, for the purposes of this subsection, by rules and regulations define, and prescribe means reasonably designed to prevent, such acts and practices as are fraudulent, deceptive, or manipulative.
60. See generally 1967 Senate Hearings, supra note 5, at 116 (testimony of Robert Mundheim, Professor of Law, Univ. of Pa.), 120 (testimony of Stanley Kaplan, Professor of Law, Univ. of Chicago), 131 (testimony of A. Fleisher, Jr., Attorney at Law).
61. 1967 Senate Hearings, supra note 5, at 141 (federal regulation should not be addressing questions which are essentially matters for state law to determine). See 1968 House REPORT, supra note 1, at 2813 ("It was urged during the hearings that takeover bids should not be discouraged because they serve a useful purpose in providing a check on entrenched but inefficient management. . . . The bill avoids tipping the balance . . . either in favor of management or in favor of the [offeror].").
62. See supra note 55.
63. See supra note 52.
the scope of section 13(e) of the Williams Act. This section regulates stock repurchases by the issuer. The section 13(e) limitation is significant because it implies that Congress intended to regulate only the defensive tactic of issuer repurchases, even though Congress was fully advised of the wide array of techniques used by target corporations in opposing hostile acquisitions. Also, even in this limited area, section 13(e) emphasizes disclosure of the repurchases rather than prohibition of the acquisitions.

b. S.E.C. Regulations

The Congressional hearings on the 1968 legislation included testimony by persons expressing the view that the S.E.C. should be given wide rulemaking power to regulate the dynamic, everchanging types of manipulative practices that are used by both aggressors and targets. The S.E.C. itself, in statements before the 1967 Senate hearings, noted both the disclosure and antimanipulation responsibilities of the Commission. However, it was not until 1970 that Congress delegated the job of determining what constitutes manipulation to the S.E.C. by amending section 14(e) to give the Commission rule-making authority. By assigning authority to the S.E.C., Congress apparently realized that the dynamic nature of the tender offer field mandated the use of the more flexible rule-making procedure; that is, Congress recognized that the term “manipulative” must re-

64. 15 U.S.C. § 78m(e) (1976).
65. See 1967 Senate Hearings, supra note 5, at 137-38.
67. "[I]n view of the almost infinite variety in terms of most tender offers, which are limited only by the ingenuity of the offeror and his counsel, some flexibility through rule making is needed [to adequately implement the antimanipulation language]." 1967 Senate Hearings, supra note 5, at 18 (testimony of Hon. Manuel F. Cohen, Comm'r of the S.E.C.); "[the S.E.C.] should be provided with the adequate tools to deal effectively with the various techniques that have been developed, [and] are continuing to be devised, to initiate or to prevent takeover bids. . . ." Id. at 16 (testimony of Hon. Manuel F. Cohen); "appropriate rules [should] be adopted [to prevent management] from arranging bids or purchases to raise the market so as to defeat a tender offer, and similarly, the maker of an offer should be prevented from arranging offers or sales to depress the market or keep a ceiling on it in order to make the tender offer attractive." Id. at 131 (prepared statement by A. Fleisher, Jr.).
68. The Commission’s responsibility should be limited to requiring appropriate disclosure [and] to guarding against deceptive and unfair devices designed to coerce or prevent action. 1967 Senate Hearings, supra note 5, at 16 (statement of Hon. Manuel F. Cohen, Comm'r of S.E.C.).
69. Pub. L. No. 91-567, 84 Stat. 1497 (1970), amended section 14(e) of the Williams Act by adding “The Commission shall, for the purposes of this subsection, by rules and regulations define, and prescribe means reasonably designed to prevent, such acts and practices as are fraudulent, deceptive, or manipulative.”
main flexible. Senator Williams, co-sponsor of the bill, emphasized this Congressional recognition when he stated: "[The amendment] would give the Commission rule-making power with respect to fraudulent, deceptive and manipulative acts used in tender offers. The techniques currently being used in the offers have become increasingly sophisticated and they change rapidly. This is particularly true when the takeover is resisted by incumbent management."

Pursuant to its Congressional grant of authority, the Commission has issued rules designed to prevent manipulative acts or practices within the meaning of section 14(e). However, none of these rules address any acts or practices remotely related to the use of lock-ups.

c. Judicial Interpretation

With the failure of Congress and the Commission to adequately define the term "manipulation," practitioners have been relegated to extracting a composite definition from the case law. Although the courts have yet to devise a workable formula for determining the existence of manipulation in connection with a tender offer, most courts and commentators have viewed the manipulative language of section 14(e) as having the same meaning as the manipulative language of section 10(b) in the 1934 Act.

Consistent with the recognition of the similarity in the usage of

70. "The term 'manipulative' must remain flexible in the face of new techniques which artificially affect securities markets." Mobil Corp. v. Marathon Oil Co., 669 F.2d 366, 374 (6th Cir. 1981); "No doubt Congress meant to prohibit the full range of ingenius devices that might be used to manipulate securities prices." Santa Fe Indus., Inc. v. Green, 430 U.S. at 477.


72. The rules currently in existence have dealt largely with the disclosure area, although some provisions pertaining to amendments of the terms of an outstanding tender offer have also been made.


