

October 1984

The Legality of Lock-Ups Under Section 14(e) of the Williams Act: Balancing the Scales

Bradley A. Maxa

Follow this and additional works at: <https://scholarship.law.wm.edu/wmlr>



Part of the [Law Commons](#)

Repository Citation

Bradley A. Maxa, *The Legality of Lock-Ups Under Section 14(e) of the Williams Act: Balancing the Scales*, 26 Wm. & Mary L. Rev. 115 (1984), <https://scholarship.law.wm.edu/wmlr/vol26/iss1/8>

NOTES

THE LEGALITY OF LOCK-UPS UNDER SECTION 14(E) OF THE WILLIAMS ACT: BALANCING THE SCALES

Corporate acquisitions through cash tender offers have become increasingly popular in recent years.¹ Tender offers enable potential buyers to bargain directly with the target corporation's stockholders, with or without management approval, in an attempt to gain a controlling interest.² Target managements have responded aggressively to hostile takeover bids. Companies faced with hostile tender offers have developed sophisticated tactics to defeat them.³ The most popular defense is the "lock-up," an amicable arrangement between the target and another corporation that gives the friendly corporation a competitive advantage over the hostile tender offeror in a bidding contest for the target's stock.⁴

Management traditionally has enjoyed wide latitude in employing such tactics under state fiduciary laws.⁵ Its discretion, however,

1. See Prentice, *Target Board Abuse of Defensive Tactics: Can Federal Law Be Mobilized to Overcome the Business Judgment Rule?*, 8 J. CORP. LAW 337 (1983).

2. Comment, *Tender Offers, Lock-ups and the Williams Act: A Critical Analysis of Mobil Corp. v. Marathon Oil Co.*, 21 DUQ. L. REV. 669, 672 (1983).

3. See Lynch & Steinberg, *The Legitimacy of Defensive Tactics in Tender Offers*, 64 CORNELL L. REV. 901, 901-02 (1974); Prentice, *supra* note 1, at 339-43.

4. Fraidin & Franco, *Lock-up Arrangements*, 14 REV. SEC. REG. 821, 821 (1981).

5. State corporate law generally employs one of two approaches in examining the scope of management's fiduciary duties. The "business judgment rule" states that a director who exercises his good faith business judgment in choosing a particular course of action will not be liable even if that judgment is faulty. Courts presume that management has acted properly and in good faith in matters requiring business judgment. Arsh, *The Business Judgment Rule Revisited*, 8 HOFSTRA L. REV. 93, 111-12 (1979); Note, *Lock-up Options: Toward a State Law Standard*, 96 HARV. L. REV. 1068, 1076-77 (1983). The "primary purpose test," used by the Delaware courts, requires management to demonstrate that the primary purpose of the challenged action was to further the corporation's interests. See, e.g., *Bennett v. Propp*, 41 Del. 14, 22, 187 A.2d 405, 409 (1962). Neither standard provides a serious obstacle to a corporation opposing a takeover bid. See *Treadway Companies, Inc. v. Care Corp.*, 638 F.2d 357, 382-84 (2d Cir. 1980) (approving management's behavior in a takeover contest under the business judgment rule); *Cheff v. Mathes*, 41 Del. 494, 199 A.2d 548 (1964) (allowing, under the primary purpose test, management to repurchase shares to thwart a takeover attempt).

is narrower under federal law. Section 14(e) of the Williams Act⁶ provides that "[i]t shall be unlawful for any person . . . to engage in any fraudulent, deceptive or manipulative acts or practices, in connection with any tender offer. . . ." The definition of "manipulative acts" under section 14(e) governs the extent to which federal securities law restricts management's use of defensive maneuvers to resist tender offers.

In *Mobil Corp. v. Marathon Oil Co.*,⁸ the United States Court of Appeals for the Sixth Circuit became one of the first courts to question seriously the legality of defensive tactics under section 14(e).⁹ In a widely criticized opinion,¹⁰ the court held that certain lock-up arrangements were "manipulative acts" prohibited by the Williams Act.¹¹ Since *Mobil*, courts have struggled to characterize manipulation in the contested takeover bid context. This struggle has produced confusion. Nearly three years after *Mobil*, no consensus exists regarding the scope of manipulative behavior under section 14(e).¹²

This Note discusses the proper standard for determining whether lock-ups and other defenses to hostile tender offers are

6. Williams Act of 1968, Pub. L. 90-439, 82 Stat. 454 (1968). The Williams Act provides comprehensive regulation of the tender offer process. Congress enacted the Act in 1968 primarily to protect the target shareholder's interests. See *infra* text accompanying notes 83-86. The act added § 13(d)-(e), 15 U.S.C. 78m(d)-(e) (1982) and § 14 (d)-(f), 15 U.S.C. § 78n(d)-(f) (1982) to the Securities Exchange Act of 1934.

7. 15 U.S.C. § 78n(e) (1982).

8. 669 F.2d 366 (6th Cir. 1981).

9. Some courts previously had invalidated defensive maneuvers by reading into section 14(e) a federal fiduciary standard. See, e.g., *Applied Digital Data Sys., Inc. v. Milgo Elec. Corp.*, 425 F. Supp. 1145 (S.D.N.Y. 1977); *Anaconda Co. v. Crane Co.*, 411 F. Supp. 1210 (S.D.N.Y. 1975). The Supreme Court discredited this approach, however, in *Santa Fe Indus. v. Green*, 430 U.S. 462 (1977). But see *Lynch & Steinburg*, *supra* note 3 (arguing for a federal fiduciary standard).

10. See, e.g., *Data Probe Acquisition Corp. v. Datatab, Inc.*, 722 F.2d 1, 5 (2d Cir. 1983); *Buffalo Forge Co. v. Ogden Corp.*, 717 F.2d 757, 760 (2d Cir. 1983); *Schreiber v. Burlington Northern, Inc.*, 568 F. Supp. 197, 203 (D. Del. 1983); *Martin Marietta Corp. v. Bendix Corp.*, 549 F. Supp. 623, 630 (D. Md. 1982); *Marshall Field & Co. v. Icahn*, 537 F. Supp. 413, 422 (S.D.N.Y. 1982); Prentice, *supra* note 1, at 353-58; Comment, *supra* note 2; Note, *Tender Offer Defensive Tactics—Federal Regulation of Management's Prerogative*, 10 FORDHAM URB. L.J. 633, 650-52 (1982); Note, "Lock-up" Enjoined Under Section 14(e) of Securities Exchange Act, 12 SETON HALL L.J. 881, 891-95 (1982).

11. See 669 F.2d at 374-76.

12. Presently, the majority rule appears to be the "deception test," which equates manipulation with misrepresentation. See *infra* text accompanying notes 38-55.

"manipulative acts" under section 14(e). The Note describes briefly how lock-up arrangements work. It then examines the different approaches courts have used to define section 14(e) manipulation. After identifying the general purpose and specific goals of the Williams Act, the Note rejects the traditional rule of equating manipulation with deception or misrepresentation. Instead, the Note concludes that defensive tactics tending to disrupt the competitive balance between a target corporation and a tender offeror are the proper object of the Act's prohibition of manipulation.

LOCK-UPS

In a tender offer, a corporation¹³ publicly offers to purchase from shareholders all or a substantial portion of a publicly owned corporation's stock.¹⁴ A merger between the target and the acquiring corporation usually follows the offeror's successful purchase of a controlling interest in the target.¹⁵ Although the tender offer process is simple in theory,¹⁶ it becomes complicated in practice when the target management actively opposes the takeover bid. Technically, this opposition occurs because management either wants to wait for a better offer¹⁷ or believes that the resulting acquisition would contravene the shareholders' "best interest."¹⁸ Practically, however, management's real motivation is usually self-preservation.¹⁹ Consequently, their actions in lock-ups often neither represent nor protect the shareholders' interests.

A variety of tactics can defeat unwanted takeover bids.²⁰ The lock-up is the most popular, and possibly the most effective, de-

13. This Note will assume that any tender offeror is a corporation. Groups and individuals, however, also make tender offers.

14. Comment, *supra* note 2, at 671.

15. *Id.* at 672.

16. Note, *The Courts and the Williams Act: Try a Little Tenderness*, 48 N.Y.U. L. REV. 991, 992-93 (1973).

17. *Id.* at 995.

18. Comment, *supra* note 2, at 679; Note, *supra* note 16, at 995.

19. See Bromberg, *Tender Offers: Safeguards and Restraints—An Interest Analysis*, 21 CASE W. RES. L. REV. 613, 656 (1970); Comment, *supra* note 2, at 679.

20. See Lynch & Steinberg, *supra* note 3, at 901-02; Prentice, *supra* note 1, at 339-43; Weiss, *Defensive Responses to Tender Offers and the Williams Act's Prohibition Against Manipulation*, 35 VAND. L. REV. 1087, 1121-28 (1982).

fense. A defensive lock-up²¹ involves an agreement, made in response to a hostile tender offer, between the target corporation and another company, often called a "white knight." The white knight agrees to make a tender offer higher than the hostile bid. In return, the target's management makes concessions that increase the likelihood that the white knight's offer will succeed.²² A lock-up is any such concession.

