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Hostile Takeover Defenses in the Face of the Business Judgment Rule

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Scope

This guide provides an overview of defensive maneuvers to hostile takeovers. This guide consists of cases, secondary materials and relevant resources. It aims to give the researcher a starting point when researching the validity of takeover measures, despite a board of directors fiduciary obligations.

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Overview

This research guide attempts to guide the researcher on the path of legally fending off unwanted corporate takeovers. While most corporate takeovers are friendly, publicly held corporations can be taken over when the buyer directly makes an offer to the shareholders over the objection of corporate management. Normally, once the buyer has over 50% of the shares, he has the right to control the company. There are 3 ways in which a suitor can directly entice shareholders to hand over their shares:

Tender Offers- A tender offer is an offer to buy the shares of a target company. Often, the offer is subject to the buyer receiving a minimum or maximum amount of shares from the sole seller or a group of sellers. This is to ensure that a certain number of shares are sold so that the buyer has adequate control of the company.

Proxy contests- “The most expensive, the most uncertain, and the least used of the various techniques”.- Mergers and Acquisitions 2nd Ed. Stephen M. Bainbridge Foundation press 2009. A proxy is an assignment of the right to vote. A shareholder can assign this right vote to any person they wish. However, a proxy is not a vote itself. It is simply authorization for someone to vote on your behalf. In a proxy contest, the suitor will gain control but not ownership, as this is merely a chance to vote for a slate of directors.

Combined proxy contest and tender offers- The suitor can solicit proxies with a promise of a tender offer to follow in the event that they succeed in their vote.

A board can defend itself from a hostile takeover. While in many instances, a board must allow a takeover to take place, there are certain defenses and defense mechanisms that can be used. This guide will serve as an exploration of these defense mechanisms.

Corporate managers have certain duties to their shareholders. They must act in the best interest of the corporation and not their own personal interests. Because any defense to a takeover usually involve management keeping their respective positions, the courts have struggled to balance these competing interests.

Takeover Defenses

Crown Jewel Sale- Defense where target company has particular line of business that the acquirer wants. To prevent the takeover, the target company simply disposes of the sought after line.

White Knight-The target company finds a buyer on their own. One that will run the company in a manner agreed to by management.

Pac Man-The Target corporation will attempt to buy the suitor.

Golden Parachutes- Management inserts a clause allowing for extremely large severance payments that the target company agrees to pay senior management in event of a takeover.

Poison Pill- This is a common takeover defense mechanism that makes the target unattractive to attain by inserting a clause which is activated when a takeover begins to occur.

Stand-Still Agreements- An agreement between target and suitor that the buyer will not continue to acquire shares to give time to target and provide for negotiation.

No-Shop Provision- Target agrees that they will not attempt to deal with another suitor in exchange for a favorable agreement of some sort.

Lock-Up Agreement- An agreement to sell a particular asset to a white-knight to keep it out of reach of the corporate suitor.

About the Author

Haniyah Miller is currently a third-year law student, graduating in the class of 2011. She focuses on business law. She is currently an intern to the CEO of Metropolitan Atlanta Rapid Transit Authority and the Editor-in-Chief of the Southern Region Black Law Student Association Law Journal. Haniyah also has interned as a clerk for Justice Robert Benham of the Georgia Supreme Court.

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Primary Sources

Legislation

The Securities Exchange Commission regulates tender offers, which is the primary way that a company is taken over. Thus, in order to understand Merger and Acquisitions and takeover defenses, one must be familiar with securities regulation. The following are acts that affect disclosure of tender offers.

Securities Act of 1933, 14 U.S.C.S. § 77(a) (1933).

In an effort to prevent another crash, this act was enacted after the stock market crash of 1929. The two primary goals of the act are 1) mandating disclosure of material info to investors and 2) preventing fraud. The act requires certain disclosures when the sale of securities is at issue. Because tender offers involve securities, they are governed by this act.

Securities Exchange Act of 1934, 14 U.S.C.S. § 78(a) (1934).

The first amendment to the act of 1933. This extended the act to cover secondary markets, while allowing for certain extensions. This act called for disclosure statements to be filed regularly and kept on file with the Securities Exchange Commission.

Willams Act of 1968, 14 U.S.C.S. § 78(a) (1968).

One of the most important amendments to the act of 1934 because it requires any person who makes an offeror a cash-tender offer to purchase the stock of a corporation that is required to be registered under federal law, to disclose the following: the source of the funds used in the offer, the purpose for which the offer is made, the plans the purchaser might have if successful, and any contracts or understandings concerning the target corporation to the SEC. This prevents sneak attack takeovers.

