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Greenmailing Corporate Shareholders: Is There a Solution?

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GREENMAILING CORPORATE SHAREHOLDERS: IS THERE A SOLUTION?

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I. INTRODUCTION: THE GREENMAIL DILEMMA

Greenmail,[1] described by one commentator as "legal corporate blackmail by raiders,"[2] is difficult to define and even more difficult to regulate. The unique aspects of greenmail distinguish it from other takeover situations,[3] and render existing regulatory and common law restraints obsolete.[4] The recent greenmail incident involving Walt Disney Productions (hereinafter "WDP") and Saul Steinberg illustrates both the corporate abuse wrought by greenmail, and the ineffectiveness of present laws to curtail this abuse.

The WDP Board of Directors fought off investor Saul Steinberg's hostile

[1] Greenmail occurs when acquirers of a large block of stock threaten a takeover unless the corporation's directors repurchase the shares at a premium. 16 SEC. REG. & L. REP. (BNA) No. 21, at 913 (May 25, 1984).

[2] *Commission Seeks Legislation to Limit Golden Parachutes, Tender Offer Abuses*, 16 SEC. REG. & L. REP. (BNA) No. 13, at 573 (March 30, 1984) (quoting Martin Lipton).

[3] The threatened takeover assault may be so costly and time-consuming to challenge that management often realistically has no choice but to buy the greenmailer out. Green & Junewicz, *A Reappraisal of Current Regulation of Mergers and Acquisitions*, 132 U. PA. L. REV. 647, 706 (1984).

[4] Existing federal law primarily regulates transactions leading to a shift in control. *See* Bath Indus. v. Blot, 427 F.2d 97 (7th Cir. 1970) (regarding legislative history and purpose underlying § 13(d) of the Williams Act). Legislative history shows Congress intended to protect the investor faced with a potential shift in corporate control. *Id.* at 109. Greenmail is largely unaddressed by these concerns. Stephen Friedman, of Goldman, Sachs & Co. in New York, noted that greenmail is "objectionable to anyone who minds being called a crook in the newspapers ... [and is] certain to get worse." *Dominate 15th PLI Securities Institute*, 15 SEC. REG. & L. REP. (BNA) No. 45, at 2104, 2108 (November 18, 1983) [hereinafter cited as *Acquisitions*].

tender offer[5] initially by invoking traditional defensive tactics,[6] but ultimately by purchasing Steinberg's holdings at a substantial premium over market price. Essentially, Steinberg received a "greenmail ransom" of some $31 million from the WDP Board.[7] Steinberg extracted a handsome profit while the WDP Board retained management control. The Disney scenario offers a working model of the problem resulting when management submits to the greenmailer with corporate funds but without shareholder knowledge or consent.

Between March 9 and March 19, 1984, the Steinberg-controlled Reliance Financial Services Corporation and its subsidiaries (hereinafter the "Steinberg Group" or "Group") acquired 6.3 percent of WDP's outstanding shares.[8] In early April, the Steinberg Group increased its holdings to 9.3 percent and soon afterward announced its intention to purchase up to 25 percent of Disney's shares for "investment."[9] When the Steinberg Group's holdings reached the 12.1 percent level,[10] WDP's management began to act to prevent Steinberg from acquiring a controlling interest in the corporation.

WDP management first acquired Arvida Corporation, a real estate concern, in exchange for 3.3 million WDP shares.[11] As a result, Disney assumed $190 million in Arvida debt.[12] Disney then began negotiating to acquire Gibson

[5] The terms "tender offer," "takeover bid," and "takeover offer" are sometimes used interchangeably. Note, *Corporate Battles for Control —* Edgar v. MITE *and the Constitutionality of State Takeover Legislation — The Continuing Saga*, 26 How. L.J. 1425, 1426 n.1 (1983) [hereinafter cited as *Corporate Battles*]. This type of transaction is one of four major methods of achieving a change in corporate control. A tender offer occurs when an outside entity (the "offeror") decides to acquire a corporation (the "target"), and conducts the acquisition by offering shareholders a premium price for their holdings in the target's shares. The three remaining techniques for obtaining control are mergers, the sale of corporate assets, and proxy fights. Management plays a substantial role in mergers and the sale of assets, while proxy fights are generally difficult to wage and are prohibitively expensive. The tender offer, therefore, remains the most effective means of shifting corporate control away from incumbent management. Note, *Section 14(e) of the Williams Act: Can There Be Manipulation with Full Disclosure or Was The* Mobil *Court Running on Empty?*, 12 HOFSTRA L. REV. 159, 160-161 (1983) [hereinafter cited as *Manipulation With Full Disclosure*].

[6] Defensive tactics fall into two general categories: communicative and obstructive. *See, e.g* , Lynch & Steinberg, *The Legitimacy of Defensive Tactics in Tender Offers*, 64 CORNELL L. REV. 901, 939 (1979). Communicative tactics include management's response to the tender offer, advice to shareholders regarding the adequacy of the offering price, recommendations to shareholders with respect to the offer, and communicating information about the offeror. Greene & Junewicz, *supra* note 3, at 682. Obstructive tactics, however, have a direct effect on the offer's success. Management may institute litigation against the offeror, search for a "white knight" or more attractive bidder, or enter into options which "lock up" the sale of stock or assets in friendly hands, making the takeover more difficult and/or less valuable. Lock-ups typically involve the sale of the "crown jewel"—the most valuable corporate asset — in order to defeat the offeror's intent to acquire a lucrative business. *See generally* Harrington, *If It Ain't Broke, Don't Fix It: The Legal Propriety of Defenses Against Hostile Takeover Bids*, 34 SYRACUSE L. REV. 977, 985-86 (1983).

[7] *Acquisitions, supra*, note 4; Wall St. J., June 12, 1984, at 2, col. 2.

[8] Plaintiff's Complaint, at 6-7, Heckmann v. Walt Disney Prod., No. CA000851 (Cal. App. Dep't. Super. Ct. filed June 20, 1984).

[9] *Id.* at 7-9.

[10] *Id.* at 7.

[11] *Id.*

[12] *Id.* at 6. Buying out a debt-ridden company is one form of the "scorched earth defense." This defense is designed to render the target so unattractive that no offeror would want to acquire

Greetings, Inc., a greeting card manufacturer, for a minimum of $310 million in WDP stock. These moves diluted the value of all WDP shareholders' holdings; the Steinberg Group's ownership interest was correspondingly reduced to 11.1 percent.[13]

The Steinberg Group retaliated on two fronts. First, the Group sued to enjoin the Gibson transaction as a "fraud upon shareholders." Second, on June 8 the Group submitted a tender offer of $67.50 per share for WDP stock with an actual book value of $54.25. The Steinberg Group also stated that it was prepared to raise this price to $72.50 per share if Disney would discontinue the Gibson acquisition and agree to withhold from other such agreements.[14] Steinberg announced his intention was to obtain control of WDP,[15] and to dismantle the corporation if his efforts were successful.[16]

Disney's directors met secretly to discuss the Steinberg situation and agreed to repurchase WDP stock from the Steinberg Group at $70.83 per share. Additionally, WDP paid Steinberg $28 million as reimbursement for out-of-pocket expenses. Steinberg agreed in return to dismiss the Gibson lawsuit and to refrain from purchasing WDP stock over the next 10 years.[17]

Steinberg's total profit from the four-month venture amounted to more than $31 million.[18] While WDP stock sold for about $50.00 per share prior to the Group's acquisition plan, and rose as high as $65.50 per share during the takeover threat, the price dropped to less than $50.00 per share immediately after announcement of the Disney-Steinberg agreement.[19] In addition to the loss of market value, WDP's shareholders' existing holdings were diluted by the Arvida acquisition, and Arvida's precarious debt situation left Disney less financially attractive to other investors.[20]

Disney's directors, faced with the greenmail dilemma, considered that the costliness of a takeover battle justified the sacrifice of short-term goals for long-run stability.[21] If WDP had known that Steinberg's sole motive was to sell his interest at a profit after threatening a takeover, however, management could have called his bluff. Though Steinberg threatened to dismantle the corporation, which seems to support WDP's response, WDP knew or should have known

it. *Tactical Maneuvers: From Bear Hugs to Greenmail*, PERSONAL INVESTOR, July 1985, at 15 [hereinafter cited as *Tactical Maneuvers*].

[13] Complaint, *supra* note 8, at 7.

[14] *Id.* at 8.

[15] Wall St. J., June 11, 1984, at 2, col. 3. Such threats to dismantle the corporation if the takeover is successful are commonplace. If the acquirer has earned a reputation of ousting current management after a successful bid, target managers are more willing to be greenmailed. Most recently, Warner Communications paid hostile bidder Rupert Murdoch a 35 percent premium over market value for his Warner Stock. *Tactical Maneuvers, supra* note 12, at 14. *See also infra* text accompanying notes 181-183.

[16] Complaint, *supra*, note 8, at 8.

[17] *Id.* at 9.

[18] Wall St. J., June 12, 1984, at 2, col. 2.

[19] Complaint, *supra*, note 8, at 9-10.

[20] *Id.* at 11-12; *see also* Wall St. J., June 13, 1984, at 59, col. 4.

[21] *See* Greene & Junewicz, *supra* note 3 (management's justification in responding defensively to a tender offer).

that Steinberg used greenmail successfully in the past.[22] WDP directors were therefore not entirely without notice as to his true intentions. The problem faced by WDP's management is the same problem faced in all adversarial situations: how to be sure of the opposition's intent.

Determining subjective intent is a recurrent problem in the takeover context, and is especially troublesome with greenmail. While federal law requires full disclosure by persons contemplating a takeover,[23] disclosure alone will not give management adequate notice of the greenmailer's true intentions.[24] Thus, the issue in regulating greenmail is how to preserve both corporate stability and shareholder autonomy, and how to protect the shareholders' investment, in the face of a hostile takeover bid which may or may not result in greenmail.

Tender offers are private transactions between the offeror and the target corporation's shareholders.[25] Although directors are not parties to the offer, management usually responds in some way when an offer[26] like Steinberg's is made.[27] The shareholders must then decide whether to tender (sell) their shares to the offeror, retain their holdings regardless of the outcome, or join management in resisting the offer. The price offered, shareholder satisfaction with existing management, informed knowledge about the offeror, and recommendations made by the target should all be considered in the decision. When target directors submit to greenmail, however, they preclude shareholders from responding to the hostile offer,[28] which is usually well above market price.[29]

In the ordinary tender offer situation, the underlying motive is control of the corporation. Incumbent management thus has a vested interest in maintaining its position (known as "self-entrenchment"). However, management has the countervailing duty to act in the corporation's best interests.[30] If an offeror

[22] Wall St. J., *supra* note 15.

[23] *Infra* notes 94-103 and accompanying text.

[24] *See infra* note 209 and accompanying text.

[25] *Manipulation With Full Disclosure, supra* note 5, at 160.

[26] *See supra* text accompanying notes 5-6 (management's response to hostile tender offer).

[27] The tender offer as a means of obtaining corporate control is unique, however, in that it is not subject to effective control by management. *See Manipulation With Full Disclosure, supra* note 5, at 161.

[28] Advocates of the doctrine of "shareholder autonomy" argue that stockholders should always have the freedom to respond to an advantageous tender offer and that management should have no input in the transaction, since the offer maximizes shareholder wealth and acts to check inefficient management. *See Harrington, supra* note 6, at 983.

