Tender Offer Defenses: The Need for National Guidelines in Light of Mobil

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Corporate takeovers through the use of tender offers have increased significantly in the recent past. The Williams Act was enacted in 1967 to protect shareholders who were faced with these tender offers. In particular, the Act protects shareholders by prohibiting the tender offeror or the tender offeree from engaging in manipulative acts. The Act does not, however, protect shareholders from the inherent conflict of interest directors are faced with when confronted with a hostile tender offer. The Sixth Circuit appears to have tried to relieve this conflict, but in so doing misapplied the term “manipulation” as it is used in the Act. This Comment examines the Williams Act and the meaning of manipulation, and asserts that the Sixth Circuit erred in finding manipulation absent the necessary element of intent. The Comment concludes that to reduce the potential damage to shareholders resulting from a director’s conflict of interest, new federal legislation should be enacted requiring disclosure and substantiation of the validity of a directors reasons for fighting a tender offer.

INTRODUCTION

The takeover of one corporation by another is an increasing phenomenon in today’s business world. One method of takeover frequently used is the tender offer.¹ The tender offeree (target corporation) may consider the tender offeror (bidder corporation) to be either friendly or hostile. If the target considers the bidder to be hostile, a number of defenses to the tender offer may be employed.² Any defense used by the target must not violate section 14(e) of the


Williams Act, part of the Securities Exchange Act of 1934, which states in pertinent part "[i]t shall be unlawful for any person . . . to engage in any . . . manipulative acts or practices, in connection with any tender offer. . . ."

Manipulative acts under section 14(e) were found to exist in Mobil Corp. v. Marathon Oil Co. The Mobil court held that the stock option and asset option given by Marathon to U.S. Steel were manipulative within the meaning of section 14(e). The decision reflects the conflicts courts face when dealing with defenses to hostile tender offers: Should the target corporation be able to undertake any tender offer defenses so long as there is full disclosure or should the shareholders have an absolute right to consider all tender offers regardless of target management’s desire to defend against such an offer? Manipulation under section 14(e) requires an element of intent to deceive or defraud allowing any tender offer defense so long as full disclosure occurs and intent is absent. The Mobil decision finds manipulation regardless of wrongful intent and effectively gives shareholders an absolute right to consider all tender offers.

Section 14(e) does not effectively combat certain inherent problems in defenses to hostile tender offers. For example, 14(e) does not address the inherent conflict of interest a target director faces when confronted with a hostile tender offer. The conflict arises because the director must decide whether to act in his own self interest and insure his job and power within the corporation or to act in the shareholders' best interests and objectively evaluate the tender offer. On the other hand, the Mobil decision tortures the accepted interpretation of the term manipulation in an effort to combat these potential conflicts. Regardless of section 14(e)’s failure to combat these problems, this Comment will contend the Mobil court should not have acted in a legislative manner and, effectively rewriting section 14(e) and countered the essence of the Williams Act. This Comment will contend that rather than judicial action an amendment to the Williams Act, addressing the conflict of interest problem, should be passed by Congress.

7. See infra notes 28-32 and accompanying text.
8. Id. Even with full disclosure, however, the intent needed for manipulation may be present. Additionally, intent does not necessarily follow from non-disclosure; however, non-disclosure is usually present when the intent to deceive is found. Id.
9. The inherent problem discussed in this Comment is the conflict of interest involved when a target defends against what the target considers a hostile tender offer. See infra notes 90-93 and accompanying text.
This Comment will discuss the purpose behind the Williams Act in light of judicial decisions and legislative history. Next, the Comment will analyze the term manipulation under section 14(e) as defined by case law. Further, the surprise holding in *Mobil Corp. v. Marathon Oil Co.* will be analyzed, with the assertion that such an interpretation of "manipulation" goes beyond the Supreme Court's interpretation of manipulation and the Williams Act. Finally, the Comment will assert that present state and federal laws are inadequate to combat the inherent conflict of interest involved in hostile tender offers; therefore, federal legislation is required to address the problem.

**THE WILLIAMS ACT**

The Williams Act was enacted in 1967 to provide greater protection to shareholders confronted with tender offers. The Act protects shareholders by requiring full disclosure of the identity, background, and plans of the tender offeror (bidder). Legislative history and the actual wording of the Act demonstrate an intent to provide full disclosure to shareholders. Prior to the Act, bidders could operate under a veil of secrecy, leaving unsuspecting shareholders ignorant of the bidder's identity, source of funds, or plans (once the takeover was complete).