Rules and Regulations

17.C.F.R. § 200

This set of Federal Regulations govern Securities and exchanges.

23 Fed. Proc., L. Ed. § 54:190. Anticompetitive mergers and acquisitions—Standing of target of corporate takeover.

While the prevailing rule appears to be that the target of a corporate takeover has no standing to bring antitrust claims against the tender offeror, Second Circuit law grants standing to the target of a hostile takeover on the basis that an alleged loss of the ability to compete independently constitutes antitrust injury, even if the target alleges only a loss of potential competition.

Cases

The Following cases are key to the development of takeover defenses. Please note that Delaware is home to many corporations and much business law has originated in their courts. Other states often look to Delaware law when making decisions. Note: because each of the following cases builds upon the other, they are listed in reverse chronological order.

Cheff v. Mathes, 41 Del. Ch. 494, 199 A.2d 548 (1964).

Maremount proposed a merger between itself and Holland Furnace. Maremount was a rival company, which had a reputation for buying companies and then liquidating them for profit. They began buying shares from Holland Furnace. After Holland refused to sell, they began buying back the company stock on the market. Eventually, the board of Holland decides to repurchase its own shares from Maremount at a price significantly higher than the prevailing market price. Minority shareholders brought a derivative action. The court held that if a company reasonably believes that buying out a stockholder is necessary to run an effective business, then the board will not be liable, even if the outcome is bad.

Smith v. Van Gorkom, 488 A.2d 858 (Del. 1985).

This is perhaps one of the most important cases in corporate law because it is the case that established the business judgment rule. This rule presumes that, when directors make business decisions on an informed basis and in good faith, they are acting in the best interest of the company and a court will presume that their decisions are valid.

Unocal Corp. v. Mesa Petroleum co., 493 A.2d 946 (Del. 1985).

Mesa owned thirteen percent of Unocal stock. They made a hostile tender offer to purchase enough stock to become the majority owner. Unocal's board decided to use company funds to purchase its own shares to prevent Mesa's control. Thus, they rejected Mesa's offer and proceeded to purchase their own shares. Mesa challenged this arguing that Unocal breached a fiduciary duty it owed to its shareholders. The court held that Unocal's actions were protected by the business judgment rule as the decision had a rational purpose.

Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., (506 A.2d 173 (Del. 1985).

A suitor attempting to purchase Revlon brought suit in this action. Another company attempted to bid for Revlon as well, thus the sale of Revlon was unavoidable. Revlon approved a leverage buyout whereby the company would be broken up. The court held that although Delaware law permits agreements and takeover defenses, the defenses may not cause a breach of the fiduciary duty owed to shareholders. Once a sale appears inevitable, the target must shift from being defensive to seeking to maximize the company's value to ensure the highest price.

Paramount Communications, Inc. v. Time Inc., 571 A.2d 1140 (Del. 1989).

Time was in negotiations with Warner for a stock for stock purchase. Paramount decided to offer Time a large amount for its stock, in fact larger than that of Warner's offer. Time refused Paramount's offer and Paramount filed suit. The court held that if a board is pursuing a merger for strategic reasons and a higher offer is made, the board has the right to decline the higher offer. Time felt that the merger would yield a higher long term return whereas the purchase by Paramount would yield only a short term gain and not retain the company culture, the court agreed.

Paramount Communications Inc. v. QVC Network, Inc., 637 A.2d 34 (Del. 1994).

Paramount entered merger talks with Viacom to thwart an unsolicited tender offer by QVC to buy Paramount. Paramount approved a merger that would turn Paramount stock into Viacom stock and exempted the merger from its poison pills put into place. The two agreed to a no shop clause preventing Paramount from negotiating with any other prospective buyers. Pricing wars continued for the 2 competing suitors. QVC brought sought. The court held that a board selling its company has a duty to obtain the best price for its shareholders and cannot give preference to one bidder over another.

Broz. v. Cellular Info. Sys., Inc., 673 A.2d 148 (Del. 1996).

The court held that a fiduciary must place the corporation interest before his own interest.

In re Pure Resources, Inc., Shareholders Litigation, 808 A.2d 421 (Del. Ch. 2002).

This court reiterated a long standing presumption that "a majority stockholder owes a duty to permit the independent directors on the target board of directors both free rein and adequate time to react to an acquisition tender offer".