[29] *See id.* at 982-83. The theory of the "efficient capital market" holds that efficient markets reflect all information regarding corporate management in the current price for the company's stock. If the company is poorly managed, the stock price will be correspondingly low. The only tender offerors willing to purchase the stock at a premium, therefore, would be those who feel they could manage the corporation more efficiently. If this perception is correct, everyone benefits from the resulting change in control. The shareholders who tender their shares receive a profit, shareholders retaining their holdings are rewarded by more efficient management, and society as a whole benefits from the allocation of scarce resources into more productive channels. *Id.*

[30] *Id.* at 989-90. In takeovers, a conflict of interest is "unavoidably thrust upon" the corporation's directors. *Id.* (quoting Marsh, *Are Directors Trustees?*, 22 BUS. LAW. 35, 60 (1966)). The tension exists between maximizing shareholder wealth and perpetuating management's control over the corporation as well as the "jobs, salaries, prerequisites, power, and prestige of the individual managers". *Id.*

seeks to "loot" the corporation after acquisition, management may, in addition to recommending that shareholders not respond, act to further block the offer.[31] Some advocates, in fact, argue that management should have unlimited discretion over the corporation's response to a takeover bid.[32] This allocation of responsibility, some argue, allows management to consider long-term goals as well as short-term wealth maximization for shareholders.[33] However, where the offeror is a greenmailer and is not seeking control of the corporation, management has no reason to block the offer.[34] Instead of reacting to entrench itself in office, management can simply refuse to pay the greenmailer and leave the final decision to the shareholders.[35]

Federal lawmakers recognize that takeover attempts can be either detrimental or beneficial to the corporate welfare,[36] and have attempted to balance the interests of both target and offeror. The federal policy of neutrality,[37] however, does little to protect investors deprived of a tender offer because of greenmail.[38] Federal antifraud provisions prohibit "manipulation" of the securities market,[39] but that regulation has not been read to include self-entrenchment tactics.[40] Moreover, while state law imposes fiduciary duties of care and loyalty upon corporate directors, courts are reluctant to impose strict standards.[41] Instead, the so-called "business judgment rule"[42] effectively bars most state claims by

[31] *See supra* note 6 (obstructive tactics which block the offer).

[32] Under this view, the decision to oppose a tender offer is indistinguishable from other corporate decisions. Note, *Tender Offer Defensive Tactics and the Business Judgment Rule*, 58 N.Y.U. L. Rev. 621, 655 (1983).

[33] *See* Harrington, *supra* note 6 at 979 ("[w]ith few exceptions, the judicial decisions squarely support this...view....").

[34] *See* Chock Full O'Nuts Corp. v. Finkelstein, 548 F. Supp. 212, 219 (S.D.N.Y. 1982) ("management need merely refuse to pay more than fair market value for stock offered by the alleged coercive Insurgents....").

[35] *Id.*

[36] Congress initially proposed pro-management regulations intended to aid the target's efforts to defeat a takeover. However, Congress ultimately chose a policy of neutrality, recognizing that takeover bids could serve the "useful purpose" of checking "entrenched but inefficient management". Note, *supra* note 32, at 633. *See also supra* note 29 (theory of the efficient capital market). Some takeovers are beneficial in disciplining management, while others may lead management to emphasize short-term rather than long-term profits, perhaps to the detriment of the corporation. *Excerpts From Final Report of SEC Advisory Committee on Tender Offers*, 15 Sec. Reg. & L. Rep. (BNA) No. 28, at 1375, 1378 (July 15, 1983).

[37] Note, *supra* note 32, at 633.

[38] *Id.* at 629-30. Greenmail circumvents federal disclosure requirements which were enacted to facilitate informed shareholder decisions, because it prevents a tender offer from even reaching shareholders. Consequently, shareholders have no decision.

[39] *See infra* notes 163, 184-88 and accompanying text (federal antifraud provisions).

[40] *See infra* notes 176-77, 210-12 and accompanying text (manipulation read narrowly).

[41] Professor Gordon notes that Florida courts have never held directors liable for negligence. M. Gordon, Florida Corporations Manual § 21.03 (1976).

[42] The business judgment rule states that courts will not interfere with managerial judgment without a showing of fraud or self-dealing. Under this doctrine, directors enjoy a presumption of good faith and corporate decisions will not be reviewed if they can be justified by any rational business purpose. Greene & Junewicz, *supra* note 3, at 712. Accordingly, Professor Cohn notes that "judicial retreat into the presumptive arena of the business judgment rule" leaves doubt as to whether there remains a "viable shareholder action in areas other than fraud, conflict of interest,

forcing shareholders to overcome a presumption of management's good faith.[43] Present law, therefore, provides an inadequate solution to the greenmail dilemma.

The SEC and Congress, in response to the recent emergence of greenmail, are attempting to remedy the problems.[44] The SEC Advisory Committee on Tender Offer Reform recently issued fifty recommendations including a ban on greenmail.[45] Proposed Congressional legislation would also ban greenmail under certain conditions,[46] and would fundamentally change existing tender offer regulation.[47] This Note will examine the present state of securities law and evaluate the probable effect of proposed legislation with respect to greenmail. The author contends that federal legislation is needed to remedy this national problem, although revision of state corporate codes would provide additional protection to shareholders. Existing proposals for change, however, may prove unworkable as both over-inclusive and under-inclusive in certain basic respects.[48]

II. Existing State Common Law and Statutory Remedies

A. *State Regulation of Director's Duties: The Business Judgment Rule*

In response to the Disney-Steinberg agreement, WDP shareholders instituted numerous derivative suits alleging state claims for breach of fiduciary duty. Under state law generally, directors and other corporate insiders owe a fiduciary duty to shareholders.[49] This obligation is traditionally couched in terms of duties of care and loyalty.[50] In the takeover context, fiduciary obligations apply to defensive tactics not solely communicative in nature[51] and require directors to refrain from opposing an offer unless they objectively determine the offer is detrimental to shareholder interests.[52] Self-entrenchment schemes as well as sub-

disloyalty, or the disclosure concerns of the federal securities laws." Cohn, *Demise of The Director's Duty of Care: Judicial Avoidance of Standards and Sanctions Through the Business Judgment Rule*, 62 Tex. L. Rev. 591, 594 (1983).

[43] In order to rebut this presumption, shareholders must show more than a self-entrenchment motive. M. Gordon, *supra* note 41, § 21.01.

[44] *See infra* notes 232-60 and accompanying text (proposals for change).

[45] *See infra* notes 232-37 and accompanying text (SEC Advisory Committee Recommendations).

[46] *See infra* notes 241-48 and accompanying text (legislative proposals to ban greenmail).

[47] *See infra* notes 258-60 and accompanying text (legislative proposals altering tender offer regulation).

[48] *See infra* notes 263-72 and accompanying text (critique of proposals and author's recommendations).

[49] Lynch & Steinberg, *supra* note 6, at 905. In addition to disclosure requirements, management has a fiduciary duty to shareholders which should apply to obstructive defensive tactics. *Id.* See note 75 *infra* for a discussion of derivative suits.

[50] Harrington, *supra* note 6, at 987.

[51] *See supra* note 6 (communicative and obstructive defensive tactics); note 49 and accompanying text (fiduciary obligations).

[52] Lynch & Steinberg, *supra* note 6, at 914-15 (managerial resistance in order to preserve jobs and status constitutes a breach of fiduciary duty). *See e.g.*, Commonwealth Oil Ref. Co. v.

mission to greenmail[53] constitute breaches of fiduciary duty if the stockholders would have profited from the proposed tender offer.[54] The presumption of managerial good faith under the business judgment rule, however, prevents strict enforcement of these fiduciary duties of care and loyalty.[55]

The Model Business Corporation Act defines management's duty of care as the obligation to manage "with such care as an ordinarily prudent person in a like position would use under similar circumstances."[56] Although this definition suggests a negligence standard, courts rarely hold directors liable for "mere" negligence.[57] Instead, the business judgment rule shields directors from liability in the absence of fraud or traditional forms of self-dealing.[58] Technically, the business judgment rule is inapplicable until directors satisfy the duty of care by exercising reasonable diligence.[59] Courts, however, often use the business judgment rule as a jurisdictional barrier precluding any judicial review of the duty of care standard.[60]

Whereas the duty of care relates to reasonable business judgment,[61] the duty of loyalty proscribes conflicts of interest, or "disloyalty" to the corporation.[62]

Tesoro Petrol. Corp., 394 F. Supp. 267, 273-74 (S.D.N.Y. 1975); Northwest Indus. v. B.F. Goodrich Co., 301 F. Supp. 706, 712-13 (N.D. Ill. 1969).

[53] Since greenmail does not actually involve a control motive, *see supra* note 4, managerial submission to greenmail is technically distinguishable from self-entrenchment. However, since the greenmailed directors' presumptions and fears are the same as those of directors facing an actual takeover, greenmail is often referred to in terms of self-entrenchment motives as well.

[54] *See supra* note 52 (self-entrenchment as breach of fiduciary duty).

[55] Cohn, *supra* note 42.

[56] MODEL BUSINESS CORPORATION ACT § 35. The act has been adopted in whole or in part by all 50 states. FLA. STAT. § 607.111 (1983) is identical to the Model Act provision. In the past, some jurisdictions favored a more stringent standard, requiring directors to exercise such care as an ordinarily prudent person would use in managing his or her own affairs. Professor Gordon favors the modern trend, noting that the more restrictive standard could lead management to become risk-aversive and thus to avoid potentially profitable transactions. M. GORDON, *supra* note 41, at § 21.01.

[57] *See supra* notes 41-43. Delaware courts have defined "self-dealing" as any benefit accruing to a director to the exclusion of and detriment to the interests of shareholders. The label is most typically applied in situations involving inequitable distribution of dividends. Sparks, *Recent Developments in Substantive Business Judgment Rule*, 61 N.C.L. REV. 534, 537 (1983).

[58] *But see* Kaplan v. Goldsamt, 380 A.2d. 556 (Del. Ch. 1977) ("the presumption of sound business judgment reposed in a Board of Directors will not be disturbed if any rational business purpose can be attributed to the decision").

[59] Harrington, *supra* note 6, at 995. The business judgment rule "properly interpreted, may not come into play until and unless the duty of reasonable care has first been discharged." *Id.*

[60] *Id.* at 995, 997. Cases have misapplied the rule without adequately considering whether management has first satisfied the obligation of "exercising reasonable care in reaching the decision to defend against a takeover effort — a necessary condition to the application of the business judgment rule."

[61] Cohn, *supra* note 42, at 603. The duty of care is defined in terms of competence and normal capacity, while the business judgment rule amounts to a finding that directors have exercised reasonable diligence in making their decisions. *Id.*

[62] See Harrington, *supra* note 6, at 989 ("In contrast with the evolution of the duty of care, courts recognized early that review of management conduct is especially appropriate where management has a conflict of interest in authorizing corporate transactions.").

Although the business judgment rule's presumption of good faith should be inapplicable to issues involving the duty of loyalty,[63] courts continue to invoke this rule in situations involving conflicts of interest.[64] Shareholders can only overcome this barrier by showing that a tactic such as greenmail involved traditional forms of self-dealing,[65] or that the action taken had no rational business purpose.[66] "Proving" that an action constitutes a proper business purpose[67] however, may easily be accomplished by pretextual explanations.[68]

A self-entrenchment motive alone is therefore insufficient to overcome the business judgment rule where the injured shareholder claims a breach of the duty of care or the duty of loyalty.[69] In the recent case of *Treco, Inc. v. Land of Lincoln Savings & Loan*,[70] shareholders objected to Lincoln's plan for a public offering of stock. The shareholders attempted to remove Lincoln's directors and liquidate the company. Lincoln's management subsequently voted to amend the corporate bylaws to require a supermajority shareholder vote of 75 percent to remove a director from office. When shareholders sued for breach of fiduciary duty, the district court held that since self-entrenchment was not the "sole" motive for the decision, management's actions were protected under the business judgment rule. The court found that the directors had acted in good faith to prevent a liquidation.[71]

Arguably, the reasoning applied in *Lincoln Savings* would also be applicable to bar a suit by WDP shareholders in the wake of the Steinberg-WDP greenmailing. Steinberg had threatened to dismantle WDP, giving Disney's directors a rational business purpose to submit to greenmail.[72] The ease of fabricating a proper business purpose will probably shield directors from liability in other greenmail situations, notwithstanding the apparent conflicts of interest involved when management uses corporate funds to preserve its position.[73]

[63] *See* Greene & Junewicz, *supra* note 3, at 714. "The good faith element of the business judgment rule was formulated to strip the rule's presumption of validity from an officer or director who ... had a 'material personal interest' in the outcome of the transaction." *Id.* (quoting Arsht, *The Business Judgment Rule Revisited*, 8 HOFSTRA L. REV. 93, 115-116 (1979)).

[64] "[T]he courts can avoid any serious inquiry into, or review of, the fairness of the defensive actions or of the underlying board motivation ..." through the business judgment rule. Harrington, *supra* note 6, at 993.