The legislative history also reveals an intent to maintain a neutral position between the target and the bidder. Senator Harrison A. Williams, Jr., author of the Act, emphasized he had "taken extreme care with this legislation to balance the scales equally to protect the legitimate interests of the corporation, management, and shareholders without unduly impeding cash takeover bids." The intent of neutrality would appear to prohibit an interpretation of the Act which would either hinder a target in legitimately defending against a takeover, or hinder a bidder by imposing undue burdens.

Judicial interpretation of the Williams Act fully recognizes the

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12. "The purpose of this bill is to require full and fair disclosure for the benefit of stockholders. . . ." 113 Cong. Rec. 854-55 (1967) (statement of Senator Harrison A. Williams, Jr.).
13. Id. at 854.
14. *Id.* See also Edgar v. Mite Corp., 102 S.Ct. 2629, 2636 (1982).
purpose of the Act is to protect shareholders. The goal of neutrality between the bidder and target, on the other hand, is not as well settled. In *Rondeau v. Mosinee Paper Corp.*, the Supreme Court recognized that neutrality was a goal of the Williams Act. One year later, in *Piper v. Chris-Craft Industries*, the Court ruled that shareholder protection was the sole purpose of the Williams Act and neutrality was but one characteristic of that overall purpose.

The most recent Supreme Court decision interpreting the Williams Act revitalizes the *Rondeau* holding. *Edgar v. Mite* states shareholder protection and neutrality between the bidder and target are within the goals of the Williams Act. The Supreme Court, in *Edgar*, recognized a second purpose of the Act—to maintain an evenhanded or neutral position when applying the regulations of the Act to a bidder or target (to the extent that such evenhandedness furthers the protection of the shareholders).

By maintaining an evenhanded role, the Act allows both the bidder and target to present arguments to the shareholder as to why the tender offer is beneficial or detrimental. Accordingly, the shareholder will be able to make an informed decision and the Act will have performed its twofold function of protecting the shareholder and maintaining a neutral role. Consequently, *Edgar* rather than *Piper*

17. *Piper* involved an unsuccessful bidder attempting to sue a competing bidder for damages. The Court held that the unsuccessful bidder did not have standing to sue in its capacity as a bidder. The *Piper* Court rejected the plaintiff's argument that the Williams Act's purpose of neutrality must necessarily imply a cause of action for damages. The Court stated that because the purpose of the Act is to protect an express class of shareholders, a cause of action would lie only if it benefitted or protected this specific class. The plaintiff was in this specific class of shareholders. The Court, nevertheless, emphasized that when the bidder sues in its capacity as a defeated bidder and not in the capacity of an injured shareholder (within the class to be protected), the benefit of the Act will not inure. See 430 U.S. 1, 29 (1977).
18. See Edgar v. Mite Corp., 102 S. Ct. 2629 (1982), "Congress sought to protect the investor not only by furnishing him with the necessary information but also by withholding from management or bidder any undue advantage that could frustrate the exercise of an informed choice." *Id.* at 2636.
19. *Id.* at 2629.
20. *Id.* at 2636.
21. Whether the Act's sole purpose is to protect shareholders, with neutrality being a mere characteristic, or whether the Act's purpose is twofold (protecting shareholders and maintaining a neutral position between bidder and target) appears largely a semantic argument. Legislative history of the Act expressly emphasizes both full disclosure and neutrality. 113 Cong. Rec. 854 (1967). Arguments expressing the purposes as divergent and independent appear to be based on a misreading of the legislative history. The protection of the shareholder is accomplished by allowing the shareholder to examine and weigh information received from both the target and the bidder. The neutral aspect of the Act provides "the offeror and management equal opportunity to fairly present their case." *Id.* at 855. The legislative history expresses concern to "avoid tipping the balance of regulatory burden in favor of management or in favor of the offeror." *Id.* at 854. The
appears to better coincide with the objectives noted in the legislative history of the Act.