74. See Mobil Corp. v. Marathon Oil Co., 669 F.2d at 373 ("Section 10(b) concerns the sale and purchase of securities rather than tender offers, but its antimanipulation language is similar to that of § 14(e)." ); Note, supra note 7, at 642 ("there is [an] indication in the legislative history of the Williams Act that the term ["manipulative" ] was intended to be interpreted under the 1934 Act."). But see 1967 Senate Hearings, supra note 5, at 141-42 (does the language in Rule 10b-5 (forbidding practices which "would operate as a fraud or deceit upon any person"), § 14(e) (forbidding "such acts and practices as are fraudulent, deceptive or manipulative"); § 10b (forbidding the use of "any manipulative or deceptive device or contrivance"), and Rule 14a-9 (forbidding "false or misleading" statements or omissions in proxy situations) mean essentially the same thing, or are any differences in meaning accounted for by differing purposes of these sections?) (testimony by W. H. Painter, Professor of Law, Univ. of Mo.).
the term in section 10(b) and section 14(e), most courts have chosen to follow the mandate of *Santa Fe Indus. v. Green.* In *Santa Fe*, the controlling shareholder notified the minority shareholders that a short-form merger between it and the controlled corporation provided all shareholders with the information needed to perfect their state law appraisal rights. Certain minority shareholders objected to the terms of the merger, but chose not to pursue their appraisal remedy in state court. Instead, they brought suit under the federal securities law asserting that effecting a merger, where the sole purpose was to eliminate minority interest, lacked any justifiable business purpose and thus constituted a violation of section 10(b) of the 1934 Act.

While the Supreme Court recognized that the term “manipulation” is “virtually a term of art when used in connection with securities markets,” it stated that the antimanipulation language of the federal securities law was not intended to “regulate transactions which constitute no more than internal corporation mismanagement.” The Court reaffirmed its previous position that “[c]orporations are creatures of state law, and investors commit their funds to corporate directors on the understanding that, except where federal law expressly requires certain responsibilities of directors with respect to shareholders, state law will govern the internal affairs of the corporation.” The Court reasoned that this standard balances the states’ right to control their own corporations while reserving the congressional right to regulate when there is an *expressed* need to infringe upon state autonomy.

In addressing the breadth and scope of the term “manipulation,” the *Santa Fe* Court recognized that “Congress meant to prohibit the full range of ingenious devices that might be used to manipulate securities prices.” However, throughout this and other Supreme Court opinions it has been repeatedly stressed that the term

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76. A short form merger is a procedure whereby a controlling corporation that owns some statutorily defined supermajority of the subsidiary’s stock, can effect a merger of the subsidiary into the controlling corporation without the need of the approval of the shareholders; all that is required is that notice of the merger be given to the shareholders. See, e.g., Del. Code Ann. Corp., § 253 (1967); Cal. Corp. Code § 1201(b) (West 1982).
77. 430 U.S. at 476 (quoting Ernst & Ernst v. Hochfelder, 425 U.S. at 199).
78. 430 U.S. at 479 (quoting Superintendent of Ins. v. Bankers Life & Cas. Co., 404 U.S. 6, 12 (1971)).
79. 430 U.S. at 479 (quoting Cort v. Ash, 422 U.S. 66, 84 (1975) (emphasis in the original)).
80. 430 U.S. at 477.
"manipulation" is to be viewed in light of any artificial effect the act or practice in question may have on the price of security. Further, the Court has emphasized that the fundamental purpose of the 1934 Act has been the implementation of a "philosophy of full disclosure; once full and fair disclosure has occurred, the fairness of the terms of the transaction is at most a tangential concern of the statute."

Following the Supreme Court's thorough examination of the antimanipulation language contained in section 10(b) of the 1934 Act, numerous lower courts applied the same reasoning and interpretation to the antimanipulation language contained in the Williams Act. Where section 10(b) was intended to prohibit manipulation in the sales of securities effected through a market or exchange, section 14(e) was intended to prohibit similar manipulation in connection with public solicitations for tenders that generally are not made through an exchange or established market. It was this gap in the area of tender efforts that Congress intended to fill with the Williams Act. Thus, it is clear that the Court will not allow the federal securities law to be used to create a federal fiduciary duty; rather, the Court will relegate "fairness" questions to the state courts for determination under applicable state law.

In sum, it seems clear that no action will lie under section 14(e) against management's use of conventional defensive tactics so long as full and fair disclosure is made and investors have not been misled. Recent cases, however, have sought to distinguish lock-ups from conventional defensive tactics. In evaluating the lock-ups in the tender offer settings, courts have looked to the prior history of state corporation law and federal securities law for guidance.

C. Section 14(e) and the Formulated Lock-up

1. Manipulation According to Mobil

In Mobil Corp. v. Marathon Oil Co., Mobil, as the aggressor, made a public tender offer for 40 million Marathon shares at $85.00

82. 430 U.S. at 478 (quoting S.E.C. v. Capital Gains Reserch Bureau, 375 U.S. 180, 186 (1963)).
84. See supra notes 58-59 and accompanying text.
85. 669 F.2d 366 (6th Cir. 1981).
per share, stating its intention to acquire the balance through a back-end merger. Marathon, in seeking to avoid the hostile takeover, induced U.S. Steel to make an offer for fifty-one percent of Marathon at $125.00 per share by giving U.S. Steel a stock option to purchase ten million authorized, but unissued, shares and an asset option to purchase Marathon’s forty-eight percent interest in the Yates Oil and Gas Field in Texas. Mobil brought suit seeking to enjoin the exercise of the options, asserting that they were “manipulative” within the meaning of section 14(e) of the Williams Act.

In granting the injunction, the Mobil court recognized that the term “manipulative” is not defined in the Securities Exchange Act nor in the Williams Act. The Mobil court, however, was swift to note that “the Supreme Court has . . . indicated that manipulation is an affecting of the market price for, or price of, securities by artificial means, i.e., means unrelated to the natural forces of supply and demand.” With this general definition in mind, the court observed that, in order to be effective, “the term ‘manipulative’ must remain flexible in the face of new techniques which artificially affect securities markets.”

Drawing from sparse legislative history, the court buttressed its “flexibility” interpretation by noting that “[n]o doubt Congress meant to prohibit the full range of ingenious devices that might be used to manipulate securities prices.”