Defensive lock-ups fall into two categories. In a stock lock-up, which is the most common, the target corporation either grants the white knight an option to purchase target shares owned by the corporation or actually sells those shares to the white knight.²³ For example, consider a hostile offer of \$20 per share. The white knight might offer \$30 per share with an option to purchase twenty percent of the target's shares at the same price.²⁴ This lock-up facilitates the friendly takeover in two ways. First, it decreases the number of shares the white knight must acquire to control the target.²⁵ Assuming both offerors need fifty percent of the stock, the white knight can gain control by exercising its option even if shareholders sell only thirty percent of their shares. Conversely, the hostile bidder must purchase fifty percent of the target's shares.

The second way that the stock lock-up facilitates the friendly takeover is by giving the favored offeror an advantage in a later bidding contest.²⁶ If the hostile bidder in the above example raised its offer to \$35 per share, it would have to purchase fifty percent of

21. Target managements do not use all lock-ups defensively. The target may employ a lock-up agreement to facilitate a negotiated merger with a single, friendly tender offeror. In addition, takeover bidders may employ offensive lock-ups, which are arrangements negotiated with target shareholders to help insure the takeover bid's success. Bialkin & Lampert, *Lock-up Devices in Friendly and Hostile Acquisitions*, 1 14TH ANN. INST. ON SEC. REG. 669, 674-75 (1982).

22. Bialkin & Lampert, *supra* note 21, at 674; Fraidin & Franco, *supra* note 4, at 821.

23. Bialkin & Lampert, *supra* note 21, at 679-80; Comment, *supra* note 2, at 676. For examples of stock lock-ups, see *Data Probe Acquisition Corp. v. Datatab, Inc.*, 722 F.2d 1 (2d Cir. 1983); *Mobil Corp. v. Marathon Oil Co.*, 669 F.2d 366 (6th Cir. 1981).

24. Frequently, the option price will be lower than the white knight's offer price, giving the white knight an even greater economic advantage over the hostile bidder in a subsequent bidding contest. See *infra* text accompanying notes 88-89.

25. At the same time, of course, such a lock-up decreases the likelihood that the hostile bidder will be able to purchase the desired percentage of stock. Because the white knight now owns twenty percent of the shares, the hostile offeror must receive all its tenders from the remaining eighty percent. See Lynch & Steinberg, *supra* note 3, at 934.

26. Bialkin & Lampert, *supra* note 21, at 679-80.

the stock at that price. To defeat that offer, however, the white knight must buy only thirty percent of the shares at the higher price and the remainder at \$30. If one million shares were outstanding, the white knight could offer \$40 per share for almost the same cost as the hostile offeror's \$35 bid.²⁷

The second form of defensive lock-up concerns the target's assets. In the asset lock-up, the target corporation sells to a friendly bidder, or grants the friendly bidder an option to buy, a highly valued asset.²⁸ In appropriate circumstances, this device is more effective than most stock lock-ups. If the asset is important to the target's attractiveness—to the extent that the offeror is unwilling to acquire the target without that asset—the lock-up will deter bidding completely.²⁹ Even a tenacious bidder cannot overcome an asset lock-up. Once the parties execute the lock-up agreement, the hostile tender offeror cannot acquire both the target and its most attractive asset.

Besides their usefulness as a defensive technique, lock-ups also benefit target corporations by stimulating competition. Even if the original tender offer is acceptable, management can use lock-ups to lure other bidders into the market.³⁰ Some potential offerors may be unwilling to bid for the target's stock without a lock-up arrangement.³¹ Lock-ups provide security for these parties. They also may allow the unsuccessful bidder to recover its expenses by reselling the acquired shares at the higher price of the winning offer.³² In short, lock-ups often are essential for securing the highest price for target stock.

Target corporations use lock-ups and other defensive tactics ex-

27. The hostile bidder's cost for its \$35 bid would be \$17,500,000 ($\$35 \times 500,000$ shares). The white knight's costs for its \$40 bid would be \$18,000,000 ($\$30 \times 200,000$) + ($\$40 \times 300,000$). See also *Mobil Corp. v. Marathon Oil Co.*, 669 F.2d 366, 375-76 (6th Cir. 1981).

28. Bialkin & Lampert, *supra* note 21, at 681-82; Comment, *supra* note 2, at 677. For examples of asset lock-ups, see *Mobil Corp. v. Marathon Oil Co.*, 669 F.2d 366 (6th Cir. 1981); *Marshall Field & Co. v. Icahn*, 537 F. Supp. 413 (S.D.N.Y. 1982).

29. To be effective, the locked-up asset actually must be the target's "crown jewel," the key to the target's attractiveness. If the target corporation consists of several attractive operations, this tactic probably will be unsuccessful. Nathan, *Lock-Ups and Leg-Ups: The Search for Security in the Acquisitions Market Place*, 13TH ANN. INST. SEC. REG. 13, 77 (1981).

30. Fraidin & Franco, *supra* note 4, at 823.

31. *Id.*

32. *Id.*

tensively. Since *Mobil*, however, their legality under section 14(e) of the Williams Act has remained in doubt. Deciding how courts should view these devices requires analysis of the different judicial definitions of "manipulative acts."

DEFINING MANIPULATION UNDER SECTION 14(E): THREE JUDICIAL APPROACHES

Because the Williams Act does not define "manipulative acts," courts have formulated their own definitions based on congressional intent and legislative history. Three basic definitions of section 14(e) manipulation have emerged from this case-by-case approach. The traditional approach equates manipulation with misrepresentation, thus making deception an essential element of a section 14(e) violation.³³ The court in *Mobil Corp. v. Marathon Oil Co.*³⁴ rejected this approach, ruling instead that a lock-up device is manipulative if it artificially affects the market for the target's stock.³⁵ The United States District Court for the Southern District of New York proposed a third approach in *Data Probe Acquisition Corp. v. Datatab, Inc.*³⁶ The court in *Data Probe* held that a lock-up arrangement is manipulative under section 14(e) if it unduly obstructs the exercise of informed and effective shareholder choice.³⁷

The Traditional Approach—The Deception Test

Courts applying the deception test hold that manipulation cannot exist under section 14(e) without evidence of misrepresentation, deception, or deceit.³⁸ The only issue under this definition is

33. See, e.g., *Data Probe Acquisition Corp. v. Datatab, Inc.*, 722 F.2d 1 (2d Cir. 1983); *Buffalo Forge Co. v. Ogden Corp.*, 717 F.2d 757 (2d Cir. 1983); *Schreiber v. Burlington Northern, Inc.*, 568 F. Supp. 197 (D. Del. 1983); *Martin Marietta Corp. v. Bendix Corp.*, 549 F. Supp. 623 (D. Md. 1982).

34. 669 F.2d 366 (6th Cir. 1981).

35. See *id.* at 374.

36. 568 F. Supp. 1538 (S.D.N.Y. 1983), *rev'd*, 722 F.2d 1 (2d Cir. 1983).

37. See *id.* at 1545, 1547.

38. See, e.g., *Data Probe Acquisition Corp. v. Datatab, Inc.*, 722 F.2d 1, 4 (2d Cir. 1983); *Buffalo Forge Co. v. Ogden Corp.*, 717 F.2d 757, 760 (2d Cir. 1983); *Atchley v. Qonaar Corp.*, 704 F.2d 355, 359 (7th Cir. 1983); *Dan River, Inc. v. Icahn*, 701 F.2d 278, 288 (4th Cir. 1983); *Panter v. Marshall Field & Co.*, 646 F.2d 271, 283 (7th Cir. 1981), *cert. denied*, 454 U.S. 1092 (1981); *Lewis v. McGraw*, 619 F.2d 192, 195 (2d Cir. 1980); *Schreiber v. Burlington*

whether the alleged wrongdoer disclosed complete and truthful information regarding the challenged activity.³⁹ No activity, regardless of the consequences, is inherently manipulative unless it necessarily involves deception. In effect, then, the deception test is non-definitional. By equating manipulation with non-disclosure, the test adds nothing to the meaning of section 14(e). It merely echoes the prohibition of fraudulent and deceptive acts already present in the section.⁴⁰

United States Supreme Court discussions both of manipulation⁴¹ and of the legislative history of the Williams Act⁴² account for the element of deception recognized by many courts in defining section 14(e) manipulation. The Court has never discussed manipulation directly within the context of the Williams Act. It has examined, however, the scope of manipulation under section 10(b) of the Securities Exchange Act of 1934,⁴³ which contains language very similar to that in section 14(e).⁴⁴

In *Ernst & Ernst v. Hochfelder*,⁴⁵ the Supreme Court maintained that "manipulative" in section 10(b) "connotes intentional or willful conduct designed to *deceive or defraud* investors by controlling or artificially affecting the price of securities."⁴⁶ In *Santa Fe Industries, Inc. v. Green*,⁴⁷ another section 10(b) case, the Court defined manipulative actions as those "intended to *mislead* investors by artificially affecting the price of securities."⁴⁸ Both

Northern, Inc., 568 F. Supp. 197, 202 (D. Del. 1983); *Martin Marietta Corp. v. Bendix Corp.*, 549 F. Supp. 623, 628 (D. Md. 1982).