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Secondary Sources

Definitions

All definitions located in: Black's Law Dictionary, (9th ed. 2009), located at www.westlaw.com

Takeover- The acquisition of ownership or control of a corporation.

Friendly takeover- A takeover that is approved by the target corporation.

Hostile takeover- A takeover that is resisted by the target corporation.

Acquisition- The gaining of possession or control over something <acquisition of the target company's assets.

Antitakeover measure- A provision in a company's organizational documents intended to discourage unwanted takeover bids by setting forth the actions the company may take, as a target, to avoid an involuntary takeover.

Freezout- A transaction in which a shareholder or group of shareholders obtains the entire common-equity interest in a company while the other shareholders receive cash, debt, or preferred stock in exchange for their common-equity shares.

Stock- The capital or principal fund raised by a corporation through subscribers' contributions or the sale of shares.

Merger- The act or an instance of combining or uniting.

Bust-up merger- A merger in which the acquiring corporation sells off lines of business owned by the target corporation to repay the loans used in the acquisition.

cash merger. A merger in which shareholders of the target company must accept cash for their shares.

DeFacto merger- A transaction that has the economic effect of a statutory merger but that is cast in the form of an acquisition or sale of assets or voting stock.

Horizontal merger- A merger between two or more businesses that are on the same market level because they manufacture similar products in the same geographic region; a merger of direct competitors.

Reverse triangular merger- A merger in which the acquiring corporation's subsidiary is absorbed into the target corporation, which becomes a new subsidiary of the acquiring corporation.

Triangular merger- A merger in which the target corporation is absorbed into the acquiring corporation's subsidiary, with the target's shareholders receiving stock in the parent corporation.

Legal Forms

6A. Am. Jur. Legal Forms 2d, Corporations §§ 74:1361- 74:1378.

6A. Am. Jur. Legal Forms 2d, Corporations §§ 74:2261- 74:228.

7A. Am. Jur. Pleading and Practice Forms, Corporations, Forms 318, 319, 324, 335, 401-425.

Law Review Articles

Because of the big boom of hostile takeovers in the 80's many scholarly articles were written in that time period. While they may be dated, they are still applicable. These early articles explored the early ethical conflicts of fiduciary duties.

Mark Gordon, *Takeover Defenses Work. Is That Such a Bad Thing?*, 55 STAN. L. REV 819 (2010).

Many have debated the effectiveness of takeover defenses to thwart hostile takeovers. Gordon not only argues that they work, but he also dives into the implications of their effectiveness on fiduciary duties.

John C. Coates IV, *Takeover Defenses in the Shadow of the Pill: A Critique of the Scientific Evidence*, 79 TEX. L. REV. 271, 287-88 (2000).

This article critiques and deciphers scientific studies that prove and disprove the effectiveness of poison pill plans.

Lucian Arye Bebchuk, John C. Coates IV & Guhan Subramanian, *The Powerful Antitakeover Force of Staggered Boards: Theory, Evidence, and Policy*, 54 STAN. L. REV. 887 (2002).

Staggered boards are a poison pill defense. When a board's terms are staggered, it is difficult to replace them, thereby gaining the majority vote. This note focuses on this specific defense tactic.

Martin M. Cohen, *Poison Pills as a Negotiating Tool: Seeking a Cease-Fire in the Corporate Takeover Wars*, 1987 COLUM. BUS. L. REV. 459 (1987).

This note focuses on one type of defense, poison pills. The author focuses on how poison pills can not only be used to thwart takeovers, but how they can be used to leverage a non-hostile takeover or one that is inevitable.

Frank H. Easterbrook & Daniel R. Fischel, *The Proper Role of a Target's Management in Responding to a Tender Offer*, 94 HARV. L. REV. 1161 (1981).

This note explores the fiduciary duty that a board owes to its shareholders. The duty that a board has once a "Revlon moment" has arisen is often in conflict with the board's self interest to protect their reign. This note explores these conflicts.

Ronald J. Gilson, *A Structural Approach to Corporations: The Case Against Defensive Tactics in Tender Offers*, 33 STAN. L. REV. 819 (1981).

This note provides a look at the negative affects of takeover defenses and why they should not be allowed.

Martin Lipton, *Takeover Bids in the Target's Boardroom*, 35 BUS. LAW. 101, 130 (1979).

This note explores the board's duties once bidding wars have begun.

Books

The following books offer insight into how hostile takeovers are performed and defensive measures and their effectiveness.