The Mobil court conceded that the 1934 Act, generally, and the Williams Act, specifically, were aimed at disclosure. However, the court noted that substantive provisions exist in the Williams Act. Acknowledging the Supreme Court’s observation in Santa Fe that “nondisclosure is usually essential to the success of a manipulative scheme,” the Mobil court went on to add that “disclosure alone does not always mean there is no manipulation.” Further, the Mobil court observed that “to find compliance with section 14(e) solely by the full disclosure of a manipulative device as a fait accompli would be to read the ‘manipulative acts and practices’ language completely out of the Williams Act.” Instead, the court asserted that

86. Id. at 374 (emphasis in the original).
87. Id.
88. Id. (quoting Santa Fe Indus., Inc. v. Green, 430 U.S. at 477).
89. 430 U.S. at 477.
90. 669 F.2d at 376. Such a realization has received some support. See Ferrara and Phillips, supra note 73 (“The Williams Act is not merely a disclosure statute with only a few minor esoteric substantive provisions.”).
91. 669 F.2d at 377. “Santa Fe . . . cannot be taken to mean that conduct that falls within the special meaning of ‘manipulative’ is legal so long as it is fully disclosed.” Id. at 376. See Bloomenthal, supra note 32, at 99.
Santa Fe stood for the proposition that only deceptive or manipulative practices had to be shown in order to fall within the purview of section 14(e). The fact that the offending acts did not involve false or misleading statements did not necessarily preclude them from being manipulative. In its reasoning, the Mobil court opined that the price ceiling effect and the anticompetitive effect of the options were indicative of manipulation, in violation of section 14(e).

a. Price Ceiling Effect

As part of the consideration for entering into a merger agreement, U.S. Steel required an irrevocable option to purchase ten million authorized, but unissued shares, of Marathon stock and an option to purchase Marathon's oil and mineral rights in Yates Field for $2.8 billion. At trial, the fact-finder expressly found that the $2.8 billion price was fair.

On appeal, the Mobil court viewed the stock and asset options as creating an artificial price ceiling in the tender offer market for Marathon shares. Thus, the court reasoned that the creation of a price ceiling constituted manipulation within the meaning of section 14(e). The effect of the options was to create a ceiling by differentiating the "basket of assets" for which Mobil and U.S. Steel would be bidding. Since U.S. Steel paid no cash consideration for the option, it was free to bid the fair value of all Marathon assets, including Yates Field. However, in valuing the assets of the target, Mobil was prevented from attaching a value to Yates Field in excess of the $2.8 billion option price because, should Mobil be successful in its takeover attempt such that U.S. Steel would choose to exercise its option, the amount realized by Mobil would be the predetermined option price of $2.8 billion. Any excessive valuation by Mobil could not be recovered. The Mobil court considered this fact significant when it noted that, although the $2.8 billion was "fair" in the context of satisfying the directors' fiduciary duty to acquire an adequate return on the sale of assets, there was evidence that the field may have been worth as much as $3.6 billion. As such, other bidders might have valued the Yates Field reserves at a higher value than $2.8 billion, but were essentially prevented from doing so by the existence of the options. Considering the ceiling effect on bidding created by the

93. 669 F.2d at 367.
94. Id. at 375.
95. Id.
96. Id.
options, the court concluded that:

the only effect of [the] option [on Yates Field] could be to deter Mobil and any other tender offeror from competing with [U.S. Steel] in an auction for control of Marathon. Others cannot compete on par with [U.S. Steel]; its bid of $125.00 per share thus amounts to an artificial price ceiling on the value the Marathon shareholders can receive for their shares.\(^97\)

b. **Anticompetitive Effects**

In a related argument, the *Mobil* court recognized that the ceiling effect of the lock-ups also created a restraint on competitive bidding for the shares in violation of section 14(e). While the *Mobil* court was not directly concerned with the anticompetitive effect the lock-up would have on Mobil per se, it was concerned with the indirect effect that a reduction in competitive bidding would have on the ultimate value paid to the Marathon shareholders. The court stated that "[t]he purpose of the Williams Act, protection of the shareholders, requires that Mobil and any other interested bidder be permitted an equal opportunity to compete in the marketplace\(^98\) for Marathon shares, and that Mobil’s adverse posture to Marathon would insure full and rigorous representation of the Marathon shareholders in the equitable action. Thus, even though the Supreme Court has stated that tender offerors are not the intended beneficiaries of the Williams Act,\(^99\) the *Mobil* court held that the injunction was needed to protect the interests of the Marathon shareholders. The Court was not concerned with the ultimate price, but reasoned that a restoration of the competitive bidding system would generate a fair appraisal of the assets once the artificial manipulation was removed.\(^100\)

Independent of, and in addition to, the deterrent effect on competition of the asset option, the *Mobil* court concluded that the size of the stock options given to U.S. Steel inhibited competition to the point of being manipulative.\(^101\) Further, the fact that the options

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97. *Id.*
98. *Id.* at 376.
100. "Our task under the Williams Act is not to speculate about what price the Marathon shareholders might have been offered if the natural market forces existed in this tender offer contest, but rather to enforce the mandate of section 14(e) against manipulation of the market." 669 F.2d at 376.
101. "[T]he stock option was large enough in this takeover contest to serve as an artificial and significant deterrent to competitive bidding for a controlling block of Marathon shares." *Id.* at 375. "The size and price of the stock option, together with the fact that it was granted to [U.S. Steel], a tender offeror, prevented all others from competing on par with [U.S. Steel] for a controlling block of Marathon shares, and tipped the scales decidedly in favor of
were granted to a competing tender offeror was sufficient to cause the court to observe that the assets worked to "tip the scales decidedly in favor of" U.S. Steel. Thus, the stock option "artificially and significantly discouraged competitive bidding for the Marathon shares."

Commentators have questioned the anticompetitive rationale of Mobil. In their view, the central issue is whether the options serve the critical function of bringing a competitive bidder into the picture. That is, were the options essential to another bidder to compete? If so, the options should not be considered anticompetitive.

c. Not a Rule of Decision

The Mobil court did not purport to "define a rule of decision for all claims of manipulation under the Williams Act, or indeed for all forms of options which might be claimed to 'lock-up' takeover battles or otherwise discourage competing tender offers." Rather, the court stated that "under the circumstances of this particular case" the Yates Field option and the stock option "individually and together [were] 'manipulative' as that term is used in section 14(e)."