39. *Martin Marietta Corp. v. Bendix Corp.*, 549 F. Supp. 623, 628 (D. Md. 1982).

40. See 15 U.S.C. § 78n(e) (1982).

41. *Santa Fe Indus. v. Green*, 430 U.S. 462 (1977); *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976).

42. *Piper v. Chris-Craft Indus.*, 430 U.S. 1 (1977); *Rondeau v. Mosinee Paper Corp.*, 422 U.S. 49 (1975).

43. 15 U.S.C. § 78j (1982). Section 10(b) applies to the sale of any security, unlike section 14(e) of the Williams Act, which covers only the tender offer process.

44. Section 10(b) provides as follows: "It shall be unlawful for any person . . . to use or employ, in connection with the purchase or sale of any security . . . any *manipulative or deceptive device*. . . ." 15 U.S.C. § 78j (1982) (emphasis added).

45. 425 U.S. 185 (1976).

46. *Id.* at 199 (emphasis added).

47. 430 U.S. 462 (1977).

48. *Id.* at 476 (emphasis added).

definitions, at least implicitly, require an element of deception.⁴⁹ The validity of the deception test rests on the premise that because section 14(e) is almost identical to section 10(b), the deception requirement also applies to section 14(e).⁵⁰

The deception test also derives support from the Supreme Court's interpretation of the legislative history of the Williams Act. In *Piper v. Chris-Craft Industries, Inc.*,⁵¹ the Court held that a defeated tender offeror did not have standing to bring an action under section 14(e) in its capacity as a takeover bidder.⁵² After reviewing the Act's legislative history, the Court determined that Congress intended to protect only investors.⁵³ To that end, the Williams Act was purely a disclosure statute, "designed solely to get needed information to the investor."⁵⁴ Under the deception test, manipulation occurs only when management (or the offeror) withholds necessary information from the shareholders.⁵⁵

Several courts have adopted the deception test in various contexts.⁵⁶ Most recently, in *Data Probe Acquisition Corp. v. Datatab, Inc.*,⁵⁷ the United States Court of Appeals for the Second Circuit applied the deception test to a lock-up arrangement. Datatab and CRC Information Systems executed a merger agreement under which CRC would purchase Datatab's outstanding shares for \$1.00 per share.⁵⁸ Data Probe then entered into competition with CRC, making a tender offer of \$1.25 per share for Datatab's stock.⁵⁹ After negotiating with Datatab, CRC agreed to counter the hostile

49. See *Schreiber v. Burlington Northern, Inc.*, 568 F. Supp. 197, 202 (D. Del. 1983); Prentice, *supra* note 1, at 354.

50. *Data Probe Acquisition Corp. v. Datatab, Inc.*, 722 F.2d 1, 4 (2d Cir. 1983); *Billard v. Rockwell Intern. Corp.*, 683 F.2d 51, 56 (2d Cir. 1982).

51. 430 U.S. 1 (1977).

52. See *id.*

53. See *id.* at 30-31.

54. *Id.* at 31.

55. See, e.g., *Martin Marietta Corp. v. Bendix Corp.*, 549 F. Supp. 623, 628 (D. Md. 1982).

56. See *supra* note 38.

57. 722 F.2d 1 (2d Cir. 1983).

58. A financially troubled company, Datatab first approached CRC to inquire if CRC would be willing to purchase the corporation. *Id.* at 2. The terms of the merger agreement suggest that the officers did not act wholly with unselfish motives. For instance, Datatab's three principal officers were to receive new three-year employment contracts. *Id.*

59. *Id.*

bid by raising its offer to \$1.40 per share.⁶⁰ In return, CRC received an option to purchase an amount of Datatab's authorized but unsold stock that would be the equivalent of two hundred percent of the target's outstanding shares.⁶¹ This enabled CRC to effect the merger simply by exercising its option.⁶²

Despite the impact of this lock-up option on Datatab's shareholders, the court held that the arrangement did not violate section 14(e) because Datatab had met disclosure requirements.⁶³ The court emphasized that the proper standard for determining the legality of tender offers is the adequacy of disclosure rather than the substantive validity of defensive tactics.⁶⁴ The fairness of the lock-up was irrelevant; absent misrepresentation, no right of action existed under section 14(e).⁶⁵

In *Buffalo Forge Co. v. Ogden Corp.*,⁶⁶ the Second Circuit chose another instance in which to apply the deception test in a case involving a lock-up agreement. Ampco-Pittsburgh Corporation made a tender offer of \$25 per share for Buffalo Forge stock.⁶⁷ Buffalo Forge's directors resisted, and entered into an agreement under which Ogden purchased 425,000 treasury shares⁶⁸ at \$32.75 per share with an option to buy 143,400 additional shares.⁶⁹ The court found that this lock-up was not manipulative.⁷⁰ Buffalo Forge had engaged in no misleading acts⁷¹ and, according to the court, an "essential ingredient" of section 14(e) manipulation is "the omission

60. *Id.* at 3.

61. *Id.*

62. *Id.*

63. *See id.* at 4-5.

64. *Id.* at 4. The court asserted that examination of the substantive validity of defensive tactics would federalize the law of fiduciary duty, an approach that was discredited by the holding of the Supreme Court in *Santa Fe Industries, Inc. v. Green*, 430 U.S. 462, 477 (1977). *See id.*

65. *Id.*

66. 717 F.2d 757 (2d Cir. 1983).

67. *Id.* at 758.

68. Treasury shares are stock that is issued and then reacquired by the corporation to be used for corporate purposes. BLACK'S LAW DICTIONARY 1346 (5th ed. 1979).

69. 717 F.2d at 758-59. Ampco eventually won the subsequent bidding war despite the lock-up arrangement. Ampco then refused to allow Ogden to exercise its option, claiming that the option agreement was a manipulative device under section 14(e). *Id.* at 759.

70. *See id.* at 760.

71. *Id.*

or misstatement of material facts."⁷²

The United States District Court for the District of Maryland defended the deception test in *Martin Marietta Corp. v. Bendix Corp.*⁷³ The case involved an aggressive response to a hostile takeover bid. When Bendix announced a tender offer to acquire a controlling interest in Marietta, Marietta's management countered with a tender offer for a majority of Bendix's stock.⁷⁴ In addition to accusing Marietta of inadequate disclosure, Bendix alleged that the defensive tactic was a manipulative act under section 14(e).⁷⁵

The court rejected Bendix's claim and refused to consider the effect of Marietta's bid.⁷⁶ It maintained that deception was a necessary element of a section 14(e) violation.⁷⁷ In this way, the court treated the manipulation analysis as identical to the disclosure analysis.⁷⁸ Marietta's intent to inhibit Bendix's tender offer was irrelevant.⁷⁹

Despite its popularity, the deception test misinterprets section 14(e). A careful analysis of both the legislative history of the Williams Act and relevant Supreme Court decisions reveals that the test frustrates congressional intent by ignoring section 14(e)'s role in the overall statutory scheme. The test overemphasizes the few Supreme Court pronouncements concerning the manipulation issue.

The Williams Act: General Purpose

The Williams Act does not define the "manipulative acts" that it proscribes. Because the statute itself is open to several interpretations, courts must turn to the legislative history of the Act.⁸⁰ This history, however, fails to clarify the scope of section 14(e) manipulation.⁸¹ Consequently, the general purpose of the Williams Act,

72. *Id.*

73. 549 F. Supp. 623 (D. Md. 1982).

74. *Id.* at 625.

75. *Id.* at 626.

76. *Id.* at 627-31.

77. *Id.* at 628-30.

78. *See id.*

79. *See id.*

80. See 2A STATUTES AND STATUTORY CONSTRUCTION 48.04 (C. Sands 4th ed. 1973).

81. Neither Congressmen nor witnesses discussed the exact definition of section 14(e) in either the Senate Hearings, the House Hearings, or on the Senate Floor.

and Congress' method of accomplishing that purpose, must provide some guidelines.⁸²

The legislative history of the Williams Act reveals that the Act's only purpose was to protect the target's shareholders,⁸³ the rightful beneficiaries of the tender offer process. Introducing the bill on the Senate floor, Senator Harrison Williams emphasized that it would "close a significant gap in *investor protection* under the federal securities laws."⁸⁴

Testifying before the Senate Subcommittee on Securities, then SEC Chairman Manuel Cohen reiterated Williams' objective: "[W]e are concerned with the investor who today is just a pawn in a form of industrial warfare. . . . The investor [during takeover bids] is lost somewhere in the shuffle. This is our only concern."⁸⁵ Congress recognized that because shareholders had no means of safeguarding their rights adequately during tender offers they needed a "more effective champion."⁸⁶ The Williams Act was intended to be that champion of investor rights.

In *Piper v. Chris-Craft Industries, Inc.*,⁸⁷ the Supreme Court endorsed the view that the primary purpose of the Williams Act was investor protection. The Court analyzed thoroughly the Act's legislative history,⁸⁸ and concluded that the legislation protects only the target's shareholders. The Act confers no privileges on tender offerors.⁸⁹ The Court maintained that "the sole purpose of the Williams Act was the protection of investors who are confronted with

82. See *Cargill, Inc. v. Hardin*, 452 F.2d 1154, 1163 (8th Cir. 1971), *cert. denied*, 406 U.S. 932 (1972); *Applied Digital Data Sys., Inc. v. Milgo Elec. Corp.*, 425 F. Supp. 1145, 1153 (S.D.N.Y. 1977); Weiss, *supra* note 20, at 1098.

