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FOR DEFENSIVE TACTICS:
IS THERE SUBSTANCE TO THE
PROPORTIONALITY REVIEW?

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Abstract

This paper examines the possible meanings of the Delaware Supreme Court's most recent formulation of the scope of target management discretion to resist a takeover: that the management's defensive tactics must be "reasonable in relation to the threat posed" by the hostile offer. Part I traces the origin of this test. Part II then identifies two questions that are key to evaluating whether the proportionality test has substance. First, does the test require more than just a threshold inquiry: that is, if target management can show that some defensive action may be warranted, must the court nonetheless evaluate the appropriateness of management's particular response? Second, what characteristics of a hostile offer warrant defensive action: that is, what threats to shareholder interests might a tender offer pose? Next, Part III examines in greater detail one of the most common -- and for the proportionality test, the most troublesome -- of the threats that target managers identify in support of defensive tactics. This threat, which we term "substantive coercion," is the claim that the shareholders will voluntarily tender to an underpriced offer. Finally, Part IV describes the key elements of a proportionality test that can effectively screen target managements' claim of shareholder coercion by underpriced offers.

The courts have long struggled with how to review management's efforts to deter or defeat hostile takeovers. Neither of the usual standards of review in corporate law, the business judgment rule and the intrinsic fairness test, quite seem to fit defensive measures that implicate both management's business acumen and its loyalty to shareholder interests. Evaluating a sale of the company is a complex business decision. From this perspective, management's response to a takeover bid resembles the normal business decisions that the business judgment rule largely insulates from judicial review.¹ At the same time, however, a hostile takeover creates a potential conflict of interest, no matter what response it evokes from management. Target managers who approve an offer may be improperly influenced by post-transaction benefits;² target managers who reject an offer

1. This argument has formed the core of Martin Lipton's tenacious defense of an undiluted application of the business judgment rule to defensive conduct. See, e.g., Lipton, Takeover Bids in the Target's Boardroom, 35 Bus. Law. 101 (1979); Lipton, Takeover Bids in the Target's Boardroom: An Update After One Year, 36 Bus. Law. 1017 (1981); Lipton & Brownstein, Takeover Responses and Director Responsibilities -- An Update, 40 Bus. Law. 1403 (1985). More recently, Lipton has concluded that, if abusive tactics by bidders were curbed, most defensive tactics would no longer be justified. See Lipton, Corporate Governance in the Age of Finance Capitalism, 136 U. Pa. L. Rev. 1 (1987).

2. The best example is a third-party leveraged buyout in which management participates. In such a transaction, target management receives a substantial ownership interest in the company if the buyout is completed. For example, in a sample of 28 management buyouts between 1979 and 1984, target management's ownership interest in the company rose from an average of 6.5% prior to the transaction to an average of 24.3% after the transaction. Lowenstein, Management Buyouts, 85 Col. L. Rev. 730, 737 (1985).

may act largely to secure their own positions. From this perspective, responding to a hostile takeover is an interested transaction that calls for judicial review under the intrinsic fairness test. Yet, invoking this rigorous standard would simply condemn most defensive tactics without any justification beyond the standard itself.³

In this Article, we examine the most recent response of the Delaware courts to the tension between the intrinsic fairness and business judgment standards in the takeover context: an intermediate standard of review mandating that management's defensive tactics must be "reasonable in relation to the threat posed" by a hostile offer.⁴ The evolutionary trajectory of this proportionality test is far from certain. Our goal here is neither to endorse proportionality review as the best approach to regulating defensive tactics nor to provide an exhaustive account of recent Delaware case law. Rather, taking Delaware's adoption of proportionality review as given, our chief objective is to facilitate the informed development of this standard as rapidly, and with as little ambiguity, as possible.

There is good reason to chart the range of possible understandings of Delaware's new test at an early date. Delaware corporate law -- in which the proportionality test now plays a major

3. See Gilson, A Structural Approach to Corporations: The Case Against Defensive Tactics in Tender Offers, 33 Stan. L. Rev. 819, 824-31 (1981).

4. Unocal v. Mesa Petroleum, 493 A.2d 946, 955 (Del. S. Ct. 1985).

role -- governs the largest proportion of what are the largest business transactions in history. Yet, the sheer volume of takeover litigation threatens to deprive the proportionality test of the time and experience that ordinarily inform the articulation of a major common law doctrine. Commentary that attempts to resolve uncertainty about the substance of the proportionality test is therefore critical.

Part I of this Article traces the origins of the Delaware proportionality test. Part II then identifies two questions that are key to evaluating whether the proportionality test has substance. First, does the test require more than just a threshold inquiry: that is, if target management can show that some defensive action may be warranted, must the court nonetheless evaluate the appropriateness of management's particular response? Second, what characteristics of a hostile offer warrant defensive action: that is, what threats to shareholder interests might a tender offer pose? Next, Part III examines in greater detail one of the most common -- and for the proportionality test, the most troublesome -- of the threats that target managers identify in support of defensive tactics. This threat, which we term "substantive coercion," is the claim that shareholders will voluntarily tender to an underpriced offer. Finally, Part IV describes the key elements of a proportionality test that can effectively screen target managements' claims of shareholder coercion by underpriced offers and the beneficial consequences of

adopting such a test.

I. THE ORIGINS OF THE PROPORTIONALITY TEST

The proportionality test is not the Delaware courts' first effort to wrestle with the difficulty of reviewing defensive tactics. Long before the most recent wave of takeover cases, *Cheff v. Mathes*⁵ demonstrated the subtlety with which the Delaware courts could disarm the seeming conflict between the intrinsic fairness and business judgment standards of review in takeover settings. *Cheff* framed a policy conflict/primary purpose test under which management's motives set the standard of review for defensive tactics. If management could demonstrate disagreement over corporate policy with a would-be acquirer, it was presumed to act from business considerations rather than self-interest. With the specter of a breach of duty of loyalty thus conveniently set aside, the appropriate standard of review became the business judgment rule:

[T]he directors satisfy their burden by showing good faith and reasonable investigation; the directors will not be penalized for an honest mistake of judgment, if the judgment appeared reasonable at the time the decision was made.⁶

Because competent counsel could always document a policy conflict with an acquirer on behalf of defending management, moreover, the *Cheff* test inevitably reduced to a routine application of the

5. 41 Del. Ch. 494, 199 A.2d 548 (1964).