Section 14(e) Manipulation

Section 14(e), a part of the Williams Act, is intended to protect shareholders and to insure neutrality between the bidder and target corporations. Section 14(e) helps to achieve these goals by making it unlawful "for any person to engage in any fraudulent, deceptive, or manipulative acts or practices in connection with any tender offer. . . ." The term "manipulative" has come under particular scrutiny in recent years. The Williams Act fails to define the term. However, courts have derived the meaning of manipulation under section 14(e) from cases interpreting the term "manipulation" under section 10(b) of the Act. Section 10(b) and section 14(e) are both sections of federal securities laws with remarkably similar wording — each legislative history seems to state explicitly that evenhandedness and shareholder protection are basically intertwined. The greatest degree of shareholder protection is achieved when neutrality is pursued and the greatest degree of neutrality is achieved when shareholder protection is pursued — each objective relying on the other. Thus, both shareholder protection and neutrality between the target and bidder are integral parts of the Williams Act and should not be seen as divergent. Senator Williams himself asserted this upon the Act's introduction. Id. at 854.

22. Section 14(e) states:
   It shall be unlawful for any person to make any untrue statement of material fact or omit to state any material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading, or to engage in any fraudulent, deceptive, or manipulative acts or practices, in connection with any tender offer or request or invitation for tenders, or any solicitation of security holders in opposition to or in favor of any such offer, request, or invitation. The Commission shall, for the purposes of this subsection, by rules and regulations define, and prescribe means reasonably designed to prevent such acts and practices as are fraudulent, deceptive, or manipulative.

23. Id. (emphasis added).

24. See, e.g., Buffalo Forge Co. v. Ogden Corp., 717 F.2d 757 (1983); Pacific Realty Trust v. APC Investments, Inc., 685 F.2d 1083 (9th Cir. 1982).

25. For examples of courts defining "manipulation" under section 10(b) of the Williams Act, see Panter v. Marshall Field & Co., 646 F.2d 271, 282 (7th Cir. 1981), cert. den., 454 U.S. 1092 (1981); Golub v. PPD Corp., 576 F.2d 759, 764 (8th Cir. 1978).

26. Section 10(b) states:
   It shall be unlawful for any person, directly or indirectly, by use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange —
   (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such
contains the term "manipulation."

Manipulation, when used in federal securities laws, is a "term of art" and should retain the same meaning no matter where it is used in federal securities laws. Thus, Supreme Court interpretations of the term manipulation as it is used within section 10(b) should be equally applicable to the term manipulation when it is used in section 14(e). 27

The Supreme Court has confronted the term "manipulation" under a section 10(b) claim. Ernst & Ernst v. Hochfelder 28 involved a claim alleging that an accounting firm's failure to conduct a prudent audit of a brokerage firm, thereby aiding and abetting a fraudulent action committed by the brokerage firm's president, amounted to a violation of section 10(b) of the securities laws. The Hochfelder Court found no such violation of section 10(b) for deceit, manipulation, or fraud absent the necessary element of scienter. 29 The Court stated manipulation is considered a "term of art" when used in connection with securities transactions, and is used in the Williams Act section 14(e) to prohibit transactions or practices which are intended to mislead investors by artificially affecting market activity. 30

A second case involving manipulation under section 10(b) is Santa Fe Industries v. Green. 31 The Santa Fe Court reemphasized that the scienter element is needed when asserting a claim of "manipulation" under securities laws. 32 Moreover, the Santa Fe Court stated that "nondisclosure is usually essential to the success of a manipulative scheme." 33 Finally, the Santa Fe Court held that an action involving a breach of a fiduciary duty did not state a claim for manipulation under section 10(b), finding that remedies under state laws offered protection from such a breach. 34

Presently, the Supreme Court has analyzed the term manipulation, when dealing with securities laws, only in the context of section 10(b). Nonetheless, because the wording of section 10(b) and section 14(e) is so similar, the analysis used for the term manipulation under section 10(b) should also be applicable to section 14(e). 35 Yet,
one court has deviated from such analysis when applying the term manipulation in section 14(e).\(^{36}\) In Mobil Corp. v. Marathon Oil Co., the court found the transactions between U.S. Steel and Marathon Oil constituted manipulative devices despite the absence of scienter and the presence of full disclosure.\(^{37}\)

**Mobil Corp. v. Marathon Oil Co.**

On October 30, 1981, Mobil Corporation initiated a tender offer with the intent of purchasing up to 40 million shares of common stock in Marathon Oil Co. for $85 per share. The offer was conditioned upon receipt of just over half (at least 30 million) of the outstanding shares. Mobil also announced its intention to obtain the balance of Marathon by merger after the purchase of those shares.