- **Dethroning the King: The Hostile Takeover of Anheuser-Busch, an American Icon** by Julie MacIntosh
ISBN: 0470592702 How one of America's most beloved corporations was taken over by a foreign conglomerate.
- **Pack Your Own Parachute: How to Survive Mergers, Takeovers, and Other Corporate Disasters** by Paul Hirsch
ISBN: 0201122057 This book explores defense mechanisms in depth and their usefulness in the event of a hostile takeover.
- **Takeover Defense, Mergers and Acquisitions** by Arthur Fleischer, Jr., Alexander R. Sussman
Call Number: Call Number: Online Resource (WLX Treatises) PubDate: 2007
ISBN: 0735594147 This is the Mergers and Acquisitions Attorney's handbook. Everything you'd want or need to know about Mergers is in this set.
- **Resisting Hostile Takeovers: The Case of Gillette by Jr., Arthur Fleischer, Alexander R. Sussman**
ISBN: 0275958302 This book explores the defense measures Gillette Inc. took to resist a hostile takeover.
- **Knights, Raiders, and Targets: The Impact of the Hostile Takeover** by John C. Coffee (Editor), Louis Lowenstein (Editor), Susan Rose-Ackerman (Editor)
Call Number: Call Number: HD2746.5 .K58 1987 PubDate: 1987
ISBN: 0195044045 Once a takeover becomes inevitable, how will a company be affected? This book seeks to answer this question.
- **Gods at War: Shotgun Takeovers, Government by Deal, and the Private Equity Implosion** by Steven M. David
Call Number: Call Number: HG4028.M4 D38 2009 PubDate: 2009
ISBN: 0470431296 Analyzes the legal issues, the politics, and the players in high-profile merger and acquisition transactions.
- **Securities regulation : hostile corporate takeovers, synopses of thirty-two attempts : fact sheet for the Chairman, Subcommittee on Oversight and Investigations, Committee on Energy and Commerce, House of Representatives** by Washington, D.C., The Office
Call Number: Call Number: GA 1.13:GGD-88-48 FS PubDate: 1988 Located: Library North 1, Government Document Micro

Encyclopedia and Dictionaries

69 Am. Jur. 2d Securities Regulation- Federal § 60 (2010).

18A Am. Jur. 2d Corporations § 1 (2010).

18B Am. Jur. 2d Corporations, Extent of judicial intervention—Circumstances requiring enhanced judicial scrutiny; defensive measures § 1477 (2010).

Donnan Mandell, **THE DEALMAKER'S DICTIONARY OF MERGER AND ACQUISITION TERMINOLOGY** (Business Publications) (1985).

Treatises

Timothy J. Galpin, Mark Herndon, The Complete Guide to Mergers and Acquisitions : Process Tools to Support M&A Integration at Every Level (Jossey-Bass Publishers 2000).

This treatise focuses on mergers and acquisitions and how they can be smoothly effectuated.

Cases in Corporate Acquisitions, Buyouts, Mergers, & Takeovers. (Gale Group 1999).

A collection of case studies on "high profile" corporate acquisitions, buyouts, mergers, and takeovers from 1868 to early 2000.

Donald Wolfe, Jr. and Michael Pittenger, Wolfe and Pittenger on Revlon, Inc. and New Standard of Judicial Review, 2008 Emerging issues 1934 (2008).

The authors conclude that Revlon has established a new standard of review. The standard of review is no longer reviewed according to the business judgment rule, but will be scrutinized for reasonableness in relation to the obligation and fiduciary responsibility to maximize the price.

American Law Reports

Lockup Option Defense to Hostile Corporate Takeover, 66 A.L.R.4th 180 (1988).

This annotation collects and discusses the state and federal cases in which the courts have considered the propriety of the use of the "lockup option" as a defense to a hostile or unfriendly, unsolicited corporate takeover, whereby the targeted corporation grants one potential suitor an option to purchase treasury or unissued corporate shares or a major asset of the corporation.

Construction and Application of State Antitakeover Statutes, 37 A.L.R.6th 1 (2008).

This annotation collects and analyzes the cases in which courts have considered and determined issues relating to the construction and application of state antitakeover statutes.

Duty of Corporate Directors to Exercise "informed" Judgment in Recommending Responses to Merger or Tender Offers, 46 A.L.R.4th 887 (1986).

This annotation collects and analyzes the state and federal cases which discuss the duty of corporate directors, under state law, to exercise informed judgment in recommending responses to merger or tender offers.