6. 41 Del Ch. at 506, 199 A.2d at 555.

business judgment standard.

Ironically, Cheff's resolution of the problem of judicial review survived unchanged only as long as its implication -- blanket protection of defensive tactics -- remained at least partly submerged. By the early 1980's, this implication was fully visible. Novel financing techniques and a dramatic rise in takeover activity stimulated demand for improved takeover defenses. New defenses, in turn, prompted new litigation and a long string of victories for targets⁷ that soon revealed the full scope of management's discretion to block takeovers under Cheff's motive analysis.⁸ Inevitably, top takeover lawyers began to pass Cheff's implicit message on to their clients:⁹ If target managers, in good faith and after reasonable investigation, could locate a policy conflict with a would-be acquirer, any defensive

7. Although defensive tactics were enjoined in a number of cases in this period, the losing targets were largely smaller companies without the benefit of advice from special counsel and investment bankers. See *Podesta v. Calumet industries, Inc.*, [1977-8 Transfer Binder] (CCH) 96,433 (N.D. Ill. 1978); *Royal Industries, Inc. v. Monogram industries, Inc.*, [1976-7 Transfer Binder] (CCH) 96,584 (S.D.N.Y. 1978); *Applied Digital Data Systems, Inc. v. Milgo Elec. Corp.*, 425 F. Supp. 1145 (S.D.N.Y. 1977).

8. This expansion in management discretion to take actions to deflect hostile offers probably hit its apogee in *Panter v. Marshall Field & Co.*, 646 F.2d 271, cert. denied 454 U.S. 1092 (1981).

9. Arguably the interpretations of case law by top takeover lawyers are among the most important sources of takeover law. It is these interpretations, after all, that give operational content to the law. The discretion that Cheff appeared to promise from the outset remained latent until an accumulation of favorable precedent encouraged the corporate bar to exploit the full implications of the motive test.

response would be protected under the business judgment rule.¹⁰

As Cheff's implications became clearly visible, however, they attracted hostile notice from other corners. An outpouring of academic commentary called for constraints on defensive tactics,¹¹ and it even appear possible that Congress might act to displace state law -- and especially Delaware law -- that was thought to be unduely favorable to target management. The political situation thus recalled an earlier period prior to the Delaware Supreme Court's decision in Singer v. Magnavox¹². Then, the sensitive issue was the dearth of standards governing the freezeout of minority shareholders by majority or controlling shareholders. And when the outcry became too loud, the Delaware Supreme Court announced a new, seemingly more stringent standard of review that promised to constrain management's discretion to force out minority shareholders.¹³ Thus, there was an historical

10. Martin Lipton put the matter as follows: "Where the directors have made a reasonable good-faith decision to reject the takeover on one or more of the bases set forth above, the business judgment rule should apply equally to any and all defensive tactics." Lipton, Takeover Bids in the Target's Boardroom, supra note 1, at 124.

11. See, e.g., Lynch & Steinberg, The Legitimacy of Defensive Tactics in Tender Offers, 64 Cornell L.Q. 901 (1979); Gelfond & Sebastian, Reevaluating the Duties of Target Management in a Hostile Tender Offer, 60 B.U.L. Rev. 403 (1980); Easterbrook & Fischel, The Proper Role of a Target's Management in Responding to a Tender Offer, 94 Harv. L. Rev. 1161 (1981); Gilson, supra note 3; Bebchuck, The Case for Facilitating Competing Tender Offers, 95 Harv. L. Rev. 1028 (1982).

12. 380 A.2d 969 (1977).

13. For suggestions that the Delaware Court's decision in Singer was influenced by political considerations, see, e.g., R. Gilson, The Law and Finance of Corporate Acquisitions 870-2 (1986); Herzl

basis for predicting that political pressure might eventually prompt the Delaware courts to tighten the lax standard of review implicit in Cheff's policy conflict/primary purpose test.

In principle, the Delaware courts had two quite different doctrinal options for reforming the Cheff standard. On the one hand, the courts could have restricted defensive tactics by emphasizing the primacy of shareholder choice to accept or reject a hostile offer that follows from the role of the tender offer in the structure of the corporation. Precisely because target management can unilaterally block a merger or sale of assets, a takeover can occur without management approval only through a tender offer made directly to target shareholders. Thus, management enjoys a monopoly over corporate control unless it is restrained from preventing shareholders from tendering to a hostile offeror.¹⁴ Alternatively, the courts could have moved from the Cheff standard to an intermediate standard of judicial review that contemplated a genuine effort to distinguish defensive tactics that might benefit shareholders from suspect tactics designed to entrench management.

In fact, the Delaware Supreme Court opted for the more con-

& Collings, Squeeze-Out Mergers in Delaware -- The Delaware Supreme Court Decision in Weinberger v. UOP, Inc., 7 Corp. L. Rev. 195 (1984); Thompson, Squeeze-Out Mergers and the "New" Appraisal Remedy, 62 Wash. U.L.Q. 415, 420 (1984); Brudney & Chirelstein, A Restatement of Corporate Freezeouts, 87 Yale L. J. 1354, 1354n.2 (1978).

14. See Gilson, *supra* note 3, at 841-50.

servative of the two approaches -- the intermediate standard of review -- in a trilogy of decisions handed down in 1985 and early 1986: *Unocal v. Mesa Petroleum*,¹⁵ *Moran v. Household International, Inc.*,¹⁶ and *Revlon v. MacAndrews and Forbes Holdings, Inc.*¹⁷ These opinions fortify the older Cheff standard by adding a second step to the traditional policy conflict/primary purpose analysis. Under the new standard, management can no longer qualify for the protections of the business judgment rule simply by pointing to a "danger to corporate policy" based on a carefully orchestrated record. Now, defensive tactics must also face a proportionality test: They must be shown to be "reasonable in relation to the threat posed."¹⁸

15. 493 A.2d 946 (Del. S. Ct. 1985).

16. 500 A.2d 1346 (Del. S. Ct. 1985).

17. 506 A.2d 173 (Del. S. Ct. 1986).