Mobil’s plans caused great concern to the directors of Marathon and resulted in an emergency board meeting.\(^{38}\) The meeting culminated in a decision by the board to seek a favorable bidder or “white knight.”\(^{39}\) On November 18, 1981, after negotiations with several companies, Marathon directors voted to recommend to the shareholders a proposal by U.S. Steel.\(^{40}\)

The U.S. Steel proposal can be divided into two parts. First, U.S. Steel offered to purchase 30 million Marathon shares at $125 per share. The offer, if successful, would be followed by a merger of Marathon with one of U.S. Steel’s subsidiary corporations (U.S.S. Corp.).\(^{41}\) Second, before U.S. Steel would agree to tender such an offer, Marathon would have to (a) grant an irrevocable option to purchase 10 million authorized but unissued Marathon shares at $90 per share, and (b) grant an option to purchase Marathon’s interest in oil and mineral rights in the Yates Field (considered to be Marathon’s most valuable asset or “crown jewel”) for $2.8 billion to be exercised only if U.S. Steel’s tender offer failed and a third party

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14(e) coextensive).

37. Id.
39. “White knight” is used to describe a company which the target feels is a more attractive candidate for merger.
41. Id. U.S. Steel and Marathon entered into a formal merger agreement on that same day, November 18, 1981. Id. at 92,268-69.
was successful in gaining control over Marathon.\textsuperscript{42} The Marathon board of directors accepted this proposal in its entirety and unanimously voted to recommend the proposal to its shareholders.\textsuperscript{43}

Mobil commenced suit in the United States District Court requesting injunctions against the exercise of the two options between U.S. Steel and Marathon, claiming the options violated section 14(e). The district court denied Mobil's request.\textsuperscript{44} The United States Court of Appeals for the Sixth Circuit reversed.\textsuperscript{45}

The Sixth Circuit held the options between U.S. Steel and Marathon represented "manipulative devices" within the meaning of section 14(e) of the Williams Act.\textsuperscript{46} Without disturbing the district court's findings that Marathon directors had not breached any fiduciary duty, the Sixth Circuit defined manipulation as any transaction which "affect[s] the market for, or price of, securities by artificial means, i.e., means unrelated to the natural forces of supply and demand."\textsuperscript{47} By defining manipulation in these terms, the Sixth Circuit ignored the prior Supreme Court definition of manipulation which requires some element of scienter.\textsuperscript{48} The court quoted directly from the two Supreme Court decisions defining manipulation under securities laws,\textsuperscript{49} yet focused solely on the element of "artificially affecting market activity."\textsuperscript{50} The requirement of intent is generally disregarded by the Mobil court. The court found that devices which artificially affect the market are enough to constitute manipulation, even absent intent.

The court held that the two options between Marathon and U.S. Steel artificially affected market activity by creating an artificial price ceiling in the tender offer market for Marathon common shares.\textsuperscript{51} The court analyzed each option separately to determine whether section 14(e) had been violated.

The Mobil court first discussed the legality of the Yates Field option. The court recognized the Yates Field asset, labelled the "crown

\begin{itemize}
\item \textsuperscript{42} Id. at 92,268.
\item \textsuperscript{43} Id.
\item \textsuperscript{44} Id. at 92,286. The district court denied the injunction because of Mobil's failure to demonstrate a strong or substantial likelihood of success on the merits of its claim that U.S. Steel and Marathon had violated section 14(e) of the Williams Act. Id.
\item \textsuperscript{45} Mobil v. Marathon Oil Co., 669 F.2d 366 (6th Cir. 1981).
\item \textsuperscript{46} Id. at 377; see supra notes 14-15 and accompanying text.
\item \textsuperscript{47} 669 F.2d at 374.
\item \textsuperscript{48} See supra notes 28-32 and accompanying text.
\item \textsuperscript{49} "[I]ntentional or willful misconduct designed to deceive or defraud investors by controlling or artificially affecting the price of securities." Ernst & Ernst v. Hochfelder, 425 U.S. 185, 199 (1976) (emphasis added). "The term refers generally to practices . . . that are intended to mislead investors by artificially affecting market activity." Santa Fe Industries v. Green, 430 U.S. 462, 476 (1977) (emphasis added). Cited in Mobil, 669 F.2d at 374.
\item \textsuperscript{50} 669 F.2d at 374.
\item \textsuperscript{51} Id. at 375.
\end{itemize}
jewel” of Marathon, was of enormous value to potential buyers of the company and, without such an asset, Marathon’s attractiveness for takeover diminished greatly. U.S. Steel was effectively deter-
ning other takeover bids by requiring Marathon to grant the option to purchase Marathon’s interest in Yates Field if a third party gained control of Marathon. As a result, U.S. Steel’s bid of $125 per share amounted to an artificial ceiling on the amount Marathon shareholders could expect to receive for their shares. Consequently, the court held the Yates Field option to be manipulative within the meaning of section 14(e).