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Interest Groups, Associations, and Misc. Materials

Government Agencies

Federal Trade Commission. Bureau of Competition. Mergers & Acquisitions

<http://www.ftc.gov/bc/mergers.shtml>

Justice Department, Antitrust Division

<http://www.usdoj.gov/atr/>

Securities Exchange Commission

<http://www.sec.gov/>

EDGAR, the Electronic Data Gathering, Analysis, and Retrieval system

<http://www.sec.gov/edgar.shtml>

Performs automated collection, validation, indexing, acceptance, and forwarding of submissions by companies and others who are required by law to file forms with the U.S. Securities and Exchange Commission (SEC).

Interest Groups

Investor Responsibility Research Center Institute (IRRC)

A leading funder of research on corporate responsibility and investing. This organization funds objective research focused on corporate governance and responsibility. The research is broadly available to investors, policymakers, and interested stakeholders to help foster informed, fact-based decisions.

Ellen Terrell, Library of Congress, Business Reference Section, LIBRARY OF CONGRESS: MERGERS, ACQUISITIONS, AND JOINT VENTURES (2003), <http://www.loc.gov/rr/business/mergers/mergers.html>

The Library of Congress has collected resources that aid in research on mergers, acquisitions, and joint ventures.

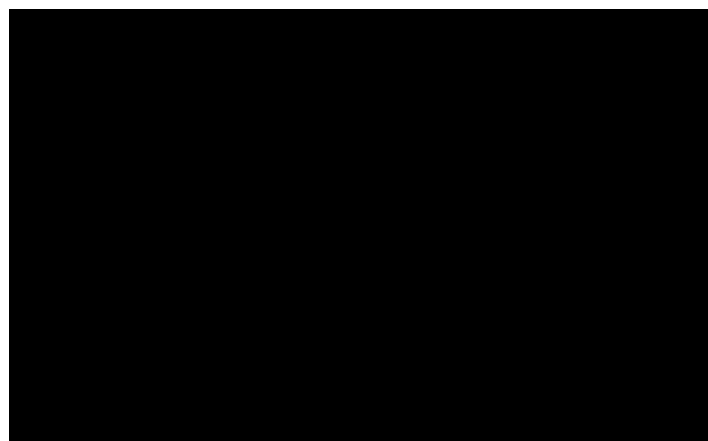
The Widener Institute of Delaware Corporate and Business Law <http://blogs.law.widener.edu/delcorp/> This website is dedicated to Delaware corporate law and covers cases and studies. They also publish the Delaware Journal of Corporate Law.

Lionsgate v. Carl Icahn

Lionsgate Vice President discusses a current takeover attempt by Carl Icahn, a well known corporate raider. In this clip we see his unwillingness to be taken-over and how he feels his shareholders will vote. He also discusses the impact of the offer on stock prices of this media corporation.

Mintz Levin- Takeover Preparation

Mintz Levin is a well known financial advisor and attorney. In this clip, he discusses how a company can prepare for an inevitable hostile bid.



[Inside The Deal: Mintz Levin's Gulotta on Takeover Bid Prepar... - Watch the best video clips here](#)

Bar Association

The American Bar Association, business section has drafted the Model Code Business Act. The act is a model set of laws that 24 states has adopted that seeks to bring consistency to the field of corporate law. The official text can be found at www.abanet.org/buslaw/library/onlinepublications/mbca2002.pdf

The ABA business law section lobbies for changes in business law. They also host various conferences and courses to assist business lawyers.

Blogs and Websites

- Business Week blog
<http://bx.businessweek.com/mergers-and-acquisitions/blogs/>
This blog attempts to keep you up to date with the legal area of Mergers.
- CNN Money
<http://money.cnn.com/news/deals/mergers/biggest.html>
CNN Money has blogs on various topics dealing with finances and corporations.
- Merger Network
<http://www.mergernetwork.com/>
This website lists businesses for sale or those seeking mergers or "white knights".
- American Bar Association Business Section
<http://www.abanet.org/buslaw/blt/>
The American Bar Association business section is instrumental in forging business law throughout the country.
- Key Delaware Key Summaries
<http://www.delawarebusinesslitigation.com/articles/case-summaries/>
This website is owned by a corporate firm. They discuss and analyze key cases in corporate law from Delaware courts.
- The Harvard Law School Forum on Corporate Governance and Financial Regulation
<http://blogs.law.harvard.edu/corpgov/welcome/>
The website states: "The Forum provides updates on working papers, seminars, speakers, and other activities sponsored by the Program. The Forum also features communications about corporate governance and financial regulation by individuals associated with the Program — faculty, fellows, and members of the Program's advisory board — as well as by guest contributors and others."

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