Subsequent courts and commentators who have expressed disagreement with the Mobil rationale have been quick to capitalize upon the admittedly factual basis of the Mobil decision by distinguishing their own facts from those in Mobil and by narrowly reading the Mobil court's holding.

2. Expansion of the "Manipulative" Language

Two years after Mobil, the Second Circuit had the opportunity
to examine the use of an option arrangement in a formulated lock-up in *Data Probe Acquisition Corp. v. Datatab, Inc.*

In *Data Probe*, Datatab approached CRC Information Systems, Inc. (CRC) to inquire whether CRC was interested in purchasing the financially troubled Datatab. Negotiations between the two culminated in a proposed merger agreement whereby CRC would purchase all of the outstanding Datatab stock at $1.00 per share. Following the formal announcement of the merger, Data Probe made a cash tender offer for all Datatab stock at $1.25 per share. The offer was conditioned upon a rejection of the sale-by-merger agreement at the upcoming Datatab shareholders' meeting. In response to this hostile tender offer, CRC raised its purchase price to $1.40 per share; this modified offer was conditioned upon Datatab granting to CRC an irrevocable one-year option to purchase authorized, but unissued, Datatab stock in an amount equal to 200% of the then outstanding shares. Datatab management accepted this revised offer and granted the irrevocable option that, in effect, guaranteed CRC the power to accomplish the proposed merger even if disapproved by the Datatab shareholders. Data Probe countered by raising its tender offer price to $1.55 and conditioning its acceptance of shares upon a corporate or judicial invalidation of the merger agreement. Simultaneously with the modification of its offer, Data Probe filed an action to enjoin the merger alleging inter alia, that the merger constituted a lock-up arrangement amounting to a violation of the antimanipulation language of section 14(e)."109

The *Data Probe* court determined that a complete reading of the legislative history and judicial precedent compelled enforcement of the dual requirements of section 14(e). The court read the Williams Act to impose two duties upon the tender offerors: first, to provide full and adequate disclosure; and second, to "refrain from any conduct that unduly impedes the shareholders' exercise of the decision-making prerogative guaranteed to them by Congress."110 As such, the court fashioned a rule that "only those forms of 'manipulative' conduct that unduly interfere with the tender offer process vio-

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110. *Id.* at ¶ 96,564-68.
111. *Id.* at ¶ 96,567-68.
late the Act."112

The court asserted that judicial precedent clearly established the federal authority to enforce the Williams Act beyond requiring mere disclosure.118 Although it must be conceded that the regulations114 and the judicial authority118 have not limited themselves solely to requiring disclosure, the contention that the Williams Act extends to a judicial examination of tender offeror acts that interfere with the exercise of shareholder decision-making is clearly in conflict with prior Supreme Court teachings. Any such examination would be, in reality, a judicial review of the substantive fairness of the actions and offers of the respective parties. Inspection into the substantive fairness of the tender offers has repeatedly been viewed by the Court as falling outside of the proscription of the federal securities laws and within the realm of state fiduciary duty.118 Thus, the Data Probe court's test amounts to a distortion of the well-defined disclosure purpose of the Williams Act.117

In addition, the Data Probe court saw the legislative history of the Williams Act as supporting, not restricting, the right of incumbent management to oppose tender offers through the use of defensive tactics.118 This, too, appears to be in conflict with the view adopted by Congress and the commentators that the statute was intended to be neutral. Congress determined that problems of unfair defensive tactics and entrenched management were better left to state control under the fiduciary laws.119 The Data Probe court, however, took offense to the oft-stated assumption that the "manipulative" language of section 14(e) was to be read in pari material with the similar language in section 10(b).180 As the Data Probe court read

112. Id. at ¶ 96,573. See FED. SEC. L. REP. (CCH) (Issn. 0162-1084) at 3 (the test "invalidates] acts that unduly obstruct the exercise of informed shareholder choice. These acts which undermine or unduly obstruct a tender offer, constitute conduct deemed 'manipulative' by the Williams Act.").
113. FED. SEC. L. REP. at ¶ 96,570.
115. See Ernst & Ernst v. Hochfelder, 425 U.S. at 199; Santa Fe Indus., Inc. v. Green, 430 U.S. at 476 ("[‘manipulation’] generally refers to practices such as wash sales, matched orders, or rigged prices, that are intended to mislead investors by artificially affecting market activity.").
116. See supra notes 81-82 and accompanying text. See also Panter v. Marshall Field, 646 F.2d at 287 ("the ‘philosophy of full disclosure’ embodied in the Securities Exchange Act . . . requires proof of an element of deception, and does not provide a remedy for the breach of a fiduciary duty a director owes his corporation and its shareholders under state law.").
117. See supra note 55.
118. FED. SEC. L. REP. at ¶ 96,568-69.
119. See supra notes 60-66 and accompanying text.
120. FED. SEC. L. REP. at ¶ 96,573. See 1967 Senate Hearings, supra note 75.
the history, the similarity between sections 10(b) and 14(e) applied only to their disclosure provisions; the manipulative language of the two sections was to be read in light of the underlying purposes of the respective sections.191

The Data Probe court interpreted the Williams Act as requiring a different kind of antimanipulation protection than was required under the 1934 Act.192

Section 10(b) is directed at insuring informed investment decision through "regulating trading markets, requiring disclosure and prohibiting deception and classic kinds of market manipulations." [Citations]. The Williams Act focuses on the narrower and more specific problem of "protection of investors who are confronted by a cash tender offer."193