The stock option was also held to be manipulative within the meaning of section 14(e). The stock option gave U.S. Steel the opportunity to purchase 10 million authorized but unissued Marathon shares at $90 per share, resulting in a decided advantage over other bidders. The court stated that, if the options were exercised, any competing bidder seeking 40 million Marathon shares would have to pay an additional 1.1 to 1.2 billion dollars just to match U.S. Steel’s offer. In other words, any competing tender offeror would have to pay a substantial amount over that which U.S. Steel would have to pay for the same number of shares, resulting in a decided advantage for U.S. Steel. The court found that the stock option had the potential of “artificially and significantly” deterring other possible tender offerors from bidding.

Mobil is a drastic deviation from the recognized use and interpretation of the term manipulation. The Supreme Court has held the term manipulation, when used with securities transactions, involves (1) an element of artificially affecting market activity, and (2) an express element of scienter—the intent to mislead or deceive investors. The Mobil court emphasized that practices which artificially affect market activity are manipulative, ignoring, or at the very least

52. The district court found the Yates Field $2.8 billion option price to be reason-
able. In contrast, the Sixth Circuit noted the value of Yates Field could run as high as $3.639 billion. Id.
53. Id.
54. Id.
55. Id.
56. Id. at 376.
58. Santa Fe, 430 U.S. at 476.
59. Id.
60. Hochfelder, 425 U.S. at 199.
brushing aside, the element of intent, previously stated as essential by the Supreme Court.

By ignoring such an important element of manipulation, the court appears to circumvent both the Supreme Court’s interpretation of manipulation and the purpose of the Williams Act. The Mobil court stated the Williams Act requires that U.S. Steel and all other interested bidders be “permitted an equal opportunity to compete in the marketplace” for Marathon shares. The Mobil court understood the Supreme Court’s interpretation of the Act, as stated in Santa Fe Industries v. Green, to mean that “mere allegations of unfairness and breach of fiduciary duty by majority shareholders to minority shareholders” do not violate section 14(e). The court further noted that nondisclosure is not the only ground on which to base a section 14(e) claim, although it is “usually essential to the success of a manipulative scheme.” Finally, the court stated that full disclosure does not necessarily extinguish a claim based on manipulation.

The Mobil court’s understanding of the Supreme Court’s interpretation appears accurate if the scienter element is retained in the analysis. Unfortunately, the court disregarded scienter and went on to find that, in spite of full disclosure, the claim of no breach of fiduciary duty, and the statute’s tangential concern for fairness, the options demanded by U.S. Steel were manipulative devices under section 14(e) because they artificially affected market forces. Mobil has created confusion over a term which previously had been clearly defined by the Supreme Court.

The Mobil court emphasized the element of artificially affecting the market forces. A careful reading of the court’s opinion, however, reveals a constant thread of implied concern for fairness and/or the fiduciary duties of the directors. The Mobil court stated that after full disclosure, the shareholders “may now understand fully how these options deter any tender offers higher than $125 per share. Yet, they have had no real alternative to accepting the [U.S. Steel]
If the Marathon directors were not breaching their fiduciary duty and if the Williams Act, for the most part, does not look to fairness of the terms, why is the Mobil court trying to get what they perceive as the best deal for the shareholders? The court appears to assume that shareholders have an absolute right to consider all tender offers, or potential tender offers, whether or not the directors think the corporation's best interest would be served. The Mobil court apparently believed it faced a dilemma: should the target corporation be able to undertake any tender offer defenses so long as there is full disclosure, or alternatively to recognize that the shareholders have an absolute right to consider all tender offers thus precluding management from taking action against any tender offers even if such tender offers are clearly not in the best interest of the corporation. Mobil apparently expanded the judicial construction of manipulation to solve this dilemma. In the process, however, the Mobil court appears to have extended the Williams Act beyond its intended purpose.