83. All courts and commentators agree that Congress' intent was investor protection. The debate concerns the nature and extent of that protection. See *supra* note 6; see *infra* text accompanying notes 84-86.

84. 113 CONG. REC. 854 (1967) (emphasis added).

85. *Full Disclosure of Corporate Equity Ownership and in Corporate Takeover Bids: Hearings on S. 510 Before the Subcommittee on Securities of the Senate Committee on Banking and Currency*, 90th Cong., 1st Sess. 178 (1967) [hereinafter cited as *Senate Hearings*].

86. *Id.* at 57 (testimony of Prof. Samuel L. Hayes, III, Columbia Univ. Grad. School of Business).

87. 430 U.S. 1 (1977).

88. See *id.* at 26-35.

89. *Id.* at 35; see *supra* text accompanying notes 51-55.

a tender offer."⁹⁰

Proponents of the deception test agree that the purpose of the Williams Act was investor protection.⁹¹ They fail to realize, however, that investor protection had for Congress a very specific meaning: safeguarding the investors' position as the ultimate decision-makers in the tender offer process. Congress recognized that true investor protection meant protecting the shareholders' ability both to decide whether to tender their shares and, if deciding to tender, to choose between competing bidders.⁹² Congress sought to ensure, therefore, not only that investors would receive adequate information but also that they would be able to use that information to make meaningful decisions.⁹³ In short, the Act's general purpose was to guarantee informed and effective shareholder choice.

The district court in *Data Probe* properly identified the purpose of the Williams Act to be the protection of investors' decision-making role.⁹⁴ After analyzing the Act's history to determine Congress' notion of investor protection, the court decided that Congress equated such protection with unhindered shareholder choice.⁹⁵ Congress intended that neither target management nor tender offerors would be able to interfere with investors' decision-making prerogative.⁹⁶

The legislative history of the Williams Act shows that Congress designed the Act to prevent tender offer participants from undermining meaningful shareholder choice. Chairman Cohen in particular emphasized the importance of investor decision-making. According to Cohen, the Act's goal was to provide investors with an

90. 430 U.S. at 35.

91. See *supra* note 83 and accompanying text.

92. See *Senate Hearings*, *supra* note 85, at 181 (testimony of Manuel Cohen, SEC Chairman). Chairman Cohen noted: "The decision whether to tender or to take other action in consequence of the tender offer is an important decision. It should be made only after careful consideration and with full knowledge of the facts." *Id.*

93. See *id.* at 188 (testimony of Manuel Cohen, SEC Chairman); see also *Hi-Shear Indus. v. Campbell*, [1981] FED. SEC. L. REP. (CCH) ¶ 97,804, at 90, 031 (D.S.C. 1981) (the Williams Act "contemplates unfettered choice by well-informed investors").

94. *Data Probe Acquisition Corp. v. Datatab, Inc.*, 568 F. Supp. 1538 (S.D.N.Y. 1983), *rev'd*, 722 F.2d 1 (2d Cir. 1983).

95. *Id.* at 1545-48.

96. See *id.*; see *infra* text accompanying notes 162-64.

opportunity to make a tender offer decision "without being subject to unwarranted techniques which are designed to prevent that from happening."⁹⁷

Cohen also wanted the SEC to help ensure effective shareholder choice. He believed that Congress should design the SEC's regulatory power "to give the investor the fairest possible opportunity to make his own investment decisions."⁹⁸ Finally, Cohen recognized that the Williams Act, through both disclosure and other methods, would "give investors a fair opportunity to reach informed judgments . . . and to *act accordingly*."⁹⁹

The deception test is invalid because it contradicts this congressional goal of meaningful shareholder choice. Requiring full disclosure from the tender offer participants clearly is essential to providing freedom of choice. Disclosure alone, however, offers little meaningful protection. Unless checked, management or tender offerors can employ tactics that essentially remove any decision-making privilege from even an informed investor.¹⁰⁰ Information is worthless unless the target shareholder also is guaranteed an opportunity to use the information to make his own investment decisions.¹⁰¹ Mere disclosure does not ensure an effective exercise of an informed choice, and thus the deception test undermines rather than promotes the general purpose of the Williams Act.

The Supreme Court View

Courts that treat misrepresentation as the only element of section 14(e) manipulation maintain that the United States Supreme Court has identified disclosure as the fundamental goal of the Williams Act.¹⁰² They cite *Piper v. Chris-Craft Industries, Inc.*¹⁰³ and *Santa Fe Industries, Inc. v. Green*¹⁰⁴ to support this proposition

97. *Senate Hearings*, *supra* note 85, at 15.

98. *Id.*

99. *Id.* at 188 (emphasis added).

100. Chairman Cohen recognized the "ability of incumbent management to frustrate an attractive and desirable tender offer." *Id.* at 184.

101. Proponents of the deception test erroneously assume that once a shareholder possesses adequate information, he can protect his own interests. Even an informed investor will be powerless during an all-out takeover contest.

102. *See supra* note 38.

103. 430 U.S. 1 (1977).

104. 430 U.S. 462 (1977).

without considering the Act's purpose.¹⁰⁵

Neither case mandates interpreting the Williams Act as solely a disclosure statute. In *Piper* the Court attempted to demonstrate only that Congress' purpose in passing the Act was investor protection.¹⁰⁶ Although the Court emphasized the disclosure language in the legislative history,¹⁰⁷ it did so only to support its conclusion that the Act protected the investor alone.¹⁰⁸ The Court never stated that disclosure was the only method of protection under the Williams Act.

In *Santa Fe*, the Court did not discuss the Williams Act, but did consider the Securities Exchange Act of 1934. In its interpretation of section 10(b) of that Act, the counterpart of section 14(e),¹⁰⁹ the Court held that the "fundamental purpose" of the 1934 Act was to require full disclosure.¹¹⁰ Supporters of the deception test argue that, by implication, the purpose of the Williams Act is identical.¹¹¹

The Court's interpretation of section 10(b) does not apply with equal force to the Williams Act.¹¹² Although both the 1934 Act and the Williams Act attempt to protect investors, their methods differ. The 1934 Act regulates securities trading.¹¹³ In that context, once the investors receive adequate information about a given corporation, they can pursue their interests without interference. They do not need a statute protecting their right to trade freely; the market is open to all. The Williams Act, on the other hand, regulates tender offers. Investors in a tender offer situation require different protection because they are not guaranteed unhindered participation in the tender offer market.¹¹⁴ Takeover battles fre-

105. See *Martin Marietta Corp. v. Bendix Corp.*, 549 F. Supp. 623, 628 (D. Md. 1982).

106. See 430 U.S. at 26-35.

107. See *id.* at 26-35.

108. See *id.* at 35.

109. See *supra* note 44.

110. 430 U.S. at 477-78.

111. See, e.g., *Schreiber v. Burlington Northern, Inc.*, 568 F. Supp. 197, 203 (D. Del. 1983).

112. *Data Probe Acquisition Corp. v. Datatab, Inc.*, 568 F. Supp. 1538, 1544 (S.D.N.Y.), *rev'd*, 722 F.2d 1 (2d Cir. 1983); Weiss, *supra* note 20, at 1097-98.

113. Weiss, *supra* note 20, at 1097.

114. See *Senate Hearings*, *supra* note 85, at 15 (testimony of Manuel Cohen, SEC Chairman).

quently involve maneuvers designed to "distort or even abort the investment decision."¹¹⁵ Consequently, merely providing information is insufficient. In the tender offer context, investor protection requires a guarantee of effective investor participation.¹¹⁶ The deception test's complete reliance on disclosure fails to implement adequately this goal of effective investor protection.

The Artificial Effect Test

In *Mobil Corp. v. Marathon Oil Co.*,¹¹⁷ the Sixth Circuit directly challenged the validity of the deception test. The court ruled that two lock-up devices used by Marathon to fend off Mobil's tender offer were manipulative acts prohibited by the Williams Act, even though neither device employed deception.¹¹⁸ In the process, the court adopted a definition of manipulation that went beyond deception. The court held that "manipulation is an affecting of the market for, or the price of, securities by *artificial* means."¹¹⁹ In short, nondisclosure alone was insufficient to establish a violation of section 14(e).¹²⁰

The court in *Mobil* considered both stock lock-up and asset lock-up arrangements. Mobil announced its plan to purchase up to 40 million shares of Marathon's stock for \$85 per share.¹²¹ Opposing any merger with Mobil, Marathon's directors sought a more attractive takeover bidder.¹²² After negotiations with several potential

115. *Data Probe Acquisition Corp. v. Datatab, Inc.*, 568 F. Supp. 1538, 1544 (S.D.N.Y.), *rev'd*, 722 F.2d 1 (2d Cir. 1983).

116. *See id.* at 1545-48.

117. 669 F.2d 366 (6th Cir. 1981).

118. *See id.* at 377.

119. *Id.* at 374 (emphasis in original).