Thus, even though the Data Probe court saw the differing underlying purposes of the two acts as warranting an examination of whether the parties "unduly interfer[ed] with the tender offer process,"194 the court asserted that Data Probe and Mobil could not be read to establish a federal fiduciary duty.195 The court buttressed this assertion by stating that under its purported test, good faith on the part of the tender offeror would be irrelevant; that is, although management's good faith might be a defense to state claims, such as fiduciary breach, it would be unpersuasive in avoiding liability under section 14(e).196 In essence, the Data Probe strict liability test is no more than a feeble attempt to circumvent the recognition in Santa Fe that, to date, there is no federal fiduciary duty, either judicially created or statutorily enacted.197

Although the Data Probe court's approach, like the approach employed by Mobil, has emotional appeal, its reading of the legislative history and judicial precedent is similarly flawed and unpersuasive. Its holding ignores the plain language of the Supreme Court in

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121. FED. SEC. L. REP. at ¶ 96,573.
122. Id. at ¶ 96,567. However, even the leading precedent in support of Data Probe's expansive reading of section 14(e) acknowledged the controlling similarity between the language of the Williams Act and the language of the 1934 Act. See Mobil Corp. v. Marathon Oil Co., 669 F.2d at 373.
123. FED. SEC. L. REP. at ¶ 96,567.
124. Id. at ¶ 96,573.
125. Id. at ¶ 96,566-67.
126. Id. at ¶ 96,574. Further, while good faith is a defense to a claim of breach of the fiduciary duty of loyalty, it may not be a defense to a claim of breach of the fiduciary duty of due care. Under the duty of due care, directors are obligated to undertake a reasonable examination before their actions will be insulated under the business judgment rule.
127. 430 U.S. at 479-80.
Chris-Craft that "[the Williams Act] is designed solely to require full and fair disclosure for the benefit of investors."\textsuperscript{128} In addition, language in Santa Fe to the effect that "once full and fair disclosure has occurred, the fairness of the terms of the transaction is at most a tangential concern of the statute"\textsuperscript{129} contradicts the Data Probe court's contention that the securities laws contemplate a substantive evaluation of the terms. If such a vast prohibition were not intended, the Supreme Court could have easily narrowed the impact of its decisions by avoiding the use of such words as "solely" and "tangential." To dismiss such wide sweeping language without any substantial legislative history or judicial precedent is to stretch judicial interpretation to the limit, in direct contradiction to the doctrine of stare decisis.

It follows, then, that the holding of Santa Fe must control: that absent some misrepresentation or omission, a cause of action under the federal securities law will not lie for a claim amounting to no more than a breach of a state law fiduciary duty.

3. Erosion by Subsequent Cases

In Marshall Field & Co. v. Icahn,\textsuperscript{130} the Icahn investment group, a dissident faction of Marshall Field shareholders, was pursuing a plan of acquisition of Marshall Field and Company through open market purchases. After acquiring five percent (5%) of Marshall Field & Company, the acquiring group filed a disclosure statement pursuant to section 13(d) of the Securities Exchange Act. Field management actively sought, and found, a white knight in BATUS, Inc., which announced a public tender offer for Field shares. Prior to the announced tender offer, Field and BATUS entered a stock purchase agreement, under which Field would sell two million shares of treasury stock to BATUS; in addition, Field conferred a right of first refusal on BATUS for the purchase of certain real properties owned by Field. The Icahn group sought a temporary restraining order against the tender offer. In denying the motion, the Icahn court distinguished the facts from those present in Mobil. The court noted that the stock purchase contract, although defeasible under certain circumstances, was not set at a bargain price.\textsuperscript{131} The purchase price proposed by BATUS was identical to the price it made in its public tender offer. In contrast, the option price for the

\begin{itemize}
\item \textsuperscript{128} 430 U.S. at 31 (emphasizing 113 CONG. REC. 24,664 (1967)).
\item \textsuperscript{129} 330 U.S. at 478.
\item \textsuperscript{130} 537 F. Supp. 413 (S.D.N.Y. 1982).
\item \textsuperscript{131} Id. at 422.
\end{itemize}
target shares in Mobil was substantially below the subsequent price in the white knight’s public offering. Thus, the price differential in Mobil, viewed by the court as indicative of a bargain price, was not present in Icahn. Similarly, the right of first refusal on the target’s real properties was noted by the Icahn court as not intended to effectuate a sale below market price. This was markedly different from the facts in Mobil where the court observed that the Yates Field asset may have been valued by others greatly in excess of the $2.8 billion option price.

Furthermore, the Icahn court stated that Mobil’s expansive reading of the “manipulative” language in section 14(e) “could unduly interfere with the right of company management to combat a takeover attempt that it believe[d] in good faith to be harmful to its shareholders.” Thus, the Icahn court made clear that director liability could only result if the facts constituted a violation of the directors’ fiduciary duties to the shareholders. The court implicitly viewed the Mobil decision as encroaching on the area of state corporation law which was expressly exempted from regulation under the Williams Act by the Supreme Court in Santa Fe. Further, the Icahn court concluded that the assertion in Mobil that the use of a lock-up option constituted a violation of section 14(e), even if it was fully disclosed, represented a “questionable legal theory.”

Along this same line, critics have expressed confusion over the Mobil court’s apparent commingling of the concepts of federal securities law and state fiduciary duty, particularly in light of the court’s express finding of good faith and loyalty by the Marathon directors. While nearly all believe that the antimanipulation provisions should be given some substantive bite, the critics are in accord

132. Id. Also, although not noted by the Icahn court, the affirmative nature of an option to purchase, as compared with a right of first refusal, factually distinguishes Mobil from Icahn. That is, in Mobil the right of U.S. Steel to compel sale by the exercise of its option worked to create differentiated “basket of assets” on which the competing tender offerors were bidding. In Icahn, however, BATUS’s right of first refusal only granted the holder of the right the power to acquire the assets, if and only if, Field decided to sell. Thus, BATUS could not compel the sale as could U.S. Steel, and hence, the right of first refusal did not result in differing “baskets of assets.” See supra notes 93-97 and accompanying text.