18. In Revlon, the Court summarized both steps in the review:

[W]hen a board implements anti-takeover measures there arises "the omnipresent specter that a board may be acting in its own interests, rather than those of the corporation and its shareholders. . . ." Unocal Corp. v. Mesa Petroleum Co., 493 A2d at 954. This potential for conflict places upon the directors the burden of proving that they had reasonable grounds for believing there was a danger to corporate policy and effectiveness, a burden satisfied by a showing of good faith and reasonable investigation. Id. at 955. In addition, the directors must analyze the nature of the takeover and its effect on the corporation in order to ensure balance -- that the responsive action is reasonable in relation to the threat posed. Id.

506 A.2d at 180.

The proportionality test brings a novel objective standard to the review of defensive tactics -- a reasonableness test that impliedly allows courts to identify and reject unreasonable tactics, whatever the motives of their authors. For corporate planners, however, the critical issue is how far the Delaware Supreme Court intends this novel rhetoric to signal a change in the actual substance of review. Again, Delaware's experience with adopting a more restrictive standard governing minority freezeouts provides a cautionary tale for the planner. In *Singer v. Magnavox*,¹⁹ the Delaware Supreme Court boldly announced a new burden on controlling shareholders to show that freezeouts met an "entire fairness" standard and served an independent business purpose apart from simply eliminating minority shareholders. Yet, by the time that *Weinberger v. UOP, Inc.*²⁰ was decided six years later, *Singer*'s requirements dwindled to little more than an inquiry into the fairness of the price paid to minority shareholders.²¹ The key question, then, is whether a similar fate awaits the new standard for reviewing defensive tactics. Put differently, is there likely to be substance to proportionality review?

II. THE MEANING OF PROPORTIONALITY REVIEW

19. 380 A.2d 969 (Del. S. Ct. 1977).

20. 457 A.2d 701 (Del. S. Ct. 1983).

21. See R. Gilson, *supra* note 13, at 904-07.

The uncertainty attending second-step proportionality review in the wake of Unocal, Moran, and Revlon centers on three issues. The initial question is whether the new standard is intended to be a substantive constraint on defensive tactics or merely another formal justification for defensive tactics that corporate planners must recite to succeed. If the standard is substantive, as we believe it is, two further questions follow from the requirement that defensive tactics be "reasonable" in relation to a "threat". First, does the new standard regulate defensive responses or merely pose a threshold test: that is, supposing some threat is shown, how far does the new standard nonetheless constrain the range of permissible tactics? Second, and closely related, what forms of hostile offers -- if any -- might fail to qualify as "threats", and so preclude any defensive tactics under the proportionality test?

A. Is There Substance to Proportionality Review?

Unocal, Moran, and Revlon can be read to suggest that proportionality review is primarily a formal, rhetorical instruction rather than substantive standard of review.²² On this view, the new standard, like the old policy conflict/primary purpose test, serves chiefly to signal judicial concern and to invite planners to proceed with their defenses only after constructing a record that demonstrates reasonableness and articulates a "threat". The

22. See, e.g., Johnson & Siegel, Corporate Mergers: Redefining the Role of Target Directors, 136 U. Penn. L. Rev. 315, 332-37 (1987).

best evidence for this construction is how little effort the Delaware Supreme Court devoted to justifying the discriminatory repurchase in Unocal²³ and the poison pill in Moran²⁴ as "proportional" to the threats posed by two-tier, front-end loaded offers and offers financed by junk bonds (or any offers made by T. Boone Pickens²⁵). The Revlon case, moreover, may be consistent with this minimalist construction insofar as it pointedly invokes the directors' duty of loyalty in lieu of a proportionality argument to block management's defensive lock-up option.²⁶

23. In Unocal, the Court's entire discussion of the coercive impact of two-tier offers consisted of the following sentence: "It is now well recognized that such [two-tiered] offers are a classic coercive measure designed to stampede shareholders into tendering at the first tier, even if the price is inadequate, out of fear of what they will receive at the back end of the transaction." 493 A.2d at 956 (citation omitted).

24. In Moran, the Court's discussion of proportionality review consisted of the following paragraph:

[T]o meet their burden, the Directors must show that the defensive mechanism was "reasonable in relationship to the threat posed." The record reflects a concern on the part of the Directors over the increasing frequency in the financial services industry of "bootstrap" and "bustup" takeovers. The Directors were also concerned that such takeovers may take the form of two-tier offers. . . . In sum, the Directors reasonably believed Household was vulnerable to coercive acquisition techniques and adopted a reasonable defensive mechanism to protect itself.

500 A.2d at 1357.

25. In Unocal, the Court seems to have held that the very fact that the offer was made by Pickens constituted a sufficient threat: "Wholly beyond the coercive aspect of an inadequate two-tier tender offer, the threat was posed by a corporate raider with a national reputation as 'greenmailer'." 493 A.2d at 956. The Court expressed a similar view of Pickens in Ivanhoe Partners v. Newmont Mining Corp., 535 A.2d 1334, 1342 (Del S.Ct. 1987).

The difficulty with construing proportionality review as simple rhetoric, however, is the care that the Delaware Court has taken to announce and reiterate the new standard. Surely, there are less confusing ways to demonstrate rhetorical concern than to articulate a new and potentially far-reaching standard of review. A more prudent reading of the cases takes proportionality review seriously. The cases introducing the new standard point to the significance of concrete threats.²⁷ The Mesa offer in Unocal was

26. "[W]hen the Revlon board entered into an auction-ending lock-up agreement with Forstmann on the basis of impermissible considerations [the fear of threatened litigation by noteholders] at the expense of the shareholders, the directors breached their primary duty of loyalty." 506 A.2d at 182.

Revlon also sets an additional limit on the operation of the proportionality test. Once it becomes "inevitable" that the target company will be sold, the obligation of the board changes appreciably:

The duty of the board had thus changed from the preservation of Revlon as a corporate entity to the maximization of the company's value at a sale for the stockholders' benefit. This significantly altered the board's responsibilities under the Unocal standards. It no longer faced threats to corporate policy or effectiveness, or to the stockholders' interests, from a grossly inadequate bid. The whole question of defensive measures becomes moot. The directors' role changed from defenders of the corporate position to auctioneers charged with getting the best price for the stockholders at a sale of the company.