120. *Id.* at 376-77. The court emphasized that "to find compliance with section 14(e) solely by the full disclosure of a manipulative device . . . would be to read the 'manipulative acts and practices' language completely out of the Williams Act." *Id.* at 377.

121. *Id.* at 367.

122. Simultaneously, Marathon filed suit against Mobil, asserting that a Marathon-Mobil merger would violate antitrust laws. *See id.* *Marathon Oil Co. v. Mobil Corp.*, 530 F. Supp. 315, 317 (N.D. Ohio 1981). The United States District Court for the Northern District of Ohio issued a preliminary injunction blocking the proposed acquisition. *See id.* at 326. The Sixth Circuit affirmed the injunctive relief on the same day it ruled on the section 14(e) claims. *See Marathon Oil Co. v. Mobil Corp.*, 669 F.2d 378, 383-84 (6th Cir. 1981), *cert. denied*, 455 U.S. 982 (1982).

Judge Merritt dissented from the court's decision that Marathon's defensive tactics were

white knights, Marathon executed a merger agreement with United States Steel.¹²³

U.S. Steel agreed to make a tender offer for thirty million Marathon shares at \$125 per share in return for two significant concessions.¹²⁴ First, Marathon granted U.S. Steel an option to purchase ten million authorized-but-unissued Marathon shares for \$90 per share.¹²⁵ Second, U.S. Steel received an option to purchase Marathon's interest in the Yates Oil Field.¹²⁶ U.S. Steel could exercise the second option only if a third party acquired Marathon.¹²⁷

As with the proponents of the deception test, the court turned to the Supreme Court's analysis of manipulation under section 10(b) in *Ernst & Ernst*¹²⁸ and *Santa Fe*¹²⁹ to determine the parameters of section 14(e) manipulation. The court nevertheless ignored the references to deception in those passages.¹³⁰ It focused instead on the language in both cases that characterized manipulation as activity "artificially affecting" the securities market.¹³¹ The key issue in *Mobil*, therefore, was the lock-up's effect on "normal healthy market activity."¹³² The court expressly rejected the view that section 14(e) only required adequate disclosure.¹³³ Using this analysis, the court had little difficulty finding that both lock-up agreements violated section 14(e).¹³⁴ Both artificially affected market activity by deterring competitive bidding for Marathon's stock.¹³⁵ This, in

manipulative on the ground that Mobil's section 14(e) claim was moot following the disposition of the antitrust case. *Mobil Corp. v. Marathon Oil Co.*, 669 F.2d 366, 378 (6th Cir. 1981) (Merritt, J., dissenting).

123. 669 F.2d at 367.

124. *Id.*

125. *Id.*

126. *Id.*

127. *Id.*

128. 425 U.S. 185 (1976).

129. 430 U.S. 462 (1977).

130. See *supra* text accompanying notes 46-50.

131. See 669 F.2d at 374. A few courts have identified an artificial market effect as an element of the deception test. See, e.g., *Schreiber v. Burlington Northern, Inc.*, 568 F. Supp. 197, 202 (D. Del. 1983) ("The manipulative activity must *artificially affect* the market price and do so in a misleading or deceptive manner.") (emphasis in original).

132. 669 F.2d at 374.

133. See *id.* at 376-77. The court determined that deception was an irrelevant factor in defining manipulation. See *id.*

134. See *id.*

135. *Id.* at 375.

turn, created a \$125 per share price ceiling on that stock.¹³⁶

The Yates Field option presented the easier problem. The court noted that Marathon was an attractive target, especially to Mobil, only because of its holdings in Yates Field, one of the world's most productive oil fields.¹³⁷ Because the lock-up ensured that only U.S. Steel could acquire both Marathon and the Field, Mobil's interest in continued bidding decreased substantially.¹³⁸ In fact, the court apparently assumed that no offeror would be willing to top U.S. Steel's offer if Yates Field was not included in the deal.¹³⁹ Furthermore, the court emphasized that Marathon designed the option solely to preclude competition; U.S. Steel could exercise the option only if it was outbid by a third party.¹⁴⁰

The court held that the stock lock-up also deterred bidding by giving U.S. Steel an unfair advantage over other offerors.¹⁴¹ Although any other bidder would have had to acquire the necessary forty million shares at full offer price, U.S. Steel needed to purchase only thirty million shares at market price after obtaining ten million shares at a bargain price.¹⁴² Thus, Mobil was significantly disadvantaged because it, or any other offeror, would have to pay about \$1.2 billion more than U.S. Steel to match the latter's bid.¹⁴³ By discouraging competition, both lock-up arrangements "circumvent[ed] the natural forces of market demand" in the takeover contest.¹⁴⁴

Some courts have rejected the *Mobil* approach expressly.¹⁴⁵ Others, especially those dealing with lock-up devices, have ac-

136. *Id.*

137. *Id.* at 367-68, 375.

138. *Id.* at 375. The court noted that the two other potential white knights negotiating with Marathon indicated that they only would consider a tender offer if given an option to purchase Yates Field. *See id.* at 368.

139. *See id.* at 375.

140. *See id.* Weiss, *supra* note 20, at 1094.

141. *See* 669 F.2d at 375.

142. *See id.* at 375-76.

143. *See id.*; *cf. supra* note 27 and accompanying text.

144. 669 F.2d at 376.

145. *See, e.g.,* Data Probe Acquisition Corp. v. Datatab, Inc., 722 F.2d 1, 5 (2d Cir. 1983); Buffalo Forge Co. v. Ogden Corp., 717 F.2d 757, 760 (2d Cir. 1983); Dan River, Inc. v. Icahn, 701 F.2d 278, 288 (4th Cir. 1983); Schreiber v. Burlington Northern, Inc., 568 F. Supp. 197, 203 (D. Del. 1983); Martin Marietta Corp. v. Bendix Corp., 549 F. Supp. 623, 630 (D. Md. 1982).

cepted the artificial effect test but distinguished the facts before them.¹⁴⁶ For example, the United States District Court for the Northern District of Illinois, in *Whittaker Corp. v. Edgar*,¹⁴⁷ distinguished *Mobil* in a case involving an agreement similar to the Yates Field lock-up. In the face of Whittaker's hostile tender offer, Brunswick sold a key asset—its Sherwood medical division—to another potential offeror.¹⁴⁸ Whittaker asserted that because it considered Sherwood to be Brunswick's major attraction, the lock-up would deter Whittaker from increasing its bid.¹⁴⁹ Therefore, as with the Yates Field option, this action affected normal market activity and was manipulative under section 14(e).¹⁵⁰

The court rejected Whittaker's argument.¹⁵¹ It distinguished *Mobil* because Brunswick sold the asset instead of "locking it up" with an option agreement.¹⁵² The court maintained that the "sale of a substantial asset by a corporation in the face of a hostile tender offer standing alone is not a violation of section 14(e)."¹⁵³ Despite the elimination of Whittaker by the lock-up, the court characterized the sale as "part of a healthy market activity" because Brunswick received a fair price.¹⁵⁴

The *Mobil* approach¹⁵⁵ is incorrect because it fails to preserve a meaningful balance between the target and the takeover bidder. The court in *Mobil* correctly focused on the necessity of maintaining unhindered market activity.¹⁵⁶ Its definition of manipulation,

146. See *Buffalo Forge Co. v. Ogden Corp.*, 555 F. Supp. 892 (W.D.N.Y.), *aff'd*, 717 F.2d 757 (2d Cir. 1983); *Whittaker Corp. v. Edgar*, 535 F. Supp. 933 (N.D. Ill. 1982); cf. *Marshall Field & Co. v. Icahn*, 537 F. Supp. 413 (S.D.N.Y. 1982) (criticizing the *Mobil* approach but distinguishing the facts even if *Mobil* represented good law).

147. 535 F. Supp. 933 (N.D. Ill. 1982).

148. *Id.* at 941.

149. *Id.* at 943-44.

150. *Id.* at 944.

151. See *id.* at 949.

152. See *id.*

153. *Id.* For a criticism of the distinction between an option to buy and a sale in applying section 14(e), see Fraidin & Franco, *supra* note 4, at 825.

154. 535 F. Supp. at 949. The United States District Court for the Western District of New York also distinguished *Mobil* in *Buffalo Forge Co. v. Ogden Corp.*, 555 F. Supp. 892 (W.D.N.Y.), *aff'd*, 717 F.2d 757 (2d Cir. 1983). The district court held that the lock-up at issue was not manipulative under the *Mobil* test because it had a positive impact on the market, stimulating rather than suppressing competition. *Id.* at 906.

155. See *supra* text accompanying notes 117-20, 128-33.

156. See *id.* at 374.

however, is simply too broad. The artificial-effect test would prohibit almost all defensive tactics available to management.¹⁵⁷ All such tactics, by definition, affect the securities market. Thus, this approach would restrict excessively management's maneuverability, rendering the target powerless in the face of a tender offer.

The Shareholder-Choice Test

In *Data Probe Acquisition Corp. v. Datatab, Inc.*,¹⁵⁸ the United States District Court for the Southern District of New York developed a third approach to section 14(e) manipulation. On appeal, the Second Circuit expressly rejected the district court's approach, adopting instead the deception test.¹⁵⁹ Nevertheless, the district court's shareholder-choice test remains an important alternative to the deception test. Despite its legal impotence, the court's well-reasoned analysis may provide a useful guide for courts struggling to interpret section 14(e).