[65] *See supra* note 57 and accompanying text (traditional forms of self-dealing).

[66] *See* Harrington, *supra* note 6, at 992 (discussing the leading case of Cheff v. Mathes, 41 De. Ch. 494, 199 A.2d 548 (1964)). *Cheff* established the "proper busines purpose" test. *See also* Greene & Junewicz, *supra* note 3, at 717 (the effect of reading the good faith requirement out of the business judgment rule is to focus "almost exclusively on the presence of any rational business purpose" for management's actions).

[67] *See* Harrington, *supra* note 6, at 992 (proper business purpose).

[68] *See id.* at 993 ("it does not require great creativity to conjure up 'policy' differences with a potential bidder."). The cases illustrate "one dominant theme" — the courts' willingness to apply the business judgment rule whenever management can offer "some ostensibly reasonable pretext" for its actions. *Id.* at 1001.

[69] *See supra* note 43 (self-entrenchment motive not enough to overcome presumption of good faith).

[70] 572 F. Supp. 1455 (N.E. D. Ill. 1983).

[71] *Id.* at 1460.

[72] Wall St. J., *supra* note 15.

[73] *See supra* note 68 (ease of fabricating rational purpose).

Cases involving shareholder derivative suits illustrate how management uses the business judgment rule to bar conflict of interest claims. This example is analogous to the greenmail situation, since both involve self-preservation by management at the expense of shareholder interests. Since derivative claims by definition are brought on behalf of the corporation,[74] courts have upheld decisions by corporate litigation committees to terminate the litigation under the business judgment rule.[75] In fact, in the 1979 case of *Lewis v. Anderson*, a WDP litigation committee terminated such derivative claims by WDP shareholders.[76] In *Lewis*, the Ninth Circuit Court of Appeals found the business judgment rule applicable to the corporate committee's decision to discontinue plaintiffs' derivative claims, even though one member of the committee was a director-defendant in the litigation.[77] Recently, however, courts have begun to recognize the inherent conflicts of interest involved in decisions to terminate shareholder litigation, and have refused to apply the business judgment rule's presumption of good faith under these circumstances.[78] This trend toward independent judicial scrutiny of management's actions should be extended to include greenmail and other situations involving similar conflicts of interest.

The business judgment rule, moreover, should not apply where tender offers are concerned.[79] According to SEC Division of Corporate Finance Director John Huber, courts should abandon the business judgment rule's presumption of good faith in situations involving hostile tender offers. The business judgment rule was originally intended to apply only to internal managerial decision-making.[80] Tender offers, conversely, are outside initiatives directed toward share-

[74] The derivative suit is a claim brought by shareholders to enforce a corporate right which ostensibly should have been pursued by the directors of the corporation. It involves a wrong to the corporation rather than to the individual shareholder-plaintiffs, and any recovery therefore inures to the benefit of the corporation rather than the shareholders. M. GORDON, *supra* note 41, at § 25.01.

[75] *E.g.*, Auerbach v. Bennett, 47 N.Y.2d 619, 393 N.E.2d 994 (1979) ("substantive aspects of a decision to terminate a shareholders derivative action against defendant corporate directors ... are beyond judicial inquiry under the business judgment rule." *Id.* at 996.) *But see* Zapata Corp. v. Maldonado, 430 A.2d 779 (Del. 1981). The court noted, "we are not satisfied that acceptance of the 'business judgment' rationale at this stage of derivative litigation is a proper balancing point. [T]here is sufficient risk in the realities of a situation like the one presented in this case to justify caution beyond adherence to the theory of 'business judgment'." *Id.* at 787. In addition to reviewing the *Auerbach* issue of committee independence, the court applied its "own independent business judgment" to determine whether the decision should stand. *Id.* at 787-89.

[76] 615 F.2d 778 (9th Cir. 1979).

[77] *Id.* at 780.

[78] Hasan v. Clevetrust Realty Investors, 729 F.2d 372 (6th Cir. 1984). A special litigation committee does not enjoy presumption of good faith and disinterestedness. The court noted, "the delegation of corporate power to a special committee, the members of which are hand-picked by defendant-directors, in fact, carries with it inherent structural biases." *Id.* at 376.

[79] Greene & Junewicz, *supra* note 3, at 712 ("It is questionable that the rule should even apply to decisions to resist a tender offer."). According to SEC Division of Corporate Finance Director John Huber, courts should abandon the business judgment rule's presumption of good faith in situations involving hostile tender offers. *Reinterpret Business Judgment Rule in Takeovers, Huber Says*, 16 SEC. REG. & L. REP. (BNA) No. 15 at 639, 639-40 (April 13, 1984).

[80] *See supra* note 79.

holders rather than management.[81] Since the business judgment rule has consistently been applied to cases involving breaches of fiduciary duties, however, greenmail will probably continue to be evaluated under its rubric.

B. *State Regulation of Tender Offers*

The scope of state authority over tender offer regulation has been unclear since the United States Supreme Court's decision in *Edgar v. MITE Corp.*[82] In *MITE*, the Court declared the Illinois Business Takeover Act unconstitutional under the commerce clause of the United States Constitution. The Illinois Act required an offeror to notify the Illinois Secretary of State and target management of its intent to make a tender offer and the terms of the offer twenty days before the offer became effective. During this period, however, target management was free to communicate with its shareholders regarding the offer. MITE, as offeror, did not comply with the Illinois Act and sought a declaratory judgment that the Act was both preempted by federal securities law and unconstitutional under the commerce clause.[83]

While a majority of the Justices split over whether federal law and the federal policy of neutrality between offeror and bidder preempted the Illinois Act,[84] the Court determined that the Act placed undue burdens on interstate commerce.[85] The Illinois regulatory scheme could encompass entirely out-of-state transactions between a foreign offeror and shareholders residing in other states.[86] The Court feared that other state laws would create a conflicting regulatory scheme, having the unfortunate result of stifling securities transactions generated by tender offers.[87] The Court found this potential burden unjustified

[81] The directors' mandate to act prudently with regard to a fully disclosed offer to shareholders is much less obvious than their authority to manage the company. Greene & Junewicz, *supra* note 3, at 712-13.

[82] 457 U.S. 624 (1982).

[83] *Id.* at 628.

[84] Justice White's preemption analysis, rejected by Justices Powell, O'Connor, and Stevens (Justices Marshall, Brennan and Rehnquist argued that the case was moot and should be dismissed. *Id.* at 655-67.) noted that the Williams Act was intended to protect investors "while maintaining the balance between management and the bidder." *Id.* at 634. In furtherance of this policy, White argued, Congress had refused to impose a precommencement disclosure requirement upon the offeror, since such a requirement would delay the offer. The Illinois Act, by imposing advance disclosure prior to commencement of the offer, was found to "frustrate the congressional purpose by introducing extended delay into the tender offer process." *Id.* at 637. Further, by providing the target with additional time to resist the offer, the Illinois Act was found to "furnish incumbent management with a powerful tool to combat tender offers, perhaps to the detriment of the stockholders who will not have an offer before them during this period. *Id.* at 635. This pro-management feature of the Illinois Act, according to J. White, upset the careful congressional balance sought to be achieved by the Williams Act. *Id.*

[85] MITE was a Delaware corporation, with principal executive offices in Connecticut. *Id.* at 626.

[86] Justice White noted that states have a legitimate interest in protecting their citizens, but have no interest whatsoever in protecting non-resident shareholders. *Id.* at 644.

[87] *Id.* at 642. *See also Corporate Battles*, *supra* note 5, at 1433-34. While most state regulation of tender offers purports to augment federal protection of local investors, commentators note that

by any state interest in protecting local shareholders.[88] The Court stated that the interest in protecting Illinois investors was "outweighed by the increased risk that the tender offer will fail due to defensive tactics employed by incumbent management."[89]

The Supreme Court's invalidation of the Illinois Act[90] can thus be read to promote shareholder protection through deterrence of manipulative defensive tactics. Under this policy, states should not be precluded from regulating the target's behavior during the offer.[91] Since state regulation would only affect corporations already subject to the chartering state's laws, the interstate commerce problem involved with regulating a foreign transaction would not arise.[92] Moreover, a balanced legal framework tailored to intrastate concerns would, under the *MITE* analysis, enhance the protection already offered to shareholders by federal law and prevent management's actions from causing a tender offer to fail. Greenmail, unlike many other obstructive tactics, does not involve a third party[93] and is an ideal candidate for such regulation; local activity alone would be subject to the state law.[94] Federal legislation, however, would more

the true purpose is to protect local concerns against takeovers by outside interests. One such commentator has stated, "[I]t is obvious that the underlying motives of the states' legislation ... is to effectively preclude tender offers for companies located in their respective states." *Id.* at 1433.

[88] *See supra* note 87.

[89] *MITE,* 457 U.S. at 645.

[90] After *MITE,* several takeover statutes have been held unconstitutional. *Cf.* Mesa Petrol. Co. v. Cities Service Co., 715 F.2d 1425 (10th Cir. 1983) (Oklahoma statute held unconstitutional under the commerce clause as an "unreasonable restraint on interstate tender offers." *Id.* at 1427, 1431. The Oklahoma Act gave the Administrator of the Oklahoma Department of Securities the power to delay the offer by passing on the adequacy of disclosure). *See also* Appalachian Co. v. Consolidated Oil & Gas Co., 15 SEC. REG. & L. REP. (BNA) No. 43, at 2047 (D.C. Colo. Oct. 28, 1983) (Colorado Securities Commissioner dismissed as defendant when he decided not to enforce the Colorado Investor Protection Act, believing it to be unconstitutional after *MITE*).

[91] Some authors note that a commerce clause challenge under *MITE* could be avoided by tailoring the legislation to reach only resident shareholders. Such regulation, however, would still impact on nationwide tender offers. Regulation of foreign corporations would clearly offend the commerce clause by delaying the tender offer process. These concerns are often read for the proposition that "[s]tate takeover legislation after *MITE* is not likely to survive a commerce clause challenge ... because of the substantial impact on commerce involved in the regulation of nationwide tender offers." *Corporate Battles, supra* note 5 at 1474. Conversely, an incorporating state's regulation of the target's conduct during the offer involves a local entity and would enhance, rather than frustrate, the availability of tender offers to shareholders.

[92] The "internal affairs doctrine" supports state jurisdiction over local corporations. The theory holds that the incorporating state has the right to regulate a corporation's internal affairs and rests on the fiction of an implied contract between the chartering state and corporate entity. Since corporate takeovers involve internal affairs of the corporation (i.e., a change in control), critics of *MITE* argue that the internal affairs doctrine should support state regulation of the bidder. Although *MITE* precludes this result, the doctrine remains valid with respect to the regulation by the chartering state of management's fiduciary duties. Casenote, *The Unsung Death of State Takeover Statutes:* Edgar v. MITE Corp., 24 B.C.L. REV. 1017, 1024 (1983). A state therefore should be constitutionally allowed to alter those statutory duties by preventing management from interfering with an outside offer.

[93] *See supra* note 6 (traditional defensive tactics).

[94] *MITE* suggests that regulation of bidder activity is suspect. *See supra* note 92. Regulation of target activity, however, would create a more favorable atmosphere for tender offers. If man-

readily assure uniformity and would offer extensive substantive regulation without creating the interstate commerce problem.

III. Existing Federal Law Remedies

Many federal laws appear facially applicable to the greenmail problems addressed thus far. Among these federal laws are sections 12 and 10(b) of the Securities Exchange Act of 1934, and sections 13(d), 13(e) and 14(e) of the Williams Act. Close analysis of these laws as applied by the courts reveals their ineffectiveness to combat greenmail. Section 12 of the Securities Exchange Act requires the registration of certain securities before they can be traded on the open market.[95] This provision is intended to provide shareholders and potential investor with information regarding the corporation.[96] Further, federal law subjects issuers to more extensive disclosure requirements through the antifraud provisions of the Securities Act. These provisions apply to all securities whether registered under section 12 or not.[97] Before the 1960's, federal provisions regulated most takeover battles, since these were conducted primarily through proxy contests or exchange offers regulated by the 1933 Securities Exchange Act.[98] The relatively recent trend toward the use of tender offers in control contests led to the 1968 adoption of the Williams Act amendments.[99]

Congress enacted the Williams Act ("the Act") to close the regulatory gap in existing securities law by bringing tender offers within the reach of federal disclosure requirements.[100] The Act regulates stock acquisitions according to

agement were precluded from responding to greenmail under state law, the greenmailer could not hope for a buy-out. Greenmail would thus be deterred and true takeover offers allowed to proceed.