506 A.2d at 182. See *Ivanhoe Partners v. Newmont Mining Corp.*, 535 A.2d 1334, 1338 (Del S.Ct. 1987) (distinguishing between the proportionality test and "the Revlon obligation to conduct a sale of the corporation"). Determining when a sale becomes inevitable is then a critical question. So, for example, if target directors adopt a restructuring plan in response to a hostile bid, is the plan a defensive tactic governed by Unocal proportionality review, or is it, in effect, a competing bid that demonstrates the inevitability of the company's sale, thereby triggering the Revlon auction standard? See note 65 infra.

27. As the Delaware Chancery Court has recently observed:

at least potentially coercive, and the poison pill in Moran, because it could be redeemed by the board, did not foreclose a particular offer. Indeed, the Court in Moran stressed that should the board determine not to redeem the pill when an actual offer was made, its decision could then be reviewed under the two-step test. Not redeeming the pill would itself qualify as a defensive tactic that management would have to justify as reasonable in relation to the threat posed by the particular offer.²⁸

Yet, concluding that Unocal, Moran, and Revlon are likely to contemplate a form of substantive review by the courts only begins the inquiry. The more difficult questions concern how rigorous a developed standard of proportionality review is likely to become.

B. Is the New Standard More than a Threshold Test?

One question is whether the proportionality standard is a threshold test or a form of regulatory review. To see this distinction clearly, consider the ambiguous holdings of Unocal and Moran, which establish that potentially coercive bids justify some forms of defensive action without indicating the range of permissible forms. If the proportionality standard is a threshold test, any hostile offer that is arguably coercive would

"Takeover bids found to be a threat have typically involved a coercively structured proposal, such as a two-tier hostile tender offer. (citation omitted)" Robert M. Bass Group, Inc. v. Evans, ___ A.2d. ___ (Del. Ch., July 14, 1988).

28. 500 A.2d at 1354.

give management a free hand without further scrutiny by the courts. By contrast, if the standard is a regulatory test, management would be forced to justify its choice of defensive actions by reference to the amount of coercion associated with a particular bid. This difference is significant because any bid, apart from an any-or-all cash bid with a commitment to freeze out non-tendering shareholders at the bid price, may have some coercive effect on target shareholders.²⁹ Thus, unless the "propor-

29. Consider an offer that may seem non-coercive on its face: a 100% cash offer at a significant premium, but without any commitment to buy out non-tendering shareholders at a fixed price. A shareholder who believes that the stock is worth more than the offer, perhaps because he expects a higher offer in the future, would prefer not to tender. However, if he does not tender while other shareholders do tender, he will be left holding minority shares in a controlled corporation with a market value that is likely to be well below the tender offer price. Thus any partial offer, including an any-or-all offer without a freezeout commitment, is potentially coercive. See Bebchuk, Toward Undistorted Choice and Equal Treatment in Corporate Takeovers, 98 Harv. L. Rev. 1693, 1717-35 (1985). How much shareholders are actually coerced in practice, however, is open to debate. The risk of competing bidders limits the opportunity for initially coercive bids. Thus, the evidence suggests that the creation of an informal auction period under the Williams Act by Rule 14d-8's extension of the minimum offering period in partial (including two-tier) offers from 10 to 20 days eliminated the difference in premia between two-tier and any-or-all bids. As part of the SEC's study of the recommendations of its Advisory Committee on Tender Offers, the Office of the Chief Economist studied 148 tender offers between 1981-83, composed of 91 any-or-all offers, 32 two-tier offers, and 25 partial offers. Although for the entire sample the average premium in any-or-all offers exceeded that in two-tier offers by 8.3% (63.4% versus 55.1%), the order was reversed for offers made after the lengthening of the offer period (average premium of 66.4% for two-tier offers and 49.6% for any-and-all offers). See R. Gilson, *supra* note 13, at 853-54. A later study that extended the sample to include 1984 offers (so that offers made after the extension of the offer period comprised approximately half the sample) confirmed this result: over the entire sample, the premium averaged 56.6% in any-or-all offers and 55.9% in two-tier offers, a difference that was not statistically significant. Comment & Jarrell, Two-Tier and

tionality" element in the new standard has regulatory import, second-step review will have very little meaning for most offers as they are now framed.

The recent decision of the Delaware Court of Chancery in *AC Acquisitions Corp. v. Anderson, Clayton & Co.*³⁰ strongly argues that the proportionality test is more than a threshold standard. For our purposes, the facts of the case can be stated simply. A cash tender offer was made for a minimum of 51% of Anderson, Clayton's common stock at \$56 per share, with the announced intention of a second-step freezeout cash merger also at \$56 per share. Thus, the hostile offer was not coercive. A shareholder who viewed the \$56 price as too low could decline to tender without fear of being disadvantaged; if other shareholders tendered and the offer succeeded, the non-tendering shareholder would still receive the same price.

Anderson, Clayton responded by offering an alternative

Negotiated Tender Offers: The Imprisonment of the Free-riding Shareholder, 19 J. Fin. Econ. 310 (1987). This may explain the dramatic recent decline in the use of two-tier bids in third-party offers. While in 1982 and 1983 there were 35 third-party two-tier bids amounting to about 20% of all tender offers, in 1985 and 1986 there were only 11 such bids amounting to only about 3% of all tender offers, and in the first five months of 1987 there were none. See J. Grundfest, Two-Tier Tender Offers: A Mythectomy (June 15, 1987) (Address to the United Shareholders Association).

30. 519 A.2d 103 (Del. 1986). For an even more recent decision affirming the analysis of *Anderson, Clayton* on similar facts, see *Robert M. Bass Group, Inc. v. Evans*, ___ A.2d ___ (Del. Ch., July 14, 1988).

transaction that the company believed would result in greater value for its shareholders: an issuer self-tender for 65% of its common stock at \$60 per share.³¹ The company's offer, however, had one wrinkle. Because it had to be accepted before the hostile offer was completed, shareholders were coerced into accepting it. A shareholder who did not tender to the company because he preferred the hostile offer would run a major risk. If other shareholders tendered to the company, the hostile offer would be withdrawn and the non-tendering shareholder would be left with, in effect, the back-end of the company's two-tier offer: the reduced value of the remaining company shares after the repurchase of 65% of its stock at a premium.³²

In reviewing a challenge to this transaction, the Anderson, Clayton court easily approved the company's offer under the traditional first step of the two-step review: Providing sharehold-

31. The court described the calculation by Anderson, Clayton's investment banker of the value of the company's offer as follows: "\$60 cash price x 65.5% (proration figure) = \$39.34 cash + the per share value of the remaining 34.5% equity interest (\$13 to \$18 pre remaining share) or in total a range of \$52.34 to \$57.34 per existing share. 519 A.2d at 108 n.6.