The district court in *Data Probe* focused on the insufficiency of the deception test.¹⁶⁰ The court accepted in principle the Sixth Circuit's reasoning in *Mobil*¹⁶¹ but narrowed the concept of manipulation even further.¹⁶² The district court emphasized the investors' right to decide for themselves between tender offers. Therefore, it related manipulation and undue interference to meaningful shareholder choice.¹⁶³ Under this approach, manipulation does not encompass all actions that adversely affect market activity, as had been suggested in *Mobil*.¹⁶⁴ Rather, section 14(e) prohibits only those actions that obstruct the tender offer process in such a way

157. See *Data Probe Acquisition Corp. v. Datatab, Inc.*, 568 F. Supp. 1538, 1550 (S.D.N.Y.), *rev'd*, 722 F.2d 1 (2d Cir. 1983).

158. 568 F. Supp. 1538 (S.D.N.Y.), *rev'd*, 722 F.2d 1 (2d Cir. 1983).

159. See *supra* text accompanying notes 63-65.

160. See 568 F. Supp. 1538, 1544 (S.D.N.Y.), *rev'd*, 722 F.2d 1 (2d Cir. 1983).

161. See *id.* at 1549-51.

162. See *id.* The district court in *Data Probe* recognized that almost all defensive tactics would be manipulative under the artificial effect test. See *id.* at 1550.

163. See *id.* at 1545-48, 1559.

164. The *Mobil* approach is far broader than the *Data Probe* approach because *Mobil* focused on maintaining unimpeded market activity. The artificial effect test ensures that the natural forces of market demand will control the tender offer process. Conversely, the district court in *Data Probe* considered only the shareholders' interests. An unimpeded market is important only insofar as it protects the investor.

as to deny the shareholders their decision-making prerogative.¹⁶⁵

The court in *Data Probe* had to determine whether a tender offeror's option to purchase two hundred percent of the target's stock was a manipulative device under section 14(e).¹⁶⁶ The court began its interpretation of section 14(e) with a detailed analysis of the history and purpose of the Williams Act, concluding that the Act was not designed merely to provide shareholders with information.¹⁶⁷ The court determined that Congress intended the Williams Act to serve two related purposes. The Act sought "not only to insure that investors were properly informed," but also to enable them "to exercise their choice in tender offer disputes without interference."¹⁶⁸ The legislation "concerned not only the provision of information but the guaranty of a fair opportunity to use it."¹⁶⁹

The court in *Data Probe* attempted to define manipulation in light of these objectives. It determined that, to protect investors' decision-making prerogative, Congress intended section 14(e) to prohibit actions that obstruct the effective exercise of informed shareholder choice.¹⁷⁰ This meant that the Williams Act entitled the shareholders "to have placed before them any [tender offer] and to decide without management's overriding control whether to accept that offer or . . . some other, competing proposal."¹⁷¹ Activities that eliminate this meaningful opportunity to decide, according to the court, are manipulative.¹⁷²

Applying the shareholder-choice test, the court ruled that section 14(e) clearly prohibited the lock-up arrangement at issue.¹⁷³ It recognized that some stock lock-ups may enhance effective shareholder choice by spurring competitive bidding.¹⁷⁴ The option granted to CRC, however, completely contradicted the goals of the

165. See 568 F. Supp. at 1545, 1559 (S.D.N.Y.), *rev'd* 722 F.2d 1 (2d Cir. 1983).

166. See *id.* at 1543.

167. See *id.* at 1545-48.

168. *Id.* at 1559.

169. *Id.* at 1547. For a similar reading of the intent of the Williams Act, see Weiss, *supra* note 20, at 1098-1105.

170. See 568 F. Supp. at 1545, 1559 (S.D.N.Y.), *rev'd*, 722 F.2d 1 (2d Cir. 1983).

171. *Id.* at 1561-62.

172. See *id.*

173. See *id.* at 1561-62; Fraidin & Franco, *supra* note 4, at 823.

174. See 568 F. Supp. at 1560 (S.D.N.Y.), *rev'd*, 722 F.2d 1 (2d Cir. 1983).

Williams Act.¹⁷⁵ Even if the shareholders rejected CRC's tender offer, or accepted Data Probe's offer, CRC could veto the investors' decision and accomplish the acquisition by exercising its option.¹⁷⁶ The lock-up arrangement thus deprived Datatab's shareholders of any legitimate choice. It effectively "aborted the tender offer process,"¹⁷⁷ rendering investor participation meaningless.

The court noted, however, that not all stock lock-ups impermissibly restrict investor choice.¹⁷⁸ The court suggested that it would permit lock-up agreements involving approximately twenty percent of the target's outstanding shares.¹⁷⁹ Although they to some extent limit investor decision-making, management may find such arrangements necessary to "help begin an auction, or attract higher prices,"¹⁸⁰ with the shareholder as the ultimate beneficiary.

Although the shareholder-choice test developed in *Data Probe* is more consistent with the purposes behind section 14(e) of the Williams Act than the two other tests, it has two drawbacks. First, because the shareholder-choice test is grounded on the Act's broad, general purpose, its definition of manipulation is necessarily vague. A wide range of factors affect "investor choice." Second, the shareholder-choice test requires that courts somehow determine the lock-up's effect on shareholders. This determination would be too speculative in all but the clear-cut cases.¹⁸¹

A NEW APPROACH TO MANIPULATION: BALANCING THE SCALES

Each of the three tests that courts have enunciated are inadequate in some way. Each, moreover, fails to provide sufficient meaning to the phrase "manipulative acts" in section 14(e). A satisfactory definition must reflect Congress' notion of investor protection as effective shareholder choice, but also must be specific enough to guide the courts. Such a definition exists, one that reflects the role of the proscription of manipulation in the overall legislative scheme. Under this definition, a manipulative act is one

175. *Id.* at 1562.

176. *Id.* at 1542, 1562.

177. *Id.* at 1562.

178. *See id.* at 1560-61.

179. *See id.*

180. *Id.* at 1561.

181. *See infra* note 227.

that unduly disrupts the competitive balance between the target corporation and the tender offeror. The validity of this definition becomes clearer after identifying the specific objectives of the Williams Act.

The Williams Act: Specific Objectives

Any definition of "manipulative acts" under section 14(e) revolves around Congress' purpose in enacting the Williams Act.¹⁸² Because investor protection, or shareholder choice, is the Act's general purpose, the purpose is too broad to lend specific meaning to the phrase.¹⁸³ Defining manipulative acts with any precision, therefore, requires an understanding of the specific objectives underlying the statutory framework—the means by which Congress sought to achieve its ultimate purpose. Congress attempted to protect investors by combining two objectives: full disclosure of material facts¹⁸⁴ (informed choice) and competitive balance between the target corporation and the takeover bidder¹⁸⁵ (effective choice).¹⁸⁶

The deception test correctly identifies the first objective. Congress intended that disclosure by the tender offer participants be the primary investor protection of the Williams Act. Most of the Act's requirements concern the provision of information, and the committee hearings refer to "disclosure" and "information" almost as often as "investor."¹⁸⁷

182. See *supra* text accompanying notes 80-82.

183. Thus the shareholder choice test applied in *Data Probe*, although accurate, is not the ideal method of defining section 14(e) manipulation. See *infra* note 226.

184. See 113 CONG. REC. 854-55 (1967). Senator Williams stated: "The purpose of this bill is to require full and fair disclosure. . . ." *Id.*

185. See *id.* at 24664.

186. See *Data Probe Acquisition Corp. v. Datatab, Inc.*, 568 F. Supp. 1538, 1559 (S.D.N.Y.), *rev'd*, 722 F.2d 1 (2d Cir. 1983).

187. See, e.g., *Takeover Bids: Bills Providing for Full Disclosure of Corporate Equity: Hearings on H.R. 14475, S. 510 Before the Committee on Interstate and Foreign Commerce*, 90th Cong., 2d Sess. 17 (1968) (testimony of Manuel Cohen, SEC Chairman) ("The purpose of this bill . . . [is] to provide information to investors so that they can arrive at an informed investment decision.") [hereinafter cited as *House Hearings*]; *Senate Hearings*, *supra* note 85, at 25 (testimony of Manuel Cohen) (the Williams Act "will fulfill the need of public stockholders to be fully informed"); *id.* at 70 (testimony of Donald Calvin) (Act's objective "is to provide full and timely disclosure to stockholders"); *id.* at 188 (testimony of Manuel Cohen) (Act "provides [an] application of the traditional full and fair disclosure policy of the Federal securities laws").