[95] 15 U.S.C. § 78(1) (1982) (requiring issuers to register with the SEC prior to trading in securities. Intrastate and private offerings are exempted from registration under § 12).

[96] H.R. Rep. No. 1542, 83d Cong., 2d Sess. 9-10, *reprinted in* 1954 U.S. Code Cong. & Ad. News 2973, 2978 (The Securities Exchange Act requires disclosure of "pertinent information securities ... sold in interstate commerce ... so that investors might be in a position to exercise an informed judgment concerning the securities offered for sale to them.").

[97] H.R. Rep. No. 1711, 90th Cong., 2d Sess. 3, *reprinted in* 1968 U.S. Code Cong. & Ad. News 2811, 2812.

> The failure to provide adequate disclosure to investors in connection with a cash takeover bid or other acquisitions which may cause a shift in control is in sharp contrast to the regulatory requirements applicable where one company offers to exchange its shares for those of another, or where a contest for control takes the form of a proxy fight.

Id.

[98] Piper v. Chris-Craft Indus , 430 U.S. 1, 22 (1976).

[99] 15 U.S.C. § 78m(d), 78m(e), 78n(d)-(f) (1982). In 1960, there were eight cash tender offers involving $200,000,000 in securities. In 1982, counting only the 50 largest transactions cash tender offers involved $48,200,000,000 in securities acquisitions. Prior to the 1960's, tender offers were used mainly for non-takeover purposes, such as corporate repurchases. At present, however, tender offers have replaced the proxy contest as the most popular means of obtaining control over a corporation. *Corporate Battles, supra* note 5, at 1426-27.

[100] *See* H.R. Rep. No. 1711 *supra* note 97, at 2-4, *reprnted in* 1968 U.S. Code Cong. & Ad. News, at 2811-14. Prior to the adoption of the Williams Act, the tender offeror was not required to disclose its identity or its intentions with respect to the corporation. *Corporate Battles, supra* note 5, at 1429.

form; for tender offers, disclosure must be made when the offer is initiated.[101] For open market purchases, disclosure is required within ten days after the holder obtains five percent of the issuer's outstanding securities.[102] The Act does not define the term "tender offer,"[103] but the SEC has recommended eight characterisitics to identify tender offers.[104] The Act seeks to preserve a balance of power in takeover contests by providing both the target and the offeror an equal opportunity to argue their positions before the shareholders. Legislative history of the Act shows that Congress adopted this neutral position because it recognized that takeover bids could either benefit or harm market efficiency.[105] Legislators believed full disclosure would protect investors in both situations by providing for an informed choice.[106]

The neutral policy of disclosure in its present form is ineffective to protect shareholders faced with greenmail. Rather than presenting shareholders with balanced information to effectuate a decision, greenmail precludes any decision at all. However, greenmail may be deterred if substantive disclosure requirements would alert target corporations of the greenmailer's true intention.[107]

A. Regulating the Offeror

Section 13(d) of the Williams Act[108] requires purchasers to disclose certain information within ten days of the acquisition of more than five percent of an issuer's registered securities. Section 14(d) of the Act[109] imposes similar disclosure requirements on a tender offeror who would acquire more than five percent through the completion of the offer. The SEC has rulemaking authority to implement these provisions, and requires purchasers to file a Schedule 13D form with the Commission and with the issuer.[110] The Schedule 13D must give

[101] 15 U.S.C. § 78n(d) (1982).

[102] 15 U.S.C. § 78m(d) (1982).

[103] The SEC has always contended that the Williams Act applies to "unconventional" tender offers, and the term was intended to be read flexibly in order to achieve the purposes underlying the Williams Act. Greene & Junewicz, *supra* note 3, at 664-65.

[104] These elements are: (1) active, widespread solicitation of public shareholders; (2) solicitation for a "substantial percentage" of the corporation's shares; (3) an offer to purchase at a premium over market price; (4) fixed, rather than negotiable terms; (5) whether the offer is conditional upon tender of a minimum, and sometimes a maximum, number of shares; (6) open for a limited time; (7) pressure on shareholders to tender shares; and (8) public announcement. *Id.* at 664 n.80.

[105] H.R. REP. No. 1711, *supra* note 97, at 4, *reprinted in* 1968 U.S. CODE CONG. & AD. NEWS at 2813 ("[t]akeover bids should not be discouraged because they serve a useful purpose in providing a check on entrenched but inefficient management ... these bids are [also] made for many other reasons, and do not always reflect a desire to improve the management of the company").

[106] *Id.*

[107] *See supra* notes 34-35 and accompanying text (management can avoid greenmail by refusing to pay).

[108] 15 U.S.C. § 78m(d) (1982).

[109] 15 U.S.C. § 78n(d) (1982).

[110] 17 C.F.R. § 240.13d, (1984). Section 78n(d)(1) authorizes the SEC to prescribe rules and regulations "as necessary and appropriate in the public interest or for the protection of investors."

all relevant information regarding the purchaser, including the intent or motive for the stock acquisition.[111]

SEC enforcement resources can only deal with a limited number[112] of cases, but courts have split over whether the issuer has implied private right of action to enforce these provisions.[113] In *Dan River, Inc. v. Unitex Limited*,[114] the Fourth Circuit Court of Appeal granted the issuer a private right of action under section 13(d). The court found the acquisitor had inadequately disclosed an intent to obtain control over the target's management, and reasoned that the obligation to file with target management inferred the obligation to file truthfully.[115] The United States Supreme Court, however, assumed a different approach in *Rondeau v. Mosinee Paper Corp.*[116] by deciding that tardy disclosure did not constitute the irreparable harm necessary to grant injunctive relief.[117] *Rondeau* can be distinguished on its facts, since tardy disclosure, if adequate, does not have the same consequences as nondisclosure. The Court noted in dicta, however, that section 13(d) was not intended to provide "a weapon for management to discourage takeover bids."[118] Decisions following the *Rondeau* approach have denied issuers standing to bring a claim under section 13(d).[119]

In the greenmail context, the *Dan River* approach is better suited than the *Rondeau* approach. Allowing issuers standing to sue on behalf of shareholders may be the only means of ensuring a timely check against the submission of misleading schedules by acquisitors.[120] Further, if the *Rondeau* holding stands for the deterrence of obstructive defensive tactics,[121] allowing issuers to demand full disclosure would obviate the need for uncertain management to submit to greenmail. The substantive disclosure required in a Schedule 13D, however, is limited.

[111] *Id.* The Schedule 13D must contain: the names of reporting parties, source of funds, citizenship or place of organization, number of shares beneficially owned, percentage of securities represented by number of shares owned, and purpose of acquisition.

[112] According to Stanley Sporkin, formerly the Director of the SEC Division of Enforcement, the Commission's limited resources do not enable it to investigate every transaction that comes within its jurisdiction. Sporkin, *SEC Enforcement and the Corporate Board Room*, 61 N.C.L. Rev. 455, 456 (1983). Theodore Levine notes that the judicial trend toward disfavoring private actions under the securities laws has had a negative impact on enforcement. This effect is due to the SEC's partial reliance on private actions to supplement Commission enforcement. Levine, *Recent Developments in SEC Enforcement*, 61 N.C.L. Rev. 463, 464 (1983).

[113] Greene & Junewicz, *supra* note 3, at 668.

[114] 624 F.2d 1216 (4th Cir. 1980).

[115] *Id.* at 1223.

[116] 422 U.S. 49 (1975).

[117] *Id.* at 59.

[118] *Id.* at 58.

[119] *E.g.*, Treadway Cos. v. Care Corp., 490 F. Supp. 660 (S.D.N.Y. 1980) (denying the issuer standing under § 13(d)). "To the extent that any prior filings by Care were misleading, the appropriate remedy would be an action for damages, [under *Rondeau*] an action which, however, as noted, may not be maintained by this plaintiff." *Id.* at 665.

[120] *See Dan River*, 624 F.2d at 1225. ("[T]he sole basis of standing in favor of the corporation ... is to enforce the statutory mandate to file a Schedule 13D, which is complete, accurate, truthful, and not misleading.").

[121] *See supra* note 119 and accompanying text.

The Schedule 13D filed by the Steinberg Group stated the purpose of the purchases of WDP stock as follows:

> for investment as part of the general investment portfolios of the Purchasers...subject to price and subject to applicable laws and regulations, the Purchasers may increase their holdings *but also reserve the right to dispose of all or a portion of such Securities on terms and at prices determined by them....*[122]

The Group referred to control or influence over WDP only in connection with increasing the investment value of its holdings.[123] If this statement was inadequate, and if WDP as issuer had standing to enjoin further purchases under *Dan River*, Steinberg would have been required to disclose an intent to greenmail Disney. Once WDP management realized it was in no danger of a takeover, management unlikely would have submitted to greenmail and bought out Steinberg's holdings.[124]

While the *Dan River* court found a violation of section 13(d) based on a lack of specificity,[125] the Eighth Circuit Court of Appeal, in *Chromalloy American Corp. v. Sun Chemical Corp.*,[126] refused to require specific disclosure of tentative plans.[127] The *Chromalloy* court recognized that the degree of specificity required in a Schedule 13D was a difficult issue. The court found that the offeror's statement that it might "at any time ... seek control of Chromalloy" was sufficient to alert investors to the potential change in control.[128] The objective of the Williams Act, the court reasoned, could be frustrated by overstatement of the definiteness of a purpose to obtain control as well as by understatement.[129] The differing results in *Dan River* and *Chromalloy* thus illustrate the difficulty courts have in evaluating issues of subjective intent, and suggest that a minimum of specific information need be disclosed in the Schedule 13D.[130]

Most cases under section 13(d) deal with insufficient disclosure of an intent to obtain control.[131] Ironically, WDP faced what turned out to be accurate disclosure of an investment purpose.[132] Disney or its shareholders could argue

[122] Complaint, *supra* note 8, at 9-10 (emphasis added).

[123] *Id.*

[124] *Supra* notes 34-35, 53 and accompanying text.

[125] *Dan River*, 624 F.2d at 1225 ("The defendants at no point have declared clearly the purpose of their acquisition.... Implicit ... is the idea that there was some purpose beyond mere investment for investment sake.").

[126] 611 F.2d 240 (8th Cir. 1979).

[127] *Id.* at 248.

[128] *See id.* at 243-48.

[129] *Id.* at 248.

[130] Greene & Junewicz, *supra* note 3, at 668 (typically, the Schedule 13D is a "model of obfuscation").

[131] *E.g.*, Kirsch Co. v. Bliss & Laughlin Indus., 495 F. Supp. 488 (W.D. Mich. 1980) (target sued the offeror under § 13(d) for misrepresenting the purpose of the acquisition as an "investment" when acquisitor intended to influence corporate affairs).

[132] Theodore Levine, Associate Director of the SEC Division of Enforcement, noted the problems involved in SEC enforcement of "purpose" disclosure. Disclosure of an "investment purpose," according to Levine, was formerly an easy case since the SEC could usually find some

in a section 13(d) action that any reference to control was misleading. However, proving that Steinberg never intended to control Disney would be problematic without direct evidence. In addition, the references to control in Steinberg's Schedule 13D were related to the protection of the investment value of the Group's holdings.[133] Steinberg's past history of greenmail, standing alone, would be inadequate under *Chromalloy* to show the statement had misled Disney's directors and shareholders.