32. Bradley & Rosenzweig, Defensive Stock Repurchases, 99 Harv. L. Rev. 1378 (1986), demonstrate that any repurchase by a target of less than the number of shares sought by the hostile bidder has the potential to be coercive in this way. Perhaps for this reason, two-tier offers have been most frequently used in recent years in support of management buyouts or, as in Anderson, Clayton, by management defending against a single tier hostile offer. See J. Grundfest, *supra* note 29.

In Anderson, Clayton, the coercive effect was magnified because the company's investment banker declined to give an opinion on the expected value of Anderson, Clayton shares after the repurchase, estimating only a range of \$13 to \$18. At all but the top end of this range, the hostile offer was more valuable.

ers with a competitive alternative to a hostile offer is self-evidently a valid corporate purpose. Yet, the court's analysis at the second step of the review was far from routine. The court might have reasoned, tautologically, that the company's offer should be considered "reasonably related" to the hostile offer by definition, merely because providing an alternative to this offer was an appropriate corporate purpose. But the court did not take this tact; instead, it carefully examined the alternative that the company actually provided:

The fatal defect with the Company Transaction, . . . becomes apparent when one attempts to apply the second leg of the Unocal test and ask whether the defensive step is "reasonable in relation to the threat posed." The [hostile] offer poses a "threat" of any kind (other than a threat to the incumbency of the Board) only in a special sense and on the assumption that a majority of the Company's shareholders might prefer an alternative to the [hostile] offer. On this assumption, it is reasonable to create an option that would permit shareholders to keep an equity interest in the firm, but, in my opinion, it is not reasonable in relation to such a "threat" to structure such an option so as to preclude as a practical matter shareholders from accepting the [hostile] offer.³³

Thus, Anderson, Clayton clearly indicates that proportionality review, unlike the policy conflict/primary purpose test, is not an empty threshold test: defensive tactics must be justified in relationship to the particular terms of hostile offers.³⁴ This

33. 519 A.2d at 112-3.

34. Anderson, Clayton's analysis is developed even more pointedly in the recent Robert M. Bass Group decision, where the Delaware Court of Chancery observes that a reasonable response to an alleged underpriced offer is to "develop an even more valuable economic alternative" for shareholders. ____ A.2d at ____ (Del. Ch., July 14, 1988).

is an important result in its own right, even if it still leaves open the basic issue of how the Delaware courts will balance defensive tactics against the terms of hostile offers in other contexts.

C. What Constitutes a Threat?

Thus far, it appears, the proportionality test limits the range of permissible defensive tactics according to the nature of the threat associated with a particular hostile offer. It is a short step from this observation to the next question: What, then, constitutes a "threat" under the proportionality test? If "threat" means that a takeover bid must pose a demonstrable risk of injury to target shareholders, might some takeover bids arguably not threaten at all? The most serious aspect of developing the likely content of the proportionality test is that, in such cases, it might reasonably be construed to bar target management from initiating any significant defensive measures at all.

Unocal, Moran, and Anderson, Clayton illustrate easy circumstances under the proportionality test for locating a threat that might reasonably seem to warrant a defensive response of some kind. In Unocal and Moran, the structure of the hostile offers threatened to coerce shareholders into tendering on unfavorable terms. In Anderson, Clayton, a hostile offer threatened to deprive shareholders of access to management's alternative offer.

Leeway to respond to these threats under the proportionality test, however, will give little comfort to defensive planners who wish to keep their companies independent.³⁵ Indeed, a broad reading of Anderson, Clayton leads to a kind of safe harbor for hostile acquirers: In response to a hostile bid that is not coercive on its face, management can do no more than offer a genuine alternative. Although this reading admittedly represents a significant narrowing of prior Delaware law, it accords with Anderson, Clayton's holding that a hostile offer may be non-coercive when it promises to cash out non-tendering shareholders at an equal price.³⁶ As the court explicitly states, tactics that preclude shareholders from accepting a hostile offer are not, without more, reasonably related to the "threat" that shareholders will accept the offer.³⁷ Thus, the case may support the proposition that the proportionality test bars preclusive defensive action whenever non-coercive takeover bids offer equal treatment to non-tendering shareholders. Such a rule would dramatically restrict the flexibility of defensive planners in a market where hostile bidders can easily raise cash financing.

Similarly, defensive planners cannot take great comfort in

35. A fair reading of Anderson, Clayton suggests that maintaining independence was management's real motive.

36. 519 A.2d at 112.

37. Id. The court's holding is summarized in the passage from the Anderson, Clayton opinion set forth TAN 33 supra. For a parallel analysis, see Robert M. Bass Group, Inc. v. Evans, ___ A.2d ___, ___ (Del Ch., July 14, 1988).

Anderson, Clayton's invitation to offer shareholders a non-coercive alternative. Inherent in Anderson, Clayton's conception of providing shareholders with a choice is that they may choose to accept the hostile offer. Considered from this perspective, moreover, management's proposal for keeping a target company independent is simply an alternative to a hostile offer rather than a presumptively favored outcome. After all, if shareholders had selected Anderson, Clayton's self-tender offer, the company would have remained independent. Anderson, Clayton clearly allows management to offer the alternative of independence, but the logic of the opinion would seem to foreclose preclusive tactics that force shareholders to accept the independence option (or prevent shareholders from choosing at all).³⁸

38. Accord *Robert M. Bass Group, Inc. v. Evans*, ___ A.2d ___ (Del. Ch., July 14, 1988).

The Delaware Supreme Court's recent decision in *Ivanhoe Partners v. Newmont Mining Corp.*, 535 A.2d 1334 (Del. S.Ct. 1987), demonstrates that the road to doctrinal clarity in Delaware is neither straight nor straightforward. There Newmont management believed the company to be caught between two potentially coercive offers. On the one hand, Ivanhoe Partners, a Boone Pickens acquisition vehicle, had announced a hostile offer for 42% of Newmont's outstanding stock. Although the Ivanhoe offer stated that it intended to acquire all remaining shares for cash at the same price of the initial offer, its offer also stated, in contrast to the hostile offer in Anderson, Clayton, "that no specific second step transaction had been devised, and that there was no firm commitment to do so." 535 A.2d at 1139. As a result, the Court concluded that the Ivanhoe offer was a two-tier offer "fit[ting] perfectly the mold of . . . a coercive device." Id. at 1324.