Impact of Mobil on Takeover Defenses

The Mobil decision speaks to competing bidders, yet will affect the tactical choices of the target. The expansive interpretation the Mobil court has given to "manipulation" may seriously prevent target management from using any effective defense against any tender offer. If indeed any potential defense by a target is prevented, Mobil circumvents the purpose of neutrality engrained in the Williams Act. The Act was never intended to eliminate the defenses used by target management; rather, the purpose is to ensure full disclosure and to allow equal opportunity to both target and bidder to present their cases to shareholders.

In presenting their cases, target and bidder must not intentionally deceive or mislead investors by using devices which artificially affect market forces. Mobil goes beyond this by eliminating the potential use of any devices which artificially affect the market, ignoring the scienter element.

To illustrate, some of target management's most popular defensive

71. Id. at 376-77.
72. See supra note 64.
73. Panter, Matyas & Panter, Why Shareholders Have the Right to Accept Tender Offers, 61 CHI. BAR REC. 368 (May/June 1980).
74. See supra notes 13-14 and accompanying text.
devices, previously considered not manipulative, may, after Mobil, be considered manipulative. Devices such as lock-ups, repurchasing of shares by the target, or target acquisitions creating anti-trust complications for the bidder, may be manipulative devices under a Mobil interpretation.

The lock-up device\textsuperscript{75} has been used with increasing frequency by target managements to defend against hostile takeovers. The Mobil court reviewed the lock-up defense and found it manipulative and violative of section 14(e). Under the Supreme Court interpretation of manipulation, the lock-up defense would not be in violation of section 14(e) so long as full disclosure occurred and no intent to deceive was present.

Another defense used by target corporations is to repurchase their own shares.\textsuperscript{76} Several purposes may be sought by this defense. First, the target may wish to increase the percentage of shares held by a control group, which it knows to be friendly, to a point which would defeat the hostile bidder.\textsuperscript{77} Second, the target may thwart the hostile bid by increasing the price of the shares, causing the bidder to raise its bid beyond that which it is willing or able to pay.\textsuperscript{78} Third, the target may buy up shares from a “weak” or dissident block of shareholders who may have been persuaded to tender their shares rather easily.\textsuperscript{79} Finally, the target may settle with the hostile bidder by offering to repurchase the bidder’s outstanding target shares, usually at a large profit to the bidder.\textsuperscript{80}

The target’s repurchase of shares, according to Mobil, may fall within the definition of manipulation. Enhancing the strength of an existing control group to deter tender offers would artificially affect market forces and would therefore be manipulative according to the court.\textsuperscript{81} A large percentage of shares held by a control group would effectively decrease the demand for takeover by bidders. Thus, a bidder may be willing to offer a premium over the market price, but will decide against the offer because of the futility of gaining control

\textsuperscript{75} A “lock up” typically involves the sale of, or grant of, an option to purchase stock or capital assets of the target corporation to the white knight (preferred suitor) tender offeror and is intended to give the preferred suitor a substantial competitive advantage over other potential acquirers. Nathan, \textit{Lock-ups and Leg-ups: The Search for Security in the Acquisitions Marketplace}, 13 ANN. INST. ON SEC. REG. 13, 69-70 (1981).

\textsuperscript{76} Stock repurchases may also be used as a mere business decision or as a preventive measure to takeovers. Nathan & Sobel, \textit{Corporate Stock Repurchases in the Context of Unsolicited Takeover Bids}, 35 BUS. LAW. 1545 (1980). This Comment will focus solely on stock repurchases used as a defense to imminent or pending hostile takeovers.

\textsuperscript{77} Id. at 1557.

\textsuperscript{78} Id.

\textsuperscript{79} Id.

\textsuperscript{80} Id.

\textsuperscript{81} \textit{Mobil}, 669 F.2d at 374.
from the control group. The repurchase could very easily be seen as artificially driving demand for a takeover downward.

Repurchasing shares to increase the price beyond that which the hostile bidder is willing or able to pay may also be manipulative. Again, the target will be creating a false demand in the market by repurchasing shares, reflected by the increase in market price. This type of defense might well fall within both the Supreme Court's definition of manipulation (i.e., an intent to mislead or deceive investors) and the Mobil definition.

Repurchasing shares from a dissident or weak block of shareholders is a purely negative defense. By itself, the repurchase will not defeat a hostile tender offer, it will merely make the first step of acquisition that much more difficult. The artificial effect is not as clear with this defense, although neither is the actual use of such a weak defense to fight tender offers. Any finding of manipulation from artificially affecting market forces would again come from falsely affecting demand upward. However, such a finding would be less likely as a result in this tender defense.