The Disney scenario thus illustrates management's dilemma when disclosure in the Schedule 13D accurately states a passive investment purpose, but the acquisitor nevertheless threatens a takeover challenge. A greenmailer probably will not divulge an intent to extort a profit from insecure management. The difficulties of proving subjective intent may therefore be insurmountable. Moreover, at least one district court has held that an intent to greenmail corporate directors need not be disclosed at all in the Schedule 13D.[134]

In *Chock Full O'Nuts v. Finkelstein*,[135] the issuer sued a group holding fifteen percent of its shares. The Schedule 13D filed by defendants was noncommittal regarding the purpose of the purchases. Plaintiff alleged nondisclosure of a purpose to extort a profit from management, i.e., greenmail, but the Southern District Court of New York found the Schedule sufficient to give notice that the holder would sell its shares at a profit if it could do so.[136] The court noted that the hope of profiting from an investment was too obvious to necessitate additional disclosure; "Economic Man" is commonly understood to make investment decisions which will bring the highest rate of return.[137] Since any rational investor would intuitively understand this principle, the court reasoned protection was unnecessary and left issues of director responsibility to state law.[138]

Under the *Chock Full O'Nuts* rationale, the Schedule 13D does not provide a viable disclosure tool enabling issuers and shareholders to distinguish true takeover attempts from greenmail. The holding neglects to consider shareholder interests in accordance with the underlying purpose of the Williams Act.[139] The reasonable investor may realize that every potential acquisitor has a price. Shareholders, however, are not parties to greenmail and thus cannot protect themselves. *Chock Full O'Nuts* should not be followed for the conclusion that weak management is lawful prey for shareholder's profits. Instead, the case is more

evidence of an intent to achieve control. Modern drafting is more sophisticated in concealing a control purpose. Levine, *supra* note 112, at 473. The emergence of greenmail, however, now frustrates evaluation of what was formerly the "easy case," since greenmail is primarily intended to bring a highly profitable return on the greemailer's "investment."

[133] *Supra* note 124 and accompanying text.

[134] *Chock Full O'Nuts*, 548 F.Supp. at 212.

[135] *Id.*

[136] *Id.* at 218.

[137] *See id.*

[138] *See id.* at 219.

[139] H.R. REP. No. 1711, *supra* note 97, at 4-5, *reprinted in* 1968 U.S. CODE CONG. & AD NEWS at 2513-14 (Williams Act was designed to "[m]ake the relevant facts known so that shareholders have a fair opportunity to make their decision").

easily rationalized as reflecting the difficulty of proving subjective intent. Thus, if shareholders could show evidence that the greenmailer's only purpose was to extort a high selling price for its shares from management, the result should be different.[140] Such a showing of intent, however, would probably fail if unsupported by direct evidence. Thus, offeror regulation is inadequate to protect shareholders injured by greenmail.

B. *Regulating the Target*

Section 13(e) of the Williams Act[141] prohibits issuers from making fraudulent, manipulative, or deceptive repurchases of registered securities.[142] SEC Rule 13e-1[143] implements this provision by requiring the issuer to file certain information with the SEC before the issuer can purchase its own securities during a tender offer.[144] Although the broad language of this provision appears to apply to greenmail as a manipulative repurchase,[145] the rule has been narrowly interpreted by courts and offers little substantive aid.[146]

The District Court of Delaware addressed section 13(e) in *Crane Co. v. Harsco Corp.*[147] In *Crane,* plaintiff began a tender offer for approximately fifteen percent of Harsco's shares. Harsco determined that fewer than 50,000 shares had been tendered, and that arbitrageurs (professional investors) held about 400,000 shares. Fearing that the arbitrageurs would tender to Crane, Harsco decided to repurchase their stock and subsequently filed a 13e-1 statement with the SEC. Harsco began mailing the statement to shareholders, but the court blocked the plan by issuing a temporary restraining order.[148]

The court afforded Crane standing to sue under section 13(e) as the only party able to obtain timely relief on behalf of shareholders.[149] The court, however, rejected Crane's substantive claims. Crane argued the Harsco statement was misleading regarding the arbitrageurs in three respects. First, Crane alleged the statement misrepresented Harsco's "active course of communications and dealings with the arbitrageurs"[150] by implying the arbitrageurs had initiated the

[140] *See Chock Full O'Nuts*, 548 F. Supp. at 219 ("[i]f offered a sufficient price by the existing management ... this Insurgent group, and any group, will sell"). The *Chock Full O'Nuts* court seemed to assume the defendant did intend to complete the offer, but was tempted by a more profitable opportunity. The court did not deal with a situation where the offer is a "sham" from the beginning, as in greenmail.

[141] 15 U.S.C. § 78m(e) (1982).

[142] *Id.* This provision gives the SEC authority to "define acts and practices which are fraudulent, deceptive, or manipulative."

[143] 17 C.F.R. § 240.13e-1 (1984).

[144] *Id.* The purchaser-issuer must disclose: the title and amount of securities purchased, the names of the holders and the market in which the purchases are made, the purpose of the purchase and intended disposition of the shares, and the source of funds.

[145] *Infra* notes 174-75 and accompanying text.

[146] *Infra* note 175.

[147] 511 F. Supp. 294 (D. Del. 1981).

[148] *Id.* at 297.

[149] *Id.* at 301.

[150] *Id.*

transaction.[151] Second, Crane contended the statement did not adequately disclose that Harsco was trying to repurchase the stock to block the Crane offer. Finally, Crane alleged the statement inadequately disclosed the premium to be paid to the arbitrageurs.[152] The court nevertheless found the statement adequate in all three respects[153] and rejected Crane's claim that the repurchase constituted an illegal counter-tender offer.[154]

Crane's second theory charged a section 13(e) violation since Harsco mailed the statement too late to ensure its receipt by shareholders before the repurchase was consummated.[155] The court, however, noted that Rule 13e-1 is silent regarding a requirement of advance notice to shareholders.[156] The court did not have to decide whether such a requirement should be read into section 13(e) itself, since the temporary restraining order had prevented any injury.[157]

If *Crane* stands for the proposition that management is never required to give shareholders advance notice before repurchasing, section 13(e) will be of little help to shareholders seeking to prevent greenmail. Moreover, although *Crane* allowed offeror standing where the issuer attempted to repurchase shares from a third party, in greenmail the issuer repurchases shares from the offeror. The greenmailer thus has no motive to bring suit under section 13(e). The unanswered question in *Crane*, nevertheless, offers a potential remedy. Section 13(e), as part of the Williams Act, has the broad purpose of ensuring adequate and timely dissemination of information to protect investors.[158] Congress recognized that management could use repurchase programs such as greenmail to strengthen and preserve its position, and legislators intended that shareholders receive "full information regarding the company's activities and intentions concerning repurchasing its own stock."[159] Without advance notice, however, after-the-fact disclosure will be ineffective to accomplish these goals. When management repurchases the shares before shareholders are notified, courts should not hesitate to find a section 13(e) violation.

As the preceding sections illustrate, existing disclosure requirements alone do not address the subtle issues of intent and purpose involved in greenmail. Courts consistently have refused to give substantive force to disclosure provisions, regardless of the effect nondisclosure has on shareholder interests. Moreover, the federal disclosure provisions discussed apply only to registered securities, leaving private and intrastate offerings unregulated.[160] To prevent abuse in these unregulated areas, Congress included broad antifraud provisions in the Securities Exchange Act.

[151] *Id.*

[152] *Id.*

[153] *Id.* at 301-02.

[154] *Id. See also infra* notes 220-26 (counter-tender offers).

[155] *Crane*, 511 F. Supp. at 302.

[156] *Id.*

[157] *Id.*

[158] H.R. Rep. No. 1711, *supra* note 97, at 5, *reprinted in* 1968 U.S. Code Cong. & Ad. News at 2814-15.

[159] *Id.* at 5, *reprinted in* 1968 U.S. Code Cong. & Ad. News at 2815.

[160] *See supra* note 5 and accompanying text (regarding § 12).

C. *The Antifraud Provisions: Regulating Everyone*

Section 10(b) of the 1934 Securities Exchange Act[161]prohibits the use of manipulative devices in connection with the purchase or sale of any security. This section applies to unregistered as well as registered securities, and regulates the conduct of all parties involved in the transaction.[162] The right of action, however, is limited by several technical requirements, including restricting standing to those who purchased or sold securities "in connection with" the manipulative practice (the "Birnbaum Rule").[163]

Applied to the Disney scenario, a strict application of the Birnbaum Rule would yield inequitable results. Since many WDP shareholders suffered diminished value of their holdings and not a loss from the purchase or sale of their shares "in connection with" the Disney-Steinberg transaction, they would be excluded as plaintiffs. This result is inconsistent with the purpose of section 10(b). The provision broadly prohibits practices which "artificially affect market activity,"[164] and greenmail is such a practice. Investors who hesitate to exchange their holdings during a greenmail attempt should not be precluded from relief when the injury can be measured in terms of diminished stock value.

A minority of courts do allow standing for shareholders whose investments diminish in value.[165] Moreover, some courts allow shareholders to bring derivative suits on behalf of the corporation if the corporation purchased or sold securities during the relevant period.[166] The issue in these cases is usually whether

[161] 15 U.S.C. § 78j(b) (1982).

[162] *Id.*

> It shall be unlawful for any person, directly or indirectly, by the use of ... interstate commerce ... (b) To use or employ, in connection with the purchase or sale of any security ... any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Id.

[163] Birnbaum v. Newport Steel Corp., 193 F.2d 461 (2d Cir. 1952) (holding that stockholders injured by the defendant's sale of a block of stock constituting voting control had no standing under § 10(b) since they were not themselves purchasers or sellers of securities). *Accord* Smith v. Chicago Corp., 566 F. Supp. 66 (N.D. Ill. 1983) (holding that plaintiffs, holders of securities investment accounts, did not have standing under § 10(b) to claim that defendants had harmed their investments by not making certain purchases as requested).

[164] *See infra* note 175 and accompanying text.

[165] Herm v. Stafford, 461 F. Supp. 502 (W.D. Ky. 1978) (allowing § 10(b) standing under theory of "reliance by inaction" where plaintiffs were induced to retain their shares because of misleading statements by management). *But see* Gilbert v. Bagley, 492 F. Supp. 714 (M.D.N.C. 1980) (rejecting "reliance by inaction" theory where plaintiffs were induced to retain their shares by corporate director's scheme to artificially maintain a high selling price for its shares); Ohashi v. Verit Indus., 536 F.2d 849 (9th Cir. 1976) (fraudulent inducement does not give shareholders retaining their stock a § 10(b) cause of action).

[166] *Accord,* Schoenbaum v. Firstbrook, 405 F.2d 215 (2d Cir. 1968) (plaintiff-shareholder's derivative claim that majority stockholder used its influence to force the corporation to acquire 500,000 shares at an inadequate price allowed under § 10(b)); Ross v. Longchamps, Inc., 336 F. Supp. 434 (E.D.Mo. 1971) (allowing stockholders standing for derivative claim under § 10(b) if sale of 53 percent interest in restaurant was "sale of securities").

a given transaction constituted a "sale" or "purchase" of shares.[167] Greenmail, however, by definition involves a purchase of stock, and the corporate entity bears the resulting financial losses. A court's decision to give shareholders standing to sue in this capacity would thus be consistent with the concept of the derivative action[168] and with the underlying policy of section 10(b).[169]

In addition to the standing obstacle, Disney plaintiffs would have to overcome the Supreme Court's narrow definition of "manipulation" in section 10(b) as interpreted in *Santa Fe Industries v. Green.*[170] In *Santa Fe,* plaintiffs asked to have a short-form merger[171] set aside because the appraisal price offered to minority shareholders did not reflect the actual value of the shares.[172] Dissenting shareholders were effectively "frozen out"[173] of the merger transaction by being forced to accept an unsatisfactorily low price for their holdings. The freeze-out was alleged to be manipulative under section 10(b), but the Court rejected plaintiff's argument, noting that the claim amounted to no more than a breach of fiduciary duty.[174] The Court suggested that "manipulation" is "virtually a term of art" in the securities context, and relates to deception or nondisclosure that affects market activity.[175] The Court reasoned that Congress would have used different language if it had intended to regulate issues of corporate mismanagement. Absent clear Congressional mandate, the court refused to interfere with state causes of action.[176]

Although greenmail profoundly affects market activity by blocking profitable tender offers it apparently falls outside the *Santa Fe* standard. The Disney transaction did not involve "deception" in the traditional sense, since WDP management did not communicate information to shareholders. Commentators note, however, that federal courts could avoid *Santa Fe* by "stretching" to find deception, or by expanding the definition of the term to include nondisclosure of

[167] Ross v. Longchamps, Inc., 336 F. Supp. 434 (E.D. Mo. 1971).

[168] *See supra* note 77 and accompanying text.