On the other hand, Newmont management believed that Consolidated Gold Fields, Newmont's largest shareholder with 26% of the outstanding stock, also posed a threat of coercion. Gold Fields held its shares subject to a 1983 standstill agreement that limited Gold Fields to a maximum holding of 33 1/3%, but that terminated if any other party acquired more than 9.9%. When Ivanhoe intentionally increased its holding to 9.95%, Gold Fields

From the perspective of defensive planners who want to keep a target independent (and "un-restructured"), then, the critical issue in evaluating Delaware's new two-step proportionality review is what can cabin a broad reading of Anderson, Clayton. Put in doctrinal terms, what "threats" from hostile bidders, apart from unequal treatment for non-tendering shareholders, are sufficiently grave to justify preclusive defensive tactics without offering any transactional alternative at all? To take an obvious candidate, suppose that management honestly believed that the price of a non-coercive hostile offer was inadequate: in management's view, the securities market undervalued the target company's assets by more than the premium offered by the acquirer. Would a preclusive defense be "reasonably related" to

became free to "cancel the 1983 standstill agreement and acquire control of the company [presumably through market purchases], thus leaving the remaining shareholders without protection on the "back end." Id.

As such, Newmont's defensive tactic -- financing a Gold Fields street sweep with a \$33 per share special dividend that give Gold Fields 49.7% of the outstanding stock but subject to a revised standstill agreement that limited Gold Fields' board membership to 40% -- could be justified as a careful effort to steer a path between the coercion threatened, explicitly or implicitly, by both Ivanhoe and Gold Fields.

Analysis is complicated, however, by the fact that the Court also refers to Newmont's desire to remain independent: "The Newmont board acted to maintain the company's independence and not merely to preserve its own control." Id. at 1344. Our preferred interpretation of the Court's opinion treats its discussion of independence as simply loose language occurring in a context in which coercion was the dominant consideration, rather than as a statement that any hostile offer is a threat to a company's independence (and that any defense is therefore reasonably related to that threat), thereby reducing the proportionality test to rhetoric. Indeed, our goal in this Article is to avoid precisely this type of confusion.

the "threat" that shareholders might accept what management deems to be an inadequate price?³⁹

To date, the cases interpreting proportionality review offer precious little guidance on this single most important issue of what "threats" will support preclusive defenses by target managers. In Unocal, where the proportionality test was first unveiled, the Delaware Supreme Court provided a litany of factors that might bear on the existence of a threat:

If a defensive measure is to come within the ambit of the business judgment rule, it must be reasonable in relation to the threat posed. This entails an analysis by the directors of the nature of the takeover bid and its effect on the corporate enterprise. Examples of such concerns may include: inadequacy of the price offered, nature and timing of the offer, questions of illegality, the impact on "constituencies" (i.e., creditors, customers, employees, and perhaps even the community generally), the risk of nonconsummation, and the quality of the securities being offered in the exchange. While not a controlling factor, it also seems to us that a board may reasonably consider the basic

39. Anderson, Clayton itself avoids the issue by noting that the case presented an unusual circumstance in which target management did not claim that the price offered by the hostile bidder was inadequate:

Unlike most of our cases treating defensive tactics, the Board does not seek to justify the Company Transaction as necessary to fend off an offer that is inherently unfair. . . . The Board recognizes that the [hostile] offer -- being for all shares and offering cash consideration that the Board's expert advisor could not call unfair -- is one that a rational shareholder might prefer.

519 A.2d at 112. Other recent opinions, however, address underpriced offers as threats per se when managers can identify more valuable economic alternatives. See Robert M. Bass Group, Inc. v. Evans, ___ A.2d ___ (Del. Ch., July 14, 1988); BNS Inc. v. Koppers Co., Inc., 683 F. Supp. 458, 475 (D. Del. 1988).

stockholder interests at stake, including those of short term speculators, whose actions may have fueled the coercive aspect of the offer at the expense of the long term investor.⁴⁰

How might these factors rise to the threshold of "threats" able to justify a preclusive defense against a non-coercive takeover bid? The answer, clearly, is that these factors can be threats only if a target's directors' believe that shareholders will mistakenly accept a non-coercive offer.⁴¹ And this returns us to our starting point: the options open to the Delaware Supreme Court after determining that defensive tactics required a more rigorous standard of review. The Court might have proceeded directly by vesting shareholders with a qualified right to choose whether to accept a hostile offer without interference by target management. Instead, it opted to proceed indirectly by adopting an intermediate standard of review to screen when directors might unilaterally block shareholders from choosing at all. As our analysis reveals, however, this intermediate standard can only

40. 493 A.2d at 955-56 (citations and footnote omitted). This litany is repeated in Ivanhoe Partners, 535 A.2d at 1341-42.

41. A possible exception concerns the impact of a hostile offer on the target's non-shareholder constituencies. If directors could prefer the interests of these constituencies over those of shareholders, then a hostile offer that shareholders would wish to accept in their own interest could pose a threat to non-shareholder interests. However, the Delaware Supreme Court seems to have foreclosed such a preference for non-shareholder interests in Revlon, where it observed: "A board may have regard for various constituencies in discharging its responsibilities, provided that there are rationally related benefits accruing to the stockholders." 506 A.2d at 182. Thus, the constituency factor is no different from the other factors set out by the court in Moran.

lead back to the core issue underlying defensive tactics: If takeover bids are not coercive, why shouldn't shareholders make up their own minds about how to respond?