Settling with the bidder by offering to purchase the already acquired shares at a handsome profit to the bidder, artificially affects the market forces by removing demand which the target deems hostile. By removing hostile demand, the target has artificially decreased total demand through payoffs. The decrease in demand would then result in an artificial decrease in the price. The payoffs might well be considered artificial and therefore manipulative under Mobil.

Finally, the target may thwart a hostile takeover by seeking a defensive acquisition of a company for the purpose of erecting an antitrust obstacle to the bidder. A subsequent takeover by the bidder might result in anticompetitive or monopolistic violations of the Clayton Act. The bidder, however, may dispose of the antitrust al-

82. The target must, however, be aware that the bidder may have a much stronger financial capacity. The target must also comply with any debt/equity ratio requirements. Nathan & Sobel, supra note 76, at 1558.

83. See supra notes 28-30 and accompanying text. If the target intends to raise the price of shares by the repurchase, then the act may well fall within the Supreme Court's definition of manipulation.

84. Nathan & Sobel, supra note 76, at 1563. The repurchase may be a “pyrrhic victory” since it may ultimately save the hostile bidder money.


86. Section 7 of the Clayton Act prohibits the takeover of one corporation by another if that takeover would tend to cause a monopoly or substantially lessen competition.
legation by agreeing to divest itself of the competing line of business once the takeover is complete.  

The antitrust acquisition by the target may also be prohibited under Mobil's definition of manipulation. The target, through the acquisition, would artificially affect the market forces by eradicating demand from, theoretically, an entire industry, i.e., that industry which would be precluded from takeover by the Clayton Act.  

Consequently, the effect of Mobil on tender offer defenses such as lock-ups, repurchasing of shares, and antitrust acquisitions may be disastrous. Mobil potentially possesses broad implications which would ultimately leave a target corporation defenseless when confronted with a hostile tender offer. The Williams Act was carefully drafted to evince a role of neutrality between a bidder and target. The Mobil interpretation would circumvent this purpose of neutrality by leaving the target defenseless.  

The Williams Act was passed when defenses to tender offers by target corporations were known to the drafters. Nevertheless, the Act does not explicitly limit or restrict any defensive maneuvers a target may take; rather, the goal of neutrality is expounded. The legislature, urging neutrality, does not wish to leave the target defenseless, as Mobil would, but wishes to allow both bidder and target to present equally their cases to the shareholders. If the target defends against the takeover, the shareholders must rely on their directors' proper business judgment that the takeover was not in their best interest. By removing the target defenses, the court forces shareholders to rely solely on conflicting disclosures of both the target and the bidder, both usually very persuasive. The average shareholder may rely on the target management's assessment that the takeover is not in the best interest of the corporation. On the other hand, the "smell" of money from the bidder may interfere with the shareholders' rational business decision-making process.  

To be sure, money currently tendered is a main factor in making a business decision; however, with the biased view of the bidder, the tendering of shares may not be in the best interest of the corporation and the shareholders, especially in light of the target's resistance. As a result, the Mobil interpretation of manipulation would leave the target defenseless in the face of hostile tender offers creating a strong possibility that the best long-term interests of the corporation

88. The target must also be aware of breaching any fiduciary duty, as well as scienter under section 14(e), when acquiring a company solely for the purpose of creating antitrust complications for a hostile bidder.
89. See supra notes 13-14 and accompanying text.
90. See infra notes 96 and 98 and accompanying text.
and shareholders would be damaged.

**Conflict of Interest Considered in Mobil Decision**

The possibility that the best interests of the shareholders would be in jeopardy also arises when target management defends against a hostile tender offer. When a hostile takeover occurs, there is a strong likelihood the incumbent directors will lose their positions. Consequently, target directors desire to defend against the hostile takeover to retain their jobs. The director’s duty is to act in the shareholders’ best interest and not in his own best interest. The defense of a hostile tender offer, however, creates a conflict of interest between the interests of the shareholders and those of the director.

The *Mobil* court was confronted with the dilemma of whether to allow shareholders the absolute right to consider a tender offer or to allow the target directors to use any defense against a tender offer (realizing the target directors’ conflict of interest) if full disclosure was present and intent to deceive was absent. The *Mobil* court, although never expressly stating it, seemed concerned with the conflict of interest and the potential damage to shareholders. The court seemed to recognize the problem, yet dealt with it in a manner which strained the statutory language. *Mobil* tortured the meaning of manipulation under section 14(e) to protect shareholders and simultaneously eliminated the inherent conflict of interest.