Senator Williams frequently focused on this objective. During the Senate Hearings, he commented on "the need to fill the existing gap in the disclosure pattern of our securities laws by providing for full disclosure in corporate takeover bids."¹⁸⁸ Senator Williams reiterated that the sponsors designed the bill "to require full and fair disclosure for the benefit of investors."¹⁸⁹

Disclosure guarantees informed shareholder choice. To ensure that shareholders can exercise that choice meaningfully, however, Congress also intended to "balance the scales" between target management and tender offeror. This competitive balance would ensure that neither party could exploit a superior position to defeat the shareholders' interests.¹⁹⁰ By ensuring competition, courts would enable the investors to make the final tender offer decision.¹⁹¹

Although not as obvious as the concern for disclosure, the balancing objective was a recurring theme in the hearings on the bill. According to Chairman Cohen, Congress designed the Williams Act so that neither management nor takeover bidders had any special privileges.¹⁹² Instead, the Act "reflect[ed] an appropriate balance among competing interests."¹⁹³ Professor Robert Mundheim¹⁹⁴ testified that the Act's supporters perceived the legislation as "merely balancing the scales equally between outsiders and management."¹⁹⁵

Senator Williams also identified this balancing objective. He noted that the Act focused on "balancing the scales"¹⁹⁶ as well as "providing the offeror and management equal opportunity to fairly present their case."¹⁹⁷ On the day the Senate passed the bill, Sena-

188. *Senate Hearings*, *supra* note 85, at 147.

189. 113 CONG. REC. 24664 (1967).

190. *See id.*

191. *See* Great W. United Corp. v. Kidwell, 577 F.2d 1256, 1277 (5th Cir. 1978), *rev'd on venue grounds sub nom.*, Leroy v. Great W. United Corp., 443 U.S. 173 (1979).

192. *See Senate Hearings*, *supra* note 85, at 16.

193. *Id.* at 25. Chairman Cohen also stated that the Act's drafters should "be careful not to tip the scales to favor either incumbent management or those who would seek to oust them." *Id.*

194. Then Professor of Law at the University of Pennsylvania. Presently, he is the Dean of the University of Pennsylvania School of Law.

195. *Senate Hearings*, *supra* note 85, at 117.

196. 113 CONG. REC. 854 (1967).

197. *Id.* at 855.

tor Williams urged once more that the Act's drafters attempted to "avoid tipping the scales either in favor of the management or in favor of the person making the takeover bids."¹⁹⁸

The Supreme Court¹⁹⁹ and several lower courts²⁰⁰ have recognized Congress' intent to maintain a balance between tender offer participants. In *Piper v. Chris-Craft Industries, Inc.*,²⁰¹ the Supreme Court explained Congress' "policy of evenhandedness."²⁰² The Court commented that although a balance between competitors was not the ultimate purpose of the Williams Act, "[n]eutrality" was "one characteristic of legislation directed toward . . . the protection of investors."²⁰³

Justice White's opinion²⁰⁴ in *Edgar v. MITE Corp.*²⁰⁵ is more significant. In ruling that the Williams Act preempted the Illinois takeover statute,²⁰⁶ Justice White focused on the Act's objectives. He found it "clear that a major aspect of the effort to protect the investor was to avoid favoring either management or the takeover bidder."²⁰⁷ According to Justice White, "Congress sought to protect the investor not only by furnishing him with necessary infor-

198. 113 CONG. REC. 24664 (1967).

199. *Edgar v. MITE Corp.*, 457 U.S. 624 (1982); *Piper v. Chris-Craft Indus.*, 430 U.S. 1 (1977); *Rondeau v. Mosinee Paper Corp.*, 422 U.S. 49, 58-59 (1975).

200. *Kennecott Corp. v. Smith*, 637 F.2d 181 (3d Cir. 1980); *MITE Corp. v. Dixon*, 633 F.2d 486 (7th Cir. 1980), *aff'd sub nom.*, *Edgar v. MITE Corp.*, 457 U.S. 624 (1982); *Great W. United Corp. v. Kidwell*, 577 F.2d 1256 (5th Cir. 1978), *rev'd on venue grounds sub nom.*, *Leroy v. Great W. United Corp.*, 443 U.S. 173 (1979); *Hi-Shear Indus. v. Campbell* [1981] Fed. Sec. L. Rep. (CCH) ¶ 97,804 (D.S.C. 1981); *Natomas Co. v. Bryon*, 512 F. Supp. 191 (D. Nev. 1981); *Crane Co. v. Lam*, 509 F. Supp. 782 (E.D. Pa. 1981); *Kennecott Corp. v. Smith*, 507 F. Supp. 1206 (D.N.J. 1981); *Dart Indus. v. Conrad*, 462 F. Supp. 1 (S.D. Ind. 1978). *But see* *AMCA Int'l Corp. v. Krouse*, 482 F. Supp. 929 (S.D. Ohio 1979) (upholding a state takeover statute that placed burdensome regulations on hostile takeover attempts).

201. 430 U.S. 1 (1977).

202. *Id.* at 29-30.

203. *Id.* at 29.

204. Justice White's opinion represented the opinion of the Court only with regard to Parts I (statement of the facts), II (holding that the case was not moot), and V-B (holding the Illinois act invalid under the Commerce Clause) of that opinion. Justice White's discussion of the Williams Act was not accepted by a majority of the court.

205. 457 U.S. 624 (1982).

206. Justice White held that the Illinois act was unconstitutional under the Supremacy Clause of the United States Constitution because the act conflicted with the purposes of the Williams Act. *See id.* at 630-640. The Illinois act "upset the careful balance struck by Congress" between the target company and the takeover bidder. *Id.* at 634.

207. *Id.* at 633; *see also* 113 CONG. REC. 24664 (1967).

mation but also by withholding from management or the bidder any *undue advantage that could frustrate the exercise of an informed choice.*"²⁰⁸

Several lower courts also have discussed the objectives of the Williams Act in examining the validity of state takeover statutes. United States Courts of Appeal for the Third, Fifth and Seventh Circuits, as well as numerous district courts, have recognized the Act's balancing objective in the context of state statutes.²⁰⁹ The United States Court of Appeals for the Fifth Circuit, in *Great Western United Corp. v. Kidwell*,²¹⁰ issued the most thorough explanation of the balance Congress intended to establish between target corporation and tender offeror. The court emphasized that the "cornerstone" of Congress' approach to investor protection was "deliberate neutrality" among the tender offer participants.²¹¹ According to the court, this balance was "indispensable" to the proper operation of the Williams Act.²¹²

The United States Court of Appeals for the Seventh Circuit, in *MITE Corp. v. Dixon*,²¹³ agreed with *Kidwell's* interpretation of the Williams Act. The court identified preserving a balance between the contending sides in a takeover battle as the Act's "principal means of investor protection."²¹⁴ Similarly, the United States Court of Appeals for the Third Circuit maintained in *Kennecott Corp. v. Smith*²¹⁵ that the Act sought to balance the target management and the takeover bidder in such a way that "neither has

208. 457 U.S. at 634 (emphasis added). Although this view was not adopted officially by the majority of the Court, no other opinion in the case specifically rejected this language.

209. See *supra* note 200. Even the Second Circuit in *Buffalo Forge Co. v. Ogden Corp.*, 717 F.2d 757 (2d Cir. 1983), in adopting the deception test, acknowledged Congress' balancing objective. See *id.* at 760.

210. 577 F.2d 1256 (5th Cir. 1978), *rev'd on venue grounds sub nom.*, *Leroy v. Great W. United Corp.*, 443 U.S. 173 (1979).

211. See *id.* at 1277.

212. See *id.* at 1279-80. The court invalidated the Idaho takeover statute because it disrupted the balance established by the Williams Act. One reason the Idaho act conflicted with the Williams Act is that it required the offeror to disclose too much information. By confusing the investor with a "mass of irrelevant data," the Idaho scheme refused the offeror a fair opportunity to present his case. See *id.* at 1280.

213. 633 F.2d 486 (7th Cir. 1980), *aff'd sub nom.*, *Edgar v. MITE Corp.*, 457 U.S. 624 (1982).

214. *Id.* at 496.

215. 637 F.2d 181 (3d Cir. 1980).

an undue advantage."²¹⁶

The Competitive Balance Test

The legislative history of the Williams Act reveals that Congress had a general purpose of investor protection and a specific purpose of guaranteeing informed and effective shareholder choice.²¹⁷ To effectuate these purposes, Congress designed the Act to accomplish two specific objectives: full disclosure of pertinent information and maintenance of a competitive balance between the tender offer participants.²¹⁸ Congress believed that the statute must further both goals to achieve adequate investor protection.²¹⁹

After identifying the Act's specific objectives, the meaning of section 14(e) manipulation becomes clearer. Congress did not forbid manipulation to achieve the disclosure objective. Absent the manipulation language, the section 14(e) prohibition of "fraudulent" and "deceptive" acts still proscribes non-disclosure.²²⁰ Therefore, Congress must have intended the anti-manipulation provision to further the balancing objective. Under this view, manipulation includes any action intended to destroy the competitive balance between target corporation and tender offeror. Any tactic that affords either party an unfair advantage in the takeover battle is manipulative under section 14(e).

A corollary definition of manipulation follows from the competitive balance test, one that applies more directly to lock-up arrangements. In any situation involving competing tender offerors,²²¹ a manipulative action is one designed by management to disrupt the competitive balance between bidders. The target corporation must not give one bidder an unfair advantage over his competitors.²²²

216. *Id.* at 188.

217. See *supra* text accompanying notes 83-99.

218. See *supra* text accompanying notes 188-208.

219. See *Data Probe Acquisition Corp. v. Datatab, Inc.*, 568 F. Supp. 1538, 1546-47 (S.D.N.Y.), *rev'd*, 722 F.2d 1 (2d Cir. 1983).