This question highlights the inherent puzzle associated with the proportionality inquiry when a takeover bid lacks the obvious coercive features of the Unocal and Ivanhoe Partners offers. The inquiry into the relationship between the defensive tactic and the threat posed by the hostile offer is intelligible only if the nature of the threat -- how the offer would injure shareholders in the absence of a defensive response -- is understood. The only threat posed by an offer that management believes to be unfair, ill-timed, or too cheap, is the threat that something will lead shareholders to accept it. But for this "threat" to warrant a defensive response, the offer must be substantively, as opposed to structurally, coercive in that shareholders somehow must be influenced to accept unfavorable substantive terms voluntarily. Such substantive coercion results in a mistake by shareholders: They would not accept such offers if they knew what management knew about their own company, about the acquisitions market, or about management itself. To be sure, management can be expected to tell shareholders, loudly and often, what it knows. In this sense, then, shareholders can be substantively coerced only because they do not believe what management says about the real value of the company.

In sum, whether proportionality review can remain both in-

ternally consistent and able to accommodate preclusive responses to offers that are structurally innocuous (as in Anderson, Clayton) depends on the development of a coherent account of substantive coercion. Without such an account, Delaware's intermediate standard can follow only one of two roads. Either internal logic will dictate what we have termed the "broad reading" of Anderson, Clayton -- that is, a rule limiting preclusive defenses to the Unocal genre of coercive bids -- or, as proved to be the case with Delaware's prior high-profile effort at devising an innovative standard in Singer, the new intermediate standard will collapse into yet another rhetorical embellishment of the business judgment rule.

III. THE PROBLEM OF SUBSTANTIVE COERCION

As the preceding analysis suggests, substantive coercion requires an informational disparity between target managers and shareholders. Given a structurally non-coercive offer of the Anderson, Clayton variety, two elements must be present before rational shareholders can be described as "mistakenly" tendering their shares because of substantive coercion. First, management must be able to produce an expected market price for the company that is higher than the hostile offer: that is, management's claim that the offer is inadequate must be correct. But second, a majority of shareholders must nonetheless believe that management will not deliver on its promise. Without the first element,

shareholders who accept a structurally non-coercive offer have not made a mistake. Without the second element, shareholders will believe management and reject underpriced offers. Or, put another way, substantive coercion can only arise when faithful managers prove unable to reassure a skeptical market.

A. Managers' Ability to Generate Higher Prices

When managers justify a preclusive defense on the ground that a hostile offer is inadequate, they implicitly claim to be able to obtain greater value for shareholders. Managers might be able to accomplish this in at least three ways: 1) by bargaining for a better price from the bidder at hand; 2) by locating other bidders who will pay more for the company; or 3) by operating the firm so successfully that share prices will eventually exceed the offer price even without selling the firm.⁴² Any of these assertions may be correct. As a practical matter, moreover, embattled managers may attempt to justify defensive tactics by making all three claims. Thus, target managers often compress these three claims into a single statement: "The firm is worth at least X if we are allowed to continue to operate it; we will repulse any offer below X but will negotiate in good faith, with the bidder at hand or anyone else who offers more than X."⁴³ But while all three claims are often asserted simultaneously, they should be

42. Cf. *Robert M. Bass Group v. Evans*, ___ A.2d ___, ___ (Del. Ch., July 14, 1988) (listing management's alternative methods of generating greater value -- negotiating, selling, or implementing a noncoercive restructuring transaction -- as reasonable responses to the threat of an underprice offer).

43. Needless to say, X is rarely given an exact dollar figure.

considered separately because they are unlikely to be equally plausible.

The least ambitious rationale for defensive tactics is the claim that management needs leverage to negotiate with a hostile bidder. Even in a competitive acquisitions market, disaggregated shareholders may require a bargaining agent to obtain top dollar for target assets.⁴⁴ Without a coordinated response from shareholders, any offer can succeed that exceeds the expected value of the firm in the hands of existing management or other competing bidders. By contrast, target managers who have the power to preclude hostile offers by deploying defensive tactics may be able to compel acquirers to pay out the bulk of their transaction gains.⁴⁵ Thus, the claim that an offer is too low may simply mean that there is room to dicker: Target managers reasonably

44. See, e.g., Jarrell, The Wealth Effects of Litigation by Targets: Do Interests Diverge in a Merger?, 28 J.L. & Econ. 151 (1985); Oesterle, Target Managers as Negotiating Agents for Target Shareholders in Tender Offers: A Reply to the Passivity Thesis, 71 Cornell L. Rev. 53, 64-70 (1985).

45. In a perfectly competitive auction market, successful bidders must presumably pay more than the value of the firm to the next highest bidder, even without management bargaining. Bargaining by target managers, however, may extract some of the incremental surplus of the highest bidder beyond the value of the firm to other bidders. In addition, such bargaining might offset competitive and strategic imperfections in the auction market. Note that for present purposes, we assume that maximizing gains to target shareholders serves the broader objectives of shareholder and social welfare. This view is generally accepted by the courts but remains controversial among some commentators. See, e.g., Easterbrook & Fischel, The Proper Role of a Target's Management in Responding to a Tender Offer, 94 Harv. L. Rev. 1161 (1981); Schwartz, Search Theory and the Tender Offer Auction, 2 J. Law, Econ. & Org. 229 (1986).

believe that an offeror will pay a higher price based on their knowledge of the true value of the target company's assets or of the synergistic gains available to a particular acquirer. The force of this claim, and the concomitant use of defensive tactics to induce an offeror to sweeten its bid, has been recently recognized by courts under Revlon's analysis of the target board's obligation to conduct an auction that maximizes shareholder value.⁴⁶ It stands as a distinct justification for poison pills, quite apart from the potential value of the pill defense in insulating shareholders from the effects of street sweeps or structurally coercive offers.⁴⁷

Beyond allowing managers to bargain credibly with particular offers, however, defensive tactics might also benefit target shareholders by providing time for managers to "shop" the firm. In this case, managers who assert that an offer is too low must claim private knowledge about either the acquisition market or the value of the firm. They must believe that other potential acquirers can be located who will pay more for the target than the hostile offeror. Because second bidders cannot always be found, this claim may seem more problematic than management's as-

46. See CFTR Corp. v. Federated Dep't Stores, Inc., [CCH] Fed. Sec. L. Rep. (current) 93,711 (S.D.N.Y., Ap. 14, 1988); Facet Enterprises Inc. v. Prospect Group Inc. (Del. Ch., Ap. 15, 1988).