[169] In a derivative suit, the shareholders can satisfy the Birnbaum Rule if the corporation was damaged as a result of the purchase or sale of securities. Hazen, *Breaches of Fiduciary Duty and the Federal Securities Laws,* 61 N.C.L. Rev. 527, 527 (1983).

[170] 430 U.S. 462 (1977). Commentators note that *Santa Fe* ended the trend toward broad interpretations of the antifraud provisions of the Securities Exchange Act. Greene & Junewicz *supra* note 3, at 708. Prior to *Santa Fe,* courts often held that federal antifraud provisions imposed a fiduciary duty on directors. After *Santa Fe,* however, the legitimacy of defensive tactics is generally not considered within the scope of federal law. Harrington, *supra* note 6, at 905-06.

[171] The statutory short-form merger involved in *Santa Fe* allowed a parent company owning 90% of the subsidiaries' stock to merge with the subsidiary. Minority shareholders of the subsidiary are bought out at a stated appraisal price. Harrington, *supra* note 6, at 906 n.26.

[172] *Santa Fe,* 430 U.S. at 467.

[173] A "freeze out" occurs where a majority of the stockholders can vote on a corporate issue of major importance, such as the short-form merger provided for under Delaware law, *supra* note 170, leaving the dissatisfied minority no choice but to live with the decision or sell their share at a stated appraisal price which may or may not reflect fair market value. Lynch & Steinberg, *supra* note 6 at 906.

[174] *Santa Fe,* 430 U.S. at 476.

[175] *Id.*

[176] *Id.* at 476-77.

"unfairness" in the transaction.[177] This broader approach is consistent with the purpose of federal securities regulation, which is to ensure that shareholders have access to all information necessary for an informed investment decision.[178]

Moreover, the *Santa Fe* facts are distinguishable from the greenmail situation, in that they only involved claims of nondisclosure and fiduciary duty. Since plaintiffs in that case did not raise the claim that section 10(b) prohibits obstructive tactics which artificially affect market activity, the Court's definition of manipulation in *Santa Fe* should not apply to greenmail.[179] The short-form merger at issue in *Santa Fe* is also distinguishable from greenmail. Full disclosure in the short-form merger context ensures that stockholders are at least aware of their options, but disclosure alone will not allow shareholders to make an informed choice if defensive tactics are allowed to completely block the offer.[180]

Courts continue, however, to read section 10(b) narrowly, as the recent holding of the United States District Court of Delaware in *Warner Communications, Inc. v. Murdoch*,[181] illustrates. In *Warner*, the target corporation attempted to thwart investor Rupert Murdoch's acquisition program by placing supermajority provisions into the corporate bylaws. Warner also entered into a stock exchange agreement with Chris-Craft Industries to create a "veto block" capable of opposing a Murdoch takeover.[182] The court rejected Murdoch's section 10(b) claims, noting that investors should be charged with the "universal" knowledge that directors will act to retain control in the face of a takeover attempt.[183] This presumption would virtually preclude courts from considering any defensive tactic violative of section 10(b). Reading *Chock Full O'Nuts* and *Warner* together, then, shareholders can expect no judicial protection from either target or offeror in the greenmail case.[184]

The antifraud provision of the Williams Act, section 14(e),[185] similar to section 10(b), applies to all securities and all parties.[186] This facially broad antifraud provision applies specifically to manipulation in connection with any tender offer but it has been limited by judicial decisions.[187] Any party to the

[177] Harrington, *supra* note 6, at 908-09.

[178] *Id.* at 910 ("[T]he purview of the Act therefore should not be limited to the adequacy of disclosure but instead should be extended to protect a shareholder's right to make a decision rather than allowing management to make his investment decision for him.").

[179] Note, *Target Defensive Tactics As Manipulative Under § 14(e)*, 84 COLUM. L. REV. 228 (1984).

[180] *Manipulation With Full Disclosure, supra* note 5, at 169.

[181] 581 F. Supp. 1482 (D. Del. 1984).

[182] *Id.* at 1485-86.

[183] *Id.* at 1492.

[184] *See supra* note 34 and accompanying text.

[185] 15 U.S.C. § 78n(e) (1982).

[186] *Id.* "It shall be unlawful for any person to make any untrue statement of a material fact ... or to engage in any fraudulent, deceptive, or manipulative acts or practices, in connection with any tender offer...." *Id.*

[187] *Altman v. Knight*, 431 F. Supp. 309 (S.D.N.Y. 1977) (acquisition of one corporation by another, at a grossly exaggerated price and for selfish purposes in resisting a tender offer, is not within the scope of section 14(e)). "Manipulation" is not read to include breaches of fiduciary duty. *Tender Offer Defensive Tactics, supra* note 32, at 623. The definition corresponds with the definition of manipulation established for § 10(b) claims. Manipulation under both provisions con-

tender offer, however, should have a right of action under this section and thus avoid the "Birnbaum Rule" standing problem under section 10(b).[188]

The United States Supreme Court addressed the standing issue in *Piper v. Chris-Craft Industries*,[189] and denied the offeror a right of action for damages under section 14(e). In so doing, however, the Court recognized the Williams Act as an investor protection statute[190] and left open the issue of shareholder standing under the Act. The Seventh Circuit's Court of Appeals subsequent holding in *Panter v. Marshall Field & Co.*,[191] nevertheless, apparently denies standing to shareholders injured by greenmail. In *Panter*, plaintiffs, who were Marshall Field shareholders, charged Field with entering into an expansion program as part of a nondisclosed policy to resist all tender offers, including a proposed offer from Carter Hawley Hale ("CHH").[192] The expansion, which involved Field's acquisition of a store which would compete with the offeror's Nieman-Marcus store, caused CHH to withdraw its proposed tender offer.[193] The court reasoned that since the offeror withdrew the proposal before shareholders could respond, the shareholders had not relied on management's tactics and, therefore, had no cause of action under section 14(e).[194] The *Panter* rationale ignores the fact that management's manipulative acts themselves may have promoted the withdrawal of the offer. The court thus allows management to profit from its wrongs.[195] Such a result is inconsistent with the broad language and underlying purpose of section 14(e).[196]

The *Panter* court did recognize that its narrow holding created potential for abuses such as greenmail. The court noted in dicta that bidders who proposed tender offers without intending to complete them should be enjoined from ex-

tains two elements: (1) intent to deceive or mislead investors; and (2) an artificial effect on market activity. *Id.* at 633-36.

[188] *See supra* note 163 and accompanying text ("Birnbaum Rule").

[189] 430 U.S. 1 (1977).

[190] Senator Williams, sponsor of the Williams Act, designed the Act to protect legitimate interests of both target and offeror. H.R. REP. No. 1711, *supra* note 97, at 4, *reprinted in* U.S. CODE CONG. & AD. NEWS at 2813. "The bill avoids tipping the balance of regulation either in favor of management or in favor of the person making the takeover bid." *Id.* The Court in *Piper* read this to mean that the "sole purpose" of the Act was to protect investors faced with a tender offer. Harrington, *supra* note 6, at 903-04.

[191] 646 F.2d 271 (7th Cir. 1981).

[192] *Id.* at 287.

[193] *Id.* at 281.

[194] *Id.* at 283. ("[B]ecause the CHH tender offer was withdrawn before the plaintiffs had the opportunity to decide whether or not to tender their shares, it was impossible for the plaintiffs to rely on any alleged deception in making the decision to tender or not.").

[195] When target shareholders are precluded from responding to an offer because of obstructive tactics, the motives and purposes underlying management's actions should be scrutinized. Traditionally, this inquiry has been restricted to an evaluation of management's fiduciary duties under state law. However, the legislative history and broad language of federal tender offer regulations should be read to preclude target management from acting to materially interfere with the shareholder's decision in response to the offer. Harrington, *supra* note 6, at 915.

[196] If the Act's sole purpose is to protect shareholders, *see supra* note 190, then management's tactics should be measured solely by their effects on investors.

erting pressure on management.[197] The court, however, offered no guidelines for distinguishing withdrawn "sham" offers from true tender offers. Without such directives, the *Panter* holding does little to curb fraud in the greenmail context.

Some courts read the "in connection with" standard of section 14(e) more broadly than the *Panter* court and would allow standing where the offer has been announced but has not become effective.[198] Although under this minority view Disney shareholders would apparently qualify for a private right of action under section 14(e), the narrow definition of "manipulation"[199] again would pose an obstacle to relief.

The Sixth Circuit Court of Appeal read "manipulation" broadly, however, in *Mobil v. Marathon Oil.*[200] In *Mobil,* plaintiff announced a tender offer in order to acquire Marathon. Marathon then sought a more attractive merger partner, and began negotiating with U.S. Steel ("USS") as a "White Knight."[201] USS then made a competing tender offer for Marathon stock, and Marathon directors voted to recommend the USS offer to the shareholders. USS also acquired an irrevocable option to purchase approximately seventeen percent of Marathon's shares ("lock up" option).[202] Additionally, if USS's offer failed and a third party acquired Marathon, USS retained an option to buy Marathon's oil and mineral rights in the highly valuable property known as Yates Field ("crown jewel" option).[203] Thus, even if Mobil's bid succeeded, its resulting acquisition would be much less valuable due to the loss of Yates Field, Marathon's "crown jewel."[204] The court found the lock-up option manipulative because it artificially affected and, in fact, completely blocked market activity in connection with the offer.[205]

The *Mobil* approach, emphasizing manipulation of market activity by "artifical means," is particularly relevant to greenmail.[206] Greenmail completely blocks market activity in connection with the offer, and is "artificial" in that it is "unrelated to the natural forces of supply and demand."[207] To remedy this problem, one commentator has recommended that defensive tactics which preclude shareholder consideration of an offer be judged under a stricter standard than the disclosure test established by *Santa Fe.*[208] Subsequent cases decided

[197] *Panter,* 646 F.2d at 287.

[198] *See* Lewis v. McGraw, 619 F.2d 192 (2d Cir. 1980) (relief denied because offer withdrawn; however, the court noted in dicta that standing would be allowed where the offer eventually became effective).

[199] *Supra* notes 174-76 (*Santa Fe* definition of manipulation).

[200] 669 F.2d 366 (6th Cir. 1981).

[201] *See supra* note 6.

[202] *See supra* note 6.

[203] *See supra* note 6.

[204] *Id.* at 367. *See also supra* note 6 ("crown jewel" defense).

[205] *Id.* at 374.

[206] *Target Defensive Tactics, supra* note 179, at 255.

[207] *Mobil,* 669 F.2d at 374.

[208] Harrington, *supra* note 6, at 933.

under section 14(e), however, illustrate that *Mobil* stands alone.[209] The Second Circuit Court of Appeal has consistently held that manipulation involves nondisclosure or misstatement of material, objective facts.[210] Management's motives underlying a defensive maneuver are considered immaterial under this standard.[211] Whether courts will continue to follow this approach in the greenmail context remains uncertain. The courts' ease in relegating issues involving other obstructive tactics to state law suggests that they would.[212] If, however, the principal concern of the Williams Act is shareholder response to a tender offer,[213] then the Act should logically apply when management's submission to greenmail precludes the opportunity to respond. Post-*Mobil* case law therefore does not adequately consider the impact of obstructive tactics on market activity.[214]

Moreover, the recent Second Circuit opinions lack support in the broad language of section 14(e). The provision prohibits "manipulative" acts as well as nondisclosure of material facts. When courts apply these standards interchangeably, finding one test satisfied when the other has been met, the "manipulative acts or practices" clause in section 14(e) is rendered meaningless. The text of section 14(e) reveals that "manipulation" does refer to substantive issues of fairness when managerial conduct artificially affects market activity.[215]

The United States Supreme Court is currently reviewing the conflict between *Mobil* and the Second Circuit's approach in *Schreiber v. Burlington Northern, Inc.*[216] In *Schreiber*, the target's shareholders lost the opportunity to profit from Burlington's initial tender offer when Burlington withdrew it. Burlington subsequently submitted a less lucrative offer, allegedly with target management's cooperation. The petition requests the Court to overturn the Third Circuit's ruling in *Schreiber* that section 14(e) reaches only issues of disclosure. Petitioners argue that Congress intended section 14(e) to reach the unique problems created by tender offers, which may not be addressed by full disclosure.[217] Petitioner's approach is particularly sound in the greenmail situation, since disclosure alone does not prevent management from obstructing the offer before presenting it to shareholders. Perhaps the Supreme court will utilize *Schreiber* to extend the scope of section 14(e).