133. Id.

134. See supra notes 75-82 and accompanying text.

135. 537 F. Supp. at 422.

136. “This writer confesses confusion regarding the [Mobil court’s] conclusions. It is very difficult to see how conduct found to be completely lawful as a matter of corporate responsibility, and fully disclosed, can constitute manipulation.” Bialkin, supra note 12, at col. 3.

137. 669 F.2d at 377.
that Mobil's expansive reading is unfounded and unpersuasive.\textsuperscript{138}

While the district court in New York was deciding Icahn, the district court in Illinois was reviewing another lock-up in Whittaker Corporation v. Edgar.\textsuperscript{139} Whittaker involved a motion by a tender offeror to enjoin the target from disposing of stock or assets of the target's wholly-owned subsidiary. Distinguishing the outright sale involved in Whittaker from the option to purchase in Mobil, the court denied the motion.\textsuperscript{140} Despite the fact that the aggressor had indicated on numerous occasions that it considered the target's subsidiary as the major attraction in its bid, the Whittaker court chose to narrowly construe Mobil. The Whittaker court noted that "the lock-up options found by the Mobil court to be in violation of section 14(e) of the Williams Act are not present in the case before the court."\textsuperscript{141} Indeed, while observing that 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)" the court went on to amplify in a footnote that such an action may constitute a breach of the state fiduciary duty.\textsuperscript{142} Thus, the Whittaker court, like the Icahn court, made clear that the matters presented were better analyzed under the state corporation law than by distorting the federal securities law to create a cause of action.

Since a sale rather than an option was involved, the Whittaker court emphasized that there was no price ceiling effect because "any potential bidders [would] be bidding for [the target] without [the subsidiary]." The court was also convinced that the sale created no ceiling because the aggressor failed to revise its offer for the target in an attempt to compete.\textsuperscript{143} The court supported its conclusion that there was no ceiling created by noting a factual distinction between the Whittaker facts and the facts of Mobil. In Mobil, the aggressor made a subsequent competing bid for Marathon shares, conditioned

\textsuperscript{138} The [Mobil] court's legal analysis was not very persuasive. The court recognized that the Supreme Court had construed the term 'manipulation' narrowly in the context of 10(b) and cited no case law or legislative history for a broader reading of 14(e)." Ferrara and Phillips, supra note 73. "While the decision may represent good policy in terms of regulating 'lock-ups' it is questionable whether the expansive interpretation of the term 'manipulative' was intended by Congress." Bloomenthal, supra note 32, at 99.

\textsuperscript{139} 535 F. Supp. 933 (N.D. Ill. 1982), aff'd mem., No. 82-1305 and No. 82-1307 (7th Cir. 1982).

\textsuperscript{140} 535 F. Supp. at 949.

\textsuperscript{141} Id.

\textsuperscript{142} Id.

\textsuperscript{143} Id. at 949 n.7.

\textsuperscript{144} Id. at 949.

\textsuperscript{145} Id.
expressly upon the options to U.S. Steel being declared void. In Whittaker, the court noted, the aggressor made no attempt to modify its bid in order to compete. The lack of any conditional curative act in Whittaker was viewed as indicative of the nonexistence of any ceiling effect of the lock-up.

The aggressor in Whittaker contended that the outright sale in the case had the same deterrent effect in competitive bidding as the options had in the Mobil case. The Whittaker court, however, countenanced the outright sale of a substantial asset by a target corporation as being "part of healthy market activity, especially in light of the fact that [the target] would receive more for [the subsidiary] in sale . . . than what [the subsidiary] was valued at by [the aggressor] . . . ." Finally, the Whittaker court stated that "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)."

Both Whittaker and Icahn questioned the precedential validity of Mobil, and distinguished their own facts from the events in Mobil. As these cases illustrate, serious questions remain concerning lock-ups as a violation of the antimanipulation provisions of the Williams Act. Few would argue that the substantive provisions of section 14(e) are meaningless; however, many would take exception to Mobil's expansive interpretation of the section's "manipulative" language. With a number of Supreme Court opinions implying that the manipulation language of section 14(e) was intended to cover acts and practices that distort the market price for stock, the Mobil court substantially expanded on this generally accepted meaning without any precedent or supporting legislative history. In effect, both the

146. Id.
147. Id.
149. "[E]ven if the Mobil decision represented controlling law, it does not compel an injunction on these facts." 537 F. Supp. at 422. "[T]he lock-up options [of Mobil] are not present in the case before the court." 535 F. Supp. at 949.
150. See Ferrara & Phillips, supra note 73; Bloomenthal, supra note 32, at 99. Similarly, the Seagram court's interpretation that the target's acts were a flagrant breach of the fiduciary duty, constituting improper market manipulation is an unprecedented and unwarranted reading of the antimanipulation language of section 14(e). Clearly, the court's recitation of the teachings of Santa Fe amounted to nothing more than lip service. See supra note 108.
Seagram, however, has remained largely an aberration. It has not been cited with approval, nor have courts distinguished the decision in subsequent cases. Similarly, the critics have largely ignored the opinion, indicating that the decision has little, if any, legal significance. Although the Seagram opinion has received scant critical review, at least one commentator saw the liquidation sales in Seagram as constituting "the ultimate 'manipulative' device." Hochman, A Hostile Tender Offer: Does It Suspend the Rules?, 4 Nat'l L.J., March 29, 1982,
Mobil and Data Probe courts have created a violation of the federal securities law out of what is essentially a breach of the state law fiduciary duty in direct contradiction to the Supreme Court's mandate in Santa Fe.\textsuperscript{151}