220. See 15 U.S.C. § 78n(e) (1982).

221. Or any situation in which a competing bidder would make a tender offer absent arrangements between the target management and the original bidder.

222. Weiss maintains a similar view regarding manipulation under section 14(e). He suggests that actions are manipulative when they "block a potential offeror or seller from entering the market or when they place one offeror or seller in a preferred position vis-a-vis all others." Weiss, *supra* note 20, at 1121.

Although the legislative history of the Williams Act mentions nothing about preserving competitive bidding, this corollary definition is consistent with the objective of balance between management and takeover bidder. If section 14(e) permitted the target to confer a significant advantage on one bidder, it would destroy the competitive balance between the target corporation and the hostile bidder. In that situation, management would always win; it could choose the successful bidder.

The competitive balance test places significant restraints on management²²³ during the tender offer process. It does not require, however, management's complete passivity in the face of a tender offer.²²⁴ The legislative history of the Williams Act shows that Congress recognized management's right to oppose takeover bids actively.²²⁵ In fact, requiring management to remain passive would violate the competitive balance test and undermine the Act's primary purpose. It would give the tender offeror an almost insurmountable advantage. Any offer at a premium price, no matter

223. Section 14(e) and the competitive balance test apply with equal force to tender offerors as well. The committee hearings clearly indicate, however, that the proponents of the Williams Act were concerned with limiting the target management's behavior. Chairman Cohen asserted that the Act would substantially reduce incumbent management's ability "to frustrate an attractive and desirable tender offer." *Senate Hearings, supra* note 85, at 184. Cohen also suggested that the Act would curb certain "unfair" practices presently engaged in by "entrenched management." *Id.* at 178.

224. An ongoing debate exists as to whether a target corporation should oppose a takeover bid. Lipton argues that "once the board of directors has in good faith and on a reasonable basis determined to reject a takeover bid, the target may take any reasonable action to accomplish this purpose" and should in fact take such action. Lipton, *Takeover Bids in the Target's Boardroom; An Update After One Year*, 36 BUS. LAW. 1017, 1017 (1981); Lipton, *Takeover Bids in the Target's Boardroom*, 35 BUS. LAW. 101 (1979); see also Herzel, Schmidt & Davis, *Why Corporate Directors Have a Right to Resist Tender Offers*, 3 CORP. L. REV. 107 (1980).

Conversely, Easterbrook and Fischel assert that resisting takeover bids reduces shareholder welfare. Therefore, they advocate a "passivity standard": management should remain completely passive in the face of a tender offer. See Easterbrook & Fischel, *Takeover Bids, Defensive Tactics, and Shareholders' Welfare*, 36 BUS. LAW. 1733 (1981); Easterbrook & Fischel, *The Proper Role of a Target's Management in Responding to a Tender Offer*, 94 HARV. L. REV. 1161 (1981); see also Gilson, *A Structural Approach to Corporations: The Case Against Defensive Tactics in Tender Offers*, 33 STAN. L. REV. 819 (1981).

225. See *Senate Hearings, supra* note 85, at 57 (testimony of Professor Hayes) (management has "the resources and the arsenal of moves and countermoves which can adequately protect their interests"); *House Hearings, supra* note 187 at 17 (testimony of Manuel Cohen, SEC Chairman) (recognizing that management can resist takeover bids, but that the Williams Act will not assist that resistance).

how inadequate or contrary to the investors' interests, probably would succeed unless a white knight appeared on its own initiative.²²⁶ Thus, passivity would defeat effective shareholder choice.

The competitive balance test also does not prevent the target corporation from favoring one bidder over another or from granting a bidder some advantage. Any arrangement with a favored bidder that is consistent with competitive principals is acceptable under section 14(e). The competitive balance test only prohibits the allowance of undue advantage. Management's behavior is manipulative only when the conferred advantage is so great as to preclude or cripple competition.

The Validity of Lock-ups: Applying the Competitive Balance Test

Under the competitive balance test, a lock-up is manipulative if it disrupts the competitive balance between competing tender offers.²²⁷ This test necessarily is subjective to some extent. Because the circumstances surrounding all takeover battles differ, no rigid rules can identify the mandated competitive balance in all cases. Rather, whether a particular lock-up arrangement violates section 14(e) depends on the specific factual situation. The courts essentially must determine on a case-by-case basis whether a given lock-up device unduly restricts competition.

The courts, however, are not completely without guidance. In most cases, application of the competitive balance test will render predictable results. Such certainty is possible because some lock-

226. See Comment, *supra* note 2, at 704.

227. The shareholder-choice test developed in *Data Probe* is not inconsistent with the competitive balance test. The primary difference between the two approaches simply is that although the *Data Probe* test derives from the Williams Act's general purpose—maintaining meaningful investor choice—the competitive balance test is based on Congress' specific method for protecting that choice. Consequently, the two tests technically should render identical results.

The competitive balance test is superior, however, for at least two reasons. First, the competitive balance test offers a clearer standard by focusing on something more tangible: the specific method adopted to achieve the Act's purpose.

More importantly, the competitive balance test allows the courts to narrow the scope of their manipulation analysis. The courts need only examine the tender offer participants' actions and then consider the effect of those actions on the other participants. In addition, courts are reasonably familiar with this type of examination. See *supra* notes 221-22.

up arrangements are subject to per se application. Stock lock-ups granting a majority (or some similar high percentage)²²⁸ of the target's shares to a favored bidder, and asset lock-ups involving the target's "crown jewel" are manipulative per se. Such arrangements necessarily destroy the competitive balance between tender offerors. They force the disfavored offeror to discontinue bidding because of the white knight's insurmountable advantage.

The asset lock-ups in *Mobil* and *Whittaker Corp. v. Edgar*²²⁹ fall into this category. In both, the asset in question was the target asset most attractive to the hostile bidder, and neither offeror was willing to continue bidding if unable to acquire the "locked-up" asset.²³⁰ Therefore, these lock-ups completely precluded competition. The stock lock-up in *Data Probe* also represented a per se section 14(e) violation. The option to purchase stock that was the equivalent of two hundred percent of the target's outstanding shares necessarily ended the bidding contest. The favored offeror could acquire the target simply by exercising its option.²³¹

Similarly, other lock-ups are valid per se under section 14(e). This category includes asset lock-ups involving unimportant target assets and stock lock-ups that allow the favored bidder to purchase only a small amount of stock, such as ten percent of the target's outstanding shares. Such arrangements openly promote competition by increasing the number of bidders. They simply give the lock-up recipient a slight advantage to lure it into or ensure continued participation in a bidding contest.²³²

Application of the competitive balance test in the grey area between these two classes of lock-ups, however, is more uncertain. The grey area consists of those lock-ups that grant the favored bidder a significant advantage, but at least technically allow some room for further competition. Such lock-ups are not subject to per

228. No bright line exists regarding the percentage of stock that can be lawfully locked-up. In general, any lock-up granting an offeror over one-third of the target's shares should be manipulative per se.

229. 535 F. Supp. 933 (N.D. Ill. 1982).

230. See *Mobil Corp. v. Marathon Oil Co.*, 669 F.2d at 375; *Whittaker Corp. v. Edgar*, 535 F. Supp. at 943.

231. See 568 F. Supp. 1538, 1542, 1562 (S.D.N.Y.), *rev'd*, 722 F.2d 1 (2d Cir. 1983).

232. See *Fraidin & Franco*, *supra* note 4, at 823; see *supra* text accompanying notes 30-32.

se application. Instead, the court in each case must determine whether the challenged arrangement unduly restricts the hostile offeror's competitive abilities. The standard employed in making this determination should be whether, in light of all the circumstances, a reasonable offeror would continue bidding despite the lock-up arrangement.²³³

For this group of lock-ups, the decision in each case will rest on the nature of both the lock-up at issue and the bidding contest generally. In *Mobil*, for instance, the option to purchase seventeen percent of Marathon's shares, absent more, probably would survive section 14(e) analysis. The option price, however, was \$35 per share below U.S. Steel's tender offer price, giving U.S. Steel an initial \$1.2 billion financial advantage.²³⁴ No reasonable offeror would continue bidding under such circumstances. Therefore, the lock-up was manipulative under the competitive balance test.

CONCLUSION

Because of their effectiveness, lock-up arrangements will continue to play an important role in the tender offer process. In ruling on the validity of these arrangements, however, the courts must ensure that lock-ups are not used to undermine investor rights by destroying the careful balance that Congress struck between the target corporation and the tender offeror. The deception test, which equates section 14(e) manipulation and misrepresentation, misinterprets the purpose behind section 14(e) and fails to provide sufficient investor protection. Because it recognizes Congress' goal of "balancing the scales" between tender offer participants, the competitive balance test represents the proper approach to defining section 14(e) manipulation. Only this approach safeguards the investors' right of meaningful choice in the tender offer process.

BRADLEY A. MAXA

233. The court should examine all the factors a reasonable offeror probably would consider in determining its course of action. The primary factor in most cases often is likely to be the offeror's possibility of success after execution of the lock-up.

234. See 669 F.2d at 375-76.