[209] *E.g.*, Data Probe Acquisition Corp. v. Datatab, Inc., 722 F.2d 1 (2d Cir. 1983) (lock-up option granted to third party in order to block a hostile takeover bid held not manipulative without a showing of nondisclosure). Buffalo Forge Co. v. Ogden Corp., 717 F.2d 757 (2d Cir. 1983) (corporation's sale of treasury shares to a corporate bidder in takeover contest resulting in a less financially attractive target for competing bidder held not manipulative without a showing of misrepresentation).

[210] *See supra* note 209.

[211] *See supra* note 187 and accompanying text (manipulation does not include breaches of fiduciary duty).

[212] *See* Data Probe Acquisitions Corp. v. Datatab, Inc., 722 F.2d 1,4 (2d Cir. 1983) ("The gravamen of the claim advanced here is a breach of management's fiduciary duty to shareholders, a matter traditionally committed to state law....").

[213] Note, *supra* note 32, at 641. ("The principal concern of the Williams Act is the ability of shareholders to respond to a tender offer, not the ability of bidders to make one.").

[214] Greene & Junewicz, *supra* note 3, at 669.

[215] *Target Defensive Tactics, supra* note 179, at 237-38.

[216] 16 Sec. Reg. & L. Rep. (BNA) No. 29, at 1223 (July 20, 1984).

[217] *Id.*

D. Regulating the Target as Offeror

The SEC recently raised a novel legal theory in *SEC v. Carter Hawley Hale Stores, Inc.*,[218] arguing that CHH's repurchase of its shares constituted an illegal counter-tender offer.[219] In *CHH*, as in *Crane*, management repurchased from a third party.[220] Despite third party involvement, the illegality argument should apply with equal force to greenmail, where the corporation repurchases the offeror's holdings. The court in *CHH*, however, read the SEC tender offer elements[221] narrowly. The SEC had contended that CHH's repurchase plan satisfied all eight tender offer requirements, but that CHH had not complied with federal disclosure requirements for counter-tenders.[222] The court rejected this theory, determining that the Commission had only proved two of the eight elements necessary for a valid tender offer: public announcement and time pressure.[223]

The *Crane* court, as noted earlier, rejected a similar illegality claim.[224] Pressure on shareholders was, in the court's view, the essential characteristic of a tender offer, and the privacy of the transaction negated the efficacy of publicity and active solicitation. Payment of a premium alone, the court reasoned, does not establish a tender offer.[225]

Applying the Disney facts to the *CHH* and *Crane* holdings, the Disney-Steinberg agreement would constitute a legal counter-tender because it was privately negotiated and not widely solicited or publicized. This result is rational in the greenmail situation. Steinberg, as a greenmailer, has no need for the protection the Williams Act provides to ordinary shareholders-offerees.[226] The injured parties are the shareholders not privy to the greenmail arrangement. While federal law purports to protect shareholder interests,[227] courts defer to state law when analyzing self-entrenchment claims, contending that defensive tactics involve no more than internal corporate mismanagement.[228] As noted however, the business judgment rule bars most state claims.[229]

Greenmail, therefore, remains unresolved by either state or federal law.[230] The SEC and Congress have recommended measures to constrict the gaps in legal coverage of tender offers, through which greenmail has thus far passed. These proposals, however, represent an inadequate resolution of the problem.

[218] 587 F. Supp. 1248 (C.D. Cal. 1984).

[219] *Id.* at 1250 (CHH had repurchased over 50% of its outstanding common stock in order to defeat an attempt by The Limited, Inc., to obtain voting control over the company).

[220] *Supra* notes 104-05 and accompanying text.

[221] *Supra* notes 103-04 and accompanying text.

[222] 17 C.F.R. § 240.13e-4 (1984).

[223] *Carter Hawley Hale*, 587 F. Supp. at 1253-55.

[224] *Supra* note 155.

[225] *Crane*, 511 F. Supp. at 296.

[226] *See supra* notes 104-05 and accompanying text (Act intended to protect investors faced with a hostile acquisitor).

[227] *See supra* notes 105-06 (legislative history of Williams Act).

[228] *See e.g., Santa Fe, supra* notes 169-76 and accompanying text.

[229] *See supra* notes 55-69 & 176 and accompanying text (business judgment rule as a barrier to recovery under state law).

[230] *See Target Defensive Tactics, supra* note 179, at 255.

IV. Proposals for Change

The SEC Advisory Committee on Tender Offers issued its final report on July 8, 1983.[231] The Committee based the report on the premise that federal securities laws should remain neutral, favoring neither offeror nor target.[232] The Committee believed that tender offers were the best way to ensure that terms, price, and conditions were equally available to all shareholders. One of the Panel's recommendations would ban greenmail by prohibiting an issuer from repurchasing its securities at a premium if the shareholder had held the stock for fewer than two years. If management obtained prior shareholder approval, the transaction would be allowed.[233]

The Panel cautioned that regulation of one type of takeover transaction should address the effect on securities regulation as a whole.[234] If a greenmail scheme did not fall within the proposed ban, however, the Committee's support of the business judgment rule would probably preclude any relief under state law.[235] Expanding this loophole, the Committee urged federal courts to leave the shareholder-manager relationship to state law.[236] This reliance on the business judgment rule, according to Felix G. Rohatyn, testifying before the House Panel on Tender Offer Reform, only encourages greenmail.[237]

Congress responded to the Committee by proposing legislation intended to

[231] *SEC Advisory Panel Issues Report on Changes in Tender Offer Laws*, 15 SEC. REG. & L. REP. (BNA) No. 28, at 1339 (July 15, 1984) [hereinafter cited as *SEC Panel Report*].

[232] *"Tender Offer Panel's Recommendations Are 'Radical' Proposals," Treadway Says,"* 16 SEC. REG. & L. REP. (BNA) No. 10, at 468 (March 9, 1984). SEC Commissioner James Treadway criticizes this premise of neutrality, calling such a system a "raw" free market which does not account for measures to protect shareholders such as a minimum period in which to consider a tender offer. *Id.*

[233] *SEC Panel Report, supra* note 231, at 1339. The requirement of shareholder approval is desirable, since shareholders, as targets of the offer, "should logically determine the nature of management's response." Further, such a requirement allows management to know the "precise extent of its discretion" when faced with a takeover bid, reducing uncertainty and the possibility of litigation. However, the requirement is problematic in that it would be difficult to obtain shareholder approval during the typically brief duration of the offer. Advance authorization may be the only realistic alternative, but such authorization would necessarily be general, thus giving management a blank check to engage in defensive tactics legitimized by shareholder approval. Greene & Junewicz, *supra* note 3, at 725-26.

[234] *SEC Panel Report, supra* note 231, at 1339.

[235] *Id. See also supra* notes 55-69 and accompanying text (business judgment rule bars most state claims). The Panel urged emphasis on shareholder democracy in the form of advisory votes, but noted that directors shouldn't be "bound to act against their business judgment in the shareholder interest." *SEC Panel Report, supra* note 231, at 1340.

[236] *SEE Panel Report, supra* note 231, at 1333. The SEC itself has faulted the Committee's reliance on the business judgment rule. The Commission would prefer that courts give equal weight to shareholder interests when resolving a takeover dispute. *SEC Faults Advisory Panel's Reliance on Business Judgment Rule in Takeovers*, 16 SEC REG. & L. REP. (BNA) No. 11, at 495, 496 (March 16, 1984).

[237] *House Panel Finds Little Agreement on Federal Tender Offer Law Reform*, 16 SEC REG. & L. REP. (BNA) No. 21, at 915 (May 25, 1984). If the SEC recommendations become law, they would tip the balance heavily against target companies and their shareholders in favor of raiders and greenmailers. *Id.* at 916.

regulate tender offers in general and greenmail in particular. Many senators have spoken out on the issue. Senator Heinz stated that greenmail "undermines the savings and retirement of thousands of Americans", and that "small investors are the ones hurt by the duplicity of this selfish, self-serving sellout."[238] Senator Riegle noted that greenmail had become such a widespread practice that in March of 1984 alone, four major companies had submitted to greenmail at a cost of over $1.6 billion in corporate funds.[239] Senators Heinz[240] and Riegle,[241] and Representative Wirth[242] have proposed bills to ban greenmail. Each version would prohibit an issuer from repurchasing its shares at a price above the market from any person holding more than three percent of a class of securities for fewer than two years.[243] The repurchases, however, would be allowed if management obtained prior shareholder approval or made the identical offer to all shareholders.[244] The Heinz and Wirth proposals are unique because they both provide for shifting the burden of proof under the business judgment rule, requiring management to prove that its actions are both prudent and fair to the corporation and shareholders.[245] All proposals would amend section 14 of the Securities Exchange Act, but most are silent regarding private rights of action.[246] The Wirth bill provides shareholders a private cause of action for injunctive relief, however, and forces management to shoulder the burden of proof.[247]

In a June 7 memorandum to the House Energy and Commerce Telecommunications, Consumer Protection, and Finance Subcommittee, Wirth noted that most congressmen agreed on "limited — but important — reform legislation that could be moved through the House with bipartisan support."[248] Wirth

[238] *Heinz Bill Would Create Federal Claims Against Managements That Pay Greenmail*, 16 SEC. REG. & L. REP. (BNA) No. 25, at 1066 (June 22, 1984).

[239] *Id.* at 1067.

[240] S. 2777, 98th Cong., 2d Sess. (1984). Since this note was written, S. 2777 died in the Senate Banking Committee.

[241] S. 2754, 98th Cong., 2d Sess., *reprinted in* 130 Cong. Rec. S. 7166 (daily ed. June 14, 1984), reintroduced as S 286, 99th Cong., 1st Sess.

[242] H.R. 5693, 98th Cong., 2d Sess. (1984). Since this note was written, H.R. 5693 died on the floor of the House.

[243] *E.g.*, S 2777, *supra* note 240. The wording of the bill read:

> It shall be unlawful for an issuer to purchase, directly or indirectly, any of its securities at a price above the market from any person who holds more than 3 per centum of the class of the securities to be purchased and has held such securities for less than two years, unless such purchase has been approved by the affirmative vote of a majority of the aggregate voting securities of the issuer, or the issuer makes an offer to acquire, of at least equal value, to all holders of securities of such class and to all holders of any class into which such securities may be converted.

Id.

[244] *Id.*

[245] *E.g.*, S. 2777, *supra* note 240.

[246] *E.g.*, *id.*

[247] H.R. 5695, 98th Cong 2d Sess. (1984). Since this note was written, H.R. 5695 died on the floor of the House.

[248] *Wirth Subcommittee Reports Bill to Reform Tender Offer Procedures*, 16 SEC. REG. & L. REP. (BNA) No. 27, at 1138 (July 6, 1984) [hereinafter cited as *Wirth Reports Bill*].

had supported a comprehensive takeover reform bill, but was urged by subcommittee members to postpone more complex issues until the following year.[249] Wirth's "limited bill" would address major abuses and regulatory gaps such as greenmail.[250] Wirth's bill was reported out of the House Energy and Commerce Committee on August 2, 1984, but the other bills have seen no action.[251] Subcommittee amendments to the Wirth proposal prohibited repurchases from any person holding more than three percent of a class of securities, whether holding for fewer than two years or not.[252] The Committee reinserted the two-year provision.[253] An additional subcommittee amendment empowers the SEC to exempt companies from the greenmail prohibition.[254]

Other proposals, which called for more fundamental changes in existing securities law were offered during the 1984 Congressional session. The Wirth and D'Amato bills would close the ten day window under section 13(d)[255] and provide investors with earlier notice of a potential change in control. Other provisions in the Wirth and D'Amato proposals would prohibit issuers from repurchasing stock during a tender offer if the offering price is more than twenty-five percent over the market price.[256] These provisions allow exceptions for "routine acquisitions."[257] Representative Penny has introduced a bill which, would amend section 14(e) by specifically defining certain defensive maneuvers as "manipulative".[258] Additionally, Representative Wirth has recently introduced a bill which would require bidders to hold tender offers open for sixty days if made in anticipation of, or in competition with, other tender offers.[259]

The blanket bans on greenmail are defective in several respects.[260] Other provisions offer potential solutions to the greenmail problem, but are directed

[249] *House Committee Approves Bill to Limit Tender Offer Abuses, Defensive Tactics*, 16 Sec Reg & L. Rep. (BNA) No. 31, at 1279 (August 3, 1984) [hereinafter cited as *Committee Approves Bill*]

[250] *Wirth Reports Bill, supra* note 248, at 1138.