The Mobil court's rationale for finding a price ceiling as a result of the manipulative acts and practices erroneously assumes a _ceteris paribus\textsuperscript{153}_ condition with respect to Marathon's other assets in that it assumes that Mobil and U.S. Steel valued the balance of Marathon's assets in the same amount. However, there was no factual finding to this effect, nor could there be one. The court's observation that Yates Field may have been valued at more than $2.8 billion by other bidders implies that other bidders may have valued Marathon's refineries, equipment, and other fixed assets at different values. Therefore, the option on Yates Field did not create a price ceiling since the bidders were free to value the remaining assets differently; rather, the option had the effect of retarding the price Marathon shareholders would have received by fixing the value of only one of Marathon's assets. While the Whittaker court did not delineate this distinction, it suggested something similar when it noted that even though there was an outright sale of one of the target's assets, the competitors were free to bid what they liked for the target's remaining assets.\textsuperscript{154} However stated, the critical factor, as viewed by the Mobil court, appears to be that the options worked to the detriment of Marathon shareholders who would have enjoyed a higher price for their shares in an open, competitive bid.

In attempting to distinguish Mobil, Whittaker may have indirectly supported Mobil. The Whittaker court's assertion that the sale of a substantial asset by a corporation in the face of a hostile tender offer, _standing alone_, is not a violation of section 14(e)\textsuperscript{154} may imply that the sale of a substantial asset plus some extra increment of activity _will_ constitute a violation of section 14(e). If that is so, then perhaps the asset option, which could be considered equivalent to a sale, _plus_ the sizable stock option would be sufficient interference to constitute manipulation within the meaning of the Williams Act.

\begin{footnotesize}
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\item \textsuperscript{151} 430 U.S. at 476.
\item \textsuperscript{152} Literally translated, "ceteris paribus" means "all other things being equal." The ceteris paribus condition is used to isolate and analyze the effect on the tender offer price resulting from the change in one variable, in this case Yates Field, while holding all other factors constant.
\item \textsuperscript{153} 535 F. Supp. at 949.
\item \textsuperscript{154} Id.
\end{itemize}
\end{footnotesize}
Thus, **Mobil** and **Whittaker** may be read to be consistent.

The **Mobil** court, however, correctly addressed the stock and asset options separately. Although similar in appearance, there are important differences between the two types of options. As previously stated, the asset option had the effect of materially altering the "basket of assets" for which Mobil could bid, creating a corresponding reduction in price that Mobil would be willing to pay. The effect on price is arguably manipulative, even though such a situation may not have been the type of manipulation envisioned by Congress. In contrast, the stock option does not reduce the basket of assets available to a bidder; all it does is place a large block of stock in friendly hands.\(^{155}\) **Icahn** implied that stock sales to white knights were exactly the kind of technique target management would need to combat an attempt it believed harmful to the shareholders. As such, the **Icahn** court made clear that federal securities law must not be read to bar management action taken in the best interest of the shareholder. Rather, the shareholder must show a breach of the fiduciary duty before liability will attach. The result of placement of a large block of stock in friendly hands is that an aggressor must raise his bid for the remaining shares if it is to induce those remaining shareholders to tender. While this may obviously be seen to have an anticompetitive effect on the aggressor, it has a beneficial effect on the target shareholders. Recalling the Supreme Court's prior teaching that tender offerors are not the intended beneficiaries of the Williams Act,\(^{156}\) such options cannot be deemed violative of section 14(e). Ignoring the clear Supreme Court mandate, the **Mobil** court, utilizing the antimanipulation language of section 14(e), has attempted to substantially enlarge the section by including anticompetitive activities. Regardless of the desirable policy implications of such a reading, the legislative history discloses no such intent to include anticompetitive practices within the purview of the section. In fact, the legislative history implies just the opposite.\(^{157}\)

**Icahn** appears to directly contradict **Mobil** on its face by giving cursory treatment to the **Mobil** analysis before concluding that the

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155. Such a placement of stock into friendly hands has tacitly been viewed as not falling within the gambit of the term "manipulation." See, e.g., Piper v. Chris-Craft Indus., 430 U.S. 1 (1977).

156. *Id.* at 28.

157. "[T]he bidder and defending management . . . do not need any additional protection . . . [t]hey have the resources and the arsenal of moves and countermoves which can adequately protect their interests." 1967 *Senate Hearings*, supra note 5, at 57. See Piper v. Chris-Craft Indus., 430 U.S. at 29.
Williams Act was not intended to encroach upon management’s prerogative to oppose a tender offer not in the shareholders’ best interests. In essence, Icahn’s treatment of lock-ups as issues of state fiduciary law is consistent with prior Supreme Court analysis and refutes the Mobil court’s interpretation of lock-ups as violations of federal securities law. However, the fact that the Icahn court had to rely on the clarification agreement implies that the court had some difficulty in distinguishing Mobil.

In sum, the cases subsequent to Mobil imply that lock-ups should no longer be characterized as options, but rather should be contracts or stock purchase agreements containing limited escape provisions for the white knights. Therefore, except in situations or factual patterns very similar to Mobil, the continued vitality of Mobil remains in doubt.

IV. PROPOSAL

In light of Santa Fe’s mandate proscribing the use of federal securities law to create a federal fiduciary duty, the use of lock-up devices by a target to thwart unsolicited takeover attempts should be attacked under state corporation law. It is clear from both the legislative history and judicial interpretation that the Williams Act, as it currently stands, is neither designed nor intended to prohibit the use of lock-ups. Unfortunately, current state corporation law provides inadequate protection for target shareholders who are the victims of defensive tactics designed to entrench management’s position of control. The requirement that shareholders must show gross management overreaching or fraud before the burden will shift to the defendant directors has resulted in a business judgment rule that is really no rule. The vast majority of the courts have even rejected the concept that the directors’ conflict of interest is sufficient to shift the burden of proof.