This conflict of interest is not addressed by section 14(e) (although *Mobil* tried its best to make section 14(e) address it), but is generally governed by the business judgment rule followed under most states’ law. The business judgment rule retains a strong presumption that corporate directors have acted in good faith, and protects directors’ decisions so long as a valid business purpose underlies those decisions. The heavy burden to overcome the business judgment rule renders the rule virtually powerless to combat the conflict of interest inherent in defenses to tender offers.

The unique problem of a conflict of interest inherent in tender offers...

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91. The hostile bidder will more than likely replace the old directors with its own.
94. *See infra* note 96 and accompanying text.
fer defenses is not adequately dealt with by the state's business judgment rule and requires federal legislation to resolve the problem. The main concern of this conflict of interest is shareholder protection which is also one of the main concerns of the Williams Act. An amendment to the Williams Act authorizing the Securities Exchange Commission (SEC) to formulate rules dealing specifically with tender offer defenses and the inherent conflict of interest would promote shareholder protection and counteract the conflict of interest.

The SEC should take care to initiate rules consistent with the federal scheme of the Williams Act—shareholder protection and neutrality between the target and bidder corporation through full and fair disclosure. The amendment, however, should allow the SEC a certain amount of flexibility due to the uniqueness of the problem. The SEC must be able to formulate requirements that insure, to the greatest degree possible, that the defensive actions of the directors are in the best interest of the shareholders. The requirements, however, must not go so far as to fully usurp the directors' business discretion or to unduly burden the target's defensive tactics.

Keeping these factors in mind, the SEC rule should require the target corporation to file with the SEC a business purpose, which is in the best interest of the shareholders, for defending against a tender offer. To insure that the directors have not merely fabricated this business purpose, sufficient information substantiating their claim must be submitted. This information may consist of either the detrimental effects the hostile bidder may have on the target or the greater beneficial effects of the defensive action or both.

This requirement is consistent with the Williams Act's purpose of shareholder protection and neutrality between the target and bidder through full and fair disclosure. The filing requirement will protect the shareholders by informing them of why their directors are defending against the takeover. In effect, the shareholders will not have to sit back and watch as the directors fight the tender offer, but instead will be informed as to the underlying goals of the directors. This will enable the shareholders to better scrutinize the actions of the directors and will also provide an action for fraud against the directors if the shareholders can prove the directors lied.

Neutrality will also not be unduly interfered with by this filing requirement. The filing does not place any more of a burden on the target than any other federal securities regulation which requires informational filings. The filing is one more step in insuring full and fair disclosure while simultaneously combating the conflict of

96. See supra notes 11-15 and accompanying text.
97. Id.
interest.

This rule does not, nor does any other rule which allows target directors to defend a hostile takeover, totally extinguish the conflict of interest. It does, however, confront the problem and alleviate it to a much greater degree than either the business judgment rule or section 14(e). The rule is also a much better remedy for the conflict of interest than the strained interpretation *Mobil* bestowed on the term manipulation.

**CONCLUSION**

The purpose of the Williams Act as interpreted by the Supreme Court, is one of shareholder protection and of regulatory neutrality between the target and bidder. The Act furthers full and fair disclosure by allowing the target and bidder to present their cases equally.

Section 14(e) of the Act prohibits manipulative acts concerning any tender offer. The Supreme Court has recognized that manipulation when used with securities is a term of art, and requires the intent to mislead investors by artificially affecting the market. The *Mobil* decision drastically deviates from the Supreme Court’s requirement of intent.

Although *Mobil* misreads or disregards the requirements for a claim of manipulation, the court recognized the inherent conflict of interests for target management when defending against takeovers. Unfortunately, the court strains the language of section 14(e) attempting to resolve this conflict of interest. Section 14(e) was not meant to resolve this problem.

The business judgment rule, with its strong presumption of good faith on the part of the directors, is also inadequate to address the conflict of interest inherent in tender offer defenses. The presumption is an almost insurmountable barrier to any challenge of a director’s business judgment.

The inadequacy of both the business judgment rule and section 14(e) requires that federal legislation specifically dealing with this conflict of interest be passed. The legislation should require the target directors to file with the SEC their purpose, along with sufficient information backing this purpose, for defending against a tender offer. This avoids the barriers of the business judgment rule, while still allowing target directors immunity for valid business judgments, all in the best interest of the shareholders.

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