[251] *Committee Approves Bill, supra* note 249, at 1279. *See supra* notes 240, 241, 242, 247, 258 & 259 (current status of legislative proposals).

[252] *Id.*

[253] *Id.*

[254] *Id.*

[255] *E g.*, H.R. 5693, *supra* note 242.

[256] *Id.*

[257] *Id.* While it is unclear what is meant by "routine acquisition", this exception would presumably allow some flexibility in the restrictions where stock repurchases are initiated for legitimate economic reasons. *See infra* note 265.

[258] H.R. 5914, 98th Cong., 2d Sess. (1984). The manipulative practices prohibited include: sale or purchase by principal stockholders of any shares at consideration greater than that given to other stockholders pursuant to a nondisclosed agreement, an issuer's refusal to permit an offeror who is a shareholder of record to inspect the target's list of shareholders, and the solicitation of acceptance or rejection of an offer before the filing of a description of the securities offered. *Id.* Since this note was written, H.R. 5914 died on the floor of the House.

[259] H.R. 5972, 98th Cong., 2d Sess. (1984). Since this note was written, H.R. 5972 died in the House Committee on Energy, Commerce and Telecommunications.

[260] SEC staff officials noted, however, that Carter Hawley Hale would have been unable to use self-tender to defeat The Limited's offer if the proposed legislation were effective. *Legislative Proposal Limiting Tactics to Defend Takeovers Approved by SEC*, 16 Sec. Reg. & L. Rep. (BNA) No. 19, at 793, 794 (May 11, 1984).

toward tender offer issues other than greenmail. While Wirth's aides believed that a "popular" bill addressing well-publicized abuses such as greenmail could pass easily,[261] Congress should not take an easy regulatory route that inadequately addresses problem areas.

An absolute ban on greenmail is facially appealing, but an isolated provision probably would not provide effective relief.[262] Existing proposals are both over-inclusive and under-inclusive.[263] The prohibition against repurchasing shares from an investor holding more than three percent, for instance, does not square with the five percent ownership necessary to trigger federal disclosure under sections 13(d) and 14(d).[264] When Congress adopted the Williams Act its members knew that stock repurchases by issuers could serve a number of legitimate purposes.[265] If repurchases from small holders required shareholder approval or an offer to all shareholders, ordinary transactions could be delayed and complicated. Management would thus be rendered less efficient overall. Moreover, the price standard under the proposals, "a price above the market,"[266] is too vague.[267] An error in calculation or in timing could expose innocent management to costly and time-consuming litigation by dissatisfied shareholders. Although these standards prove to be too harsh in their impact on management, other methods leave substantial loopholes in greenmail regulation.

The opposite extreme in setting a price standard is exemplified by the prohibitions against issuer repurchases during tender offers at a price per share of more than twenty-five percent over market.[268] The greenmailer could comply with these provisions simply by offering at a price per share which is only twenty-four percent over the market price.[269] Similarly, limiting the greenmail ban to purchases from persons holding for less than two years allows for easy evasion of the law's purpose.[270] The patient greenmailer will simply retain the

[261] *Wirth Introduces Bills to Limit Tender Offer Abuses,* 16 SEC. REG. & L. REP., (BNA) No. 21, at 913 (May 25, 1984).

[262] Robert Greenhill cautioned against changes that do not address the total system. *SEC Panel Reports, supra* note 231, at 1339.

[263] *See also supra* note 90.

[264] *See supra* notes 108-10 and accompanying text.

[265] H.R. REP. No. 1711, *supra* note 97, at 5, *reprinted in* 1968 U.S. CODE CONG. & AD. NEWS, at 2814 (For example, the need to reduce outstanding capital stock following a cash sale of subsidiaries; the need to have shares available for options, acquisitions, employee stock purchase plans, etc.).

[266] *See supra* note 243.

[267] In *CHH,* discussed *supra* notes 218-23 and accompanying text, Judge Tashima criticized the SEC's attempt to define "premium" based on a "theoretical unaffected market price." The SEC had taken the position that "premium" was any price in excess of the market, but Judge Tashima noted that "the Commission's position in this action ... is both unworkable and untenable." The vagueness of such a standard would mean that "absolutely no certainty or guidance would be available to the investment community." Id. at 1254.

[268] H.R. 5693, *supra* note 242.

[269] *See supra* note 3, at 671 (if a specific percentage is established, bidders will simply buy just less than the threshold amount).

[270] *See id.* at 732 ("It is hard to understand why a two-year holding period ... should purify the transaction such that it becomes proper to dispense with shareholder approval."). Some commentators note, however, that shareholder input can only be beneficial. Their response to the

shares until this period expires, freeing management to respond with a premium offer once the greenmailer threatens a takeover. Finally, the requirement that shareholders approve the transaction may be a meaningless check on management's authority. Management, with its superior access to proxy machinery,[271] rarely fails in obtaining shareholder approval for its actions.

Thus, while these proposals place some limitations on greenmail, they do not go far enough. An explicit private right of action should be included in all proposals, to aid SEC enforcement of the greenmail provisions.[272] Rather than attempting to regulate greenmail with a single proposal, Congress should adopt legislation which addresses the problem in a more far-reaching and inclusive manner.

V. Author's Recommendations

The over-inclusive aspects of greenmail legislation may be relaxed without providing an easy method of evading the prohibitions. Congress can close resulting loopholes by amending other securities provisions, such as section 14(e). For example, the percentage of shares required to trigger greenmail legislation should be increased from three percent to five percent, making it consistent with existing disclosure requirements. This increased percentage would make routine transactions between the issuer and small shareholders less complicated. In addition, only repurchases at a price "substantially over market" should come within the reach of the prohibition. Such a standard avoids easy compliance under a fixed percentage,[273] while allowing management some degree of leeway for error or miscalculation.[274] While this may lead to the type of judicial discretion exhibited in the context of the business judgment rule,[275] other changes in federal law should limit that discretion.

The provision in Senator Heinz' and Representative Wirth's proposals for shifting the burden of proof is valuable. Such a procedural standard will facilitate hearing shareholders' claims on their merits. Imposing a rebuttable presumption on target management is reasonable, in that the target has superior access to information regarding its motives. Further, the test does not interfere with the corporation's internal management, but only requires the target to explain its conduct.[276] Moreover, any tactic which has the effect of precluding shareholder

argument that a shareholder vote amounts to no more than a rubber stamp is that (1) this is not necessarily the case where a profitable tender offer is concerned; (2) advocacy of shareholder democracy should not be stifled because shareholders may not vote "against their own best interests;" and (3) paternalism is outmoded; shareholders are entirely justified in voting their pocketbooks. Harrington, *supra* note 6, at 1025-26.

[271] *See Manipulation With Full Disclosure, supra* note 5, at 161 (control battles through proxies give incumbent managers an edge over the offeror, since management has access to corporate funds while the offeror must use his or her own resources.) *See also* Greene & Junewicz, *supra* note 3, at 724-25 (management may wield significant influence over the outcome of a shareholder vote, since it controls the proxy solicitation process).

[272] *Supra* note 172 and accompanying text.

[273] *See supra* note 112 and accompanying text.

[274] *See supra* note 267 and accompanying text.

[275] *See supra* notes 64-69 and accompanying text (business judgment rule).

[276] Lynch & Steinberg, *supra* note 6, at 933.

response to a hostile tender offer is motivated by the purpose of defeating the offer.[277] According to one observer, "any other position ignores the realities of the corporate world."[278]

The term "manipulation" in existing federal law should be redefined to include "any action taken for the primary purpose of withdrawing a tender offer from shareholder consideration."[279] This rewording would raise evidentiary problems of proving a primary purpose, but would force courts to read manipulation more broadly in the greenmail context. Courts could then continue to evaluate legitimate defensive tactics under state law and federal disclosure provisions.[280]

Congress could remedy defects in shareholder approval requirements by passing an amendment mandating more substantive requirements under existing disclosure rules for proxy solicitation. Congress could also require freezing the offer until management has had an opportunity to contact its shareholders.[281] Requiring supermajority approval rather than a simple majority would render shareholder input more meaningful by reducing the chances for management to obtain carte blanche simply because of its incumbent authority.[282]

One of the most problematic aspects of greenmail is the dilemma directors confront. Disclosure alone will never alert management to the greenmailer's true intention.[283] To require management to rely on past history when faced with what appears to be a real threat to the corporate structure is unreasonable. If Representative Wirth's proposal for freezing tender offers were made applicable to all bids,[284] however, the greenmailer could be deterred from initiating the sham offer. Restricting management's actions during the freeze would preclude any hope of a bidder pay-off, and force offerors to consider their intentions more seriously. State regulation of target activity during the tender offer[285] should also be considered, since federal provisions may prove insufficient to restrict management's options in responding to the offer.

VI. Conclusion

Greenmail reduces the value of shareholder's investments and leaves shareholders with no voice in decisions which radically affect their interests. Greenmail also diminishes corporate funds and damages the corporate image.[286] Once

[277] *Id.*

[278] *Id.*

[279] *See* H.R. 5914, *supra* note 258 (Penny's bill defining "manipulative" defensive acts).

[280] Lynch & Steinberg, *supra* note 6, at 939. The test used to evaluate defensive tactics not "solely communicative in nature" should vary according to the effect on the shareholder's ability to respond. Conversely, tactics that do not impede a shareholder's decision should continue to be judged according to adequacy of disclosure. *Id.*

[281] *See supra* notes 105-06, and accompanying text. (Substantive disclosure to shareholders allows for informed, independent decisionmaking.). *See also supra* note 233.

[282] *Id.*

[283] *Supra* note 271 and accompanying text.

[284] *Supra* notes 131-134 and accompanying text.

[285] *See supra* notes 91-94 and accompanying text.

[286] Financial defensive tactics have two negative effects: (1) shareholders are deprived of the

management has shown a willingness to submit to greenmail, other investors may attempt to extort premiums in buy-out transactions. Furthermore, greenmail burdens society as a whole through inefficient business practices. Present regulation of defensive tactics is inadequate to protect investor interests.

Federal legislation is needed to balance the interests of bidders and targets in true takeover contests, as these bids serve an important function in a market economy. Protecting management against all offerors in an attempt to deter greenmail would solidify inefficient management and contrapose shareholder interests. Federal regulation, however, should provide substantive protection to management as well as investors when the underlying issue involves money rather than control.

Legislation should be tailored specifically to prevent courts from taking a hands-off approach to gross corporate mismangement under the business judgment rule. The law should, however, be broad enough to allow for routine, efficient business practices. Distinguishing tactics which obstruct takeover bids from those which merely affect the power relationships between the parties should accomplish these dual goals. Meanwhile, courts should re-evaluate the business judgment rule in takeover situations involving greenmail as well as in other defensive contexts where internal management of the corporation is not at issue.[287] States should also consider enacting post-*MITE* legislation to regulate intrastate corporate behavior.[288]

The greenmail dilemma involves subtle issues which cannot be controlled in an absolutist fashion. As the SEC Advisory Committee on Tender Offers noted, regulation should not stifle innovation in the securities market.[289] Greenmail is an abuse of the tender offer process, which ordinarily has a legitimate place in the securities market. Greenmail legislation, therefore, must remain flexible to curb abuse without stifling the otherwise healthful process.

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chance to tender their holdings at a profit; and (2) defenses weaken the target's financial condition, resulting in a lower market value for the target's shares in the aftermath of the takeover contest. Greene & Junewicz, *supra* note 3, at 702-03.

[287] *See supra* notes 79-81 and accompanying text.

[288] *Supra* note 94 and accompanying text.

[289] *Exerpts from Final Report of SEC Advisory Committee on Tender Offers,* 15 SEC. REG. & L. REP. (BNA) No. 28, at 1375 (July 15, 1983).