To remedy this situation and provide protection for the forgotten shareholder, the federal securities law should be amended to include a federal fiduciary standard. The Supreme Court in Santa Fe suggested the need for such a federal standard but concluded that the laws, as enacted, did not provide for one. The differing degrees of state judicial scrutiny of fiduciary responsibility illustrate the need

159. Id. at 10, col. 2.
160. 430 U.S. at 479-80.
for some national uniformity. This inconsistency is highlighted by the fact that corporations of national prominence, incorporated in one state, have the ability to affect the lives and fortunes of individual investors across the nation through interstate trading of the corporation's shares.

In the past, when there has been a perceived problem of national scope, Congress has not hesitated to enact appropriate legislation. The 1934 Act and Williams Act were both congressional responses to national problems perceived by lawmakers. The area of fiduciary regulation is clearly of equal scope.

National corporations have traditionally been owned by a geographically diverse group of shareholders representing all fifty states. To relegate these shareholders' grievances for directoral breach of fiduciary duty solely to a determination under the law of the state of residence of a given shareholder would result in similarly situated shareholders receiving unequal treatment. That is, the determination of whether or not one shareholder would have a cause of action would be based upon the mere fortuity of the shareholder's state of residence. Large multistate corporations are affected with a rational interest that makes this type of disparate treatment between shareholders intolerable. It is this kind of inequity that the 1934 Act was intended to regulate, namely, actions by fiduciaries in one state adversely affecting the interests of shareholders in other states. The underlying rationale of the 1934 Act has been that corporations affecting a national interest, that is, corporations whose securities are traded on national exchanges or through other channels of interstate commerce, require national regulation to protect shareholders in all fifty states.

Of course, federalism concerns dictate that any federal fiduciary legislation be carefully drafted to minimize any undue interference with state corporation law. As previously noted by the Court in Santa Fe, corporations are creatures of state law, and investors commit their funds to an undertaking with the assumption that state law will control unless there is some express and important reason for enacting and applying federal law. Thus, in order to address existing inequities, legislation should be limited to national types of corporations.

The disparate state judicial review of fiduciary actions in connection with tender offers, combined with the prior congressional history of regulating to protect shareholders, indicates that the time
has come to recognize a national fiduciary standard\textsuperscript{161} as suggested by the Supreme Court in Santa Fe. Further, Congress is the only governmental body with the time and authority to carefully draft this much needed legislation.

Congressional hearings disclose a clear intent that the “manipulation” term remain flexible, consistent with its interpretation in Santa Fe. But, this flexibility must be read in light of the purpose of the Williams Act to prevent the artificial distortion of the market price of shares to a level unrelated to the natural supply and demand. From this it becomes obvious that the congressional intent as interpreted by Santa Fe was that the term manipulation must be flexibly interpreted to cover “the full range of ingenious devices that might be used to manipulate securities prices.”\textsuperscript{168}

Considering this congressional mandate, the S.E.C. would be acting beyond its scope should it enact regulations to generate a federal fiduciary standard. The role of the S.E.C. is to promulgate regulations necessary to implement the congressional intent, but not to go beyond that role into the realm of independent legislation. The S.E.C. is limited to merely suggesting the existence of problems, and proposing possible solutions to Congress. Congress is the only entity that can independently enact curative legislation. Hence, the rule-making authority given to the Commission in 1970 would be inadequate in generating any regulatory federal fiduciary standard.

Judicial expansion of section 10(b) and section 14(e) to create a quasi-federal fiduciary duty is undesirable for two reasons. First, such an expansion would be a judicial encroachment on congressional authority and expertise. The area of securities regulation is a complicated one, wherein inordinate amounts of time and painstaking attention to detail are given by Congress. The congressional hearings on the Williams Act generated nearly 600 pages of testimony, illustrating the interest and expertise required in this area of legislation. This leads to the second reason enumerated in Santa Fe, namely, that the current legislation does not provide for such a national fiduciary duty and until such a duty is created by Congress, no distortion of the federal securities law should be made to create one. Thus, the Supreme Court was careful to defer to congressional

\textsuperscript{161} To avoid any undue encroachment into areas traditionally left to state regulation, this federal fiduciary legislation should be limited to corporations required to be registered pursuant to § 12 of the 1934 Act. Thus, intrastate or small family corporations would remain unaffected. This federal status is already required by § 10 of the 1934 Act, as well as many of the subsections in § 14 of the 1934 Act.
\textsuperscript{162} 430 U.S. at 477-78 (emphasis added).
judgment in an area wrought with emotional public policy arguments.

As such, the only viable method for creating national unity of treatment in an area currently receiving disparate treatment by the different states would be the creation of a federal fiduciary duty for national corporations.

Given such direction by Congress, the S.E.C. could promulgate appropriate rules so as to carefully delineate the breadth of the federal duty. Until some or all of these reforms are implemented, use of the antimanipulation language of section 14(e) to prohibit lock-up arrangements would be an unwarranted and unjustifiable expansion beyond the section's intended scope.

V. CONCLUSION

The state corporation law, as manifested in the business judgment rule, has largely been unsuccessful in preventing the injustices arising from managerial defensive responses to hostile tender offers. To date, the judiciary has not widely recognized the inherent conflict of interest that arises when target managements defend against hostile offers under the color of protecting shareholders. As was shown, such actions are often motivated by the directors' desire to maintain their positions of status and influence. In situations involving lock-ups, the courts have continued to defer to management's business judgment.

Similarly, the federal securities laws were not intended, nor designed, to prohibit lock-ups that do not significantly influence the market price for shares. Rather, the courts have essentially viewed lock-ups as constituting a breach of fiduciary duty. Since the current federal securities law was not designed to prevent director abuses, and the state law has largely refused to act unless there is a showing of fraud or gross overreaching, the dilemma of the defenseless shareholder can only be remedied by enacting a federal fiduciary standard. Such a standard would bring uniformity to the treatment of shareholders whose fiduciaries have violated their trust to act in the shareholders' best interest.

William T. Lewis