47. As Chancellor Jacobs observes in Facet Enterprises, the pill defense "provides the directors with a shield to fend off coercive offers and with a gavel to run an auction." ____ A.2d at ____ (Del Ch., Ap. 14, 1988).

section that it can serve as a local bargaining agent. Nevertheless, "white knights" may take time to emerge, particularly when management is willing to share confidential information; and the empirical literature indicates that target management often can discover second bidders for target firms.⁴⁸

Finally, the most ambitious rationale for defensive tactics is management's claim that it can better the price offered by a hostile bidder by preserving the target's independence and generating value internally. In effect, management asserts that the value of the target in its hands exceeds not only the target's pre-offer valuation by the securities market, but also the premium price offered by the acquirer. Management may rest an optimistic valuation of the target on confidential information about the company, beliefs about the future success of the company's strategic plans or, what is more concretely, on an expert appraisal of the value of the firm's assets. Again, management's claims may well be correct, even when management relies on wholly public information to value the firm: The securities market often appears to "discount" the asset values of target firms.⁴⁹ Nevertheless, invoking the target's intrinsic value to justify continued independence in the face of a premium offer is always a delicate argument for the management of a target firm to make.

48. See Jarrell, *supra* note 44, at 160-61.

49. See Kraakman, Taking Discounts Seriously: The Implications of "Discounted" Share Prices as an Acquisition Motive, 88 Col. L. Rev. 891 (1988).

Sooner or later, most shareholders sell their shares on the market, and the market has already assessed managers' efforts. Indeed, share prices might undervalue corporate assets precisely because shareholders mistrust management investment policies.⁵⁰ But even if the securities market misvalues the target firm for reasons other than the company's poor performance, managers can seldom predict when the market will come to accept their own assessment of the value of the company or explain what would cause the market to alter its valuation.⁵¹

B. Shareholder Mistrust

The mere fact that managers might truthfully claim to be able to improve upon a hostile offer, however, does not itself render an offer substantively coercive. A second element is also required: most shareholders must disbelieve managers' claims. Otherwise, shareholders simply would listen to managers' advice and reject underpriced offers out of hand. Indeed, this observation carries one step further. A structurally non-coercive offer of the Anderson, Clayton variety that is underpriced is likely to

50. See id. at 897-98. Corporate assets that generate large free cash flows in declining industries are particularly likely to be discounted by share prices if shareholders fear that managers will simply reinvest funds in the same industry. See, e.g., Jensen, Agency Costs of Free Cash Flow, Corporate Finance, and Takeovers, 76 Amer. Econ. Rev. (Papers & Proc.) 323 (1986).

51. A significant, if highly controversial, literature argues that biased or noisy share prices may discount asset values, as many managers have long suspected. See Kraakman, *supra* note 49, at 898-99. However, the assertion that a target is underpriced, even if correct, cannot guarantee that it will be accurately priced in the future unless management undertakes a major restructuring effort. See id. at 824-29.

fail even if only arbitrageurs believe managers' claim of underpricing, as long as these arbitrageurs expect other savvy traders to share their valuation of the target.⁵²

Shareholders, moreover, have good reason to mistrust managers' claims of underpricing even if they know that defensive tactics can sometimes improve upon the terms of hostile offers. Both academic analysis and recent experience⁵³ persuasively demonstrate that managers' efforts to defeat hostile bids often occur or persist despite the best interests of shareholders. Indeed, apart from the bidder itself, no one is less likely to be objective in appraising a hostile offer than an incumbent board of directors and its top managers. Knowing this, shareholders must naturally fear that in some cases management's claims of value will be self-serving and, if believed, would impose a significant "agency cost": that is, the difference between the offer price and the subsequent lower market price of the company after the offer is defeated. The fact that shareholders -- and

52. This is more complicated than it looks. The question is: to what extent does the market act as a check on shareholder skepticism. Suppose shareholders distrust managers but savvy market players know better. Then arbitrageurs will buy in at above the low-ball market price only if they expect enough other arbitrageurs to buy in to defeat the offer. We might safely say, however, that if there is some finite probability that shareholders will defeat the offer and arbitrageurs believe that the firm can do better, then target shares should trade at above the offer price -- and the offer will be defeated. The query is: How large must the initial probability be to induce arbitrageurs to participate?

53. The behavior of target management in Anderson, Clayton and Revlon provides recent examples.

the securities market -- are likely to accept a structurally non-coercive offer, despite management's claims of value, then, is compelling evidence of shareholders' belief that managers' ability to improve on the offer's terms is outweighed by the risk that managers have misrepresented either their abilities or their intentions.

This agency cost analysis is the chief justification for the broad reading of Anderson, Clayton discussed in Part II. The decision to tender or sell into the market presupposes a judgment that the risk of management misrepresentation outweighs the likelihood that management's claim of a higher value is correct.⁵⁴ Because a court will be in no better position than the target's shareholders and the market to evaluate management's claims about future value, there is no basis for a court to override the evaluation of the marketplace by sanctioning preclusive defensive tactics. Thus, a natural conclusion is that the possibility that a structurally non-coercive offer may be substantively coercive poses no threat to shareholders on a risk-adjusted basis, and, therefore, no defensive tactics are warranted.

54. For this purpose, a shareholder's decision to sell into the market while the offer is pending has the same implications as waiting and actually tendering with respect to the shareholder's calculation of the likelihood that management's claim of a higher value is correct. That the ultimate tender is then made by an arbitrageur is irrelevant. In this respect, the arbitrageur acts simply as a less risk averse proxy for the selling shareholder who, in effect, has cast her vote against management's valuation by selling. See Gilson, *supra* note 3, at 855-56.

The empirical literature on what happens to share values following unsuccessful offers clarifies both the basis for shareholder mistrust that supports a broad reading of Anderson, Clayton and the risk of substantive coercion that supports a broad reading of Unocal's litany of potential threats. Every empirical investigation of failed takeover attempts reaches the same dramatic conclusion. Unsuccessful first offers that are followed by successful second offers yield better prices for target shareholders; but when first offers are defeated and no second offer follows, share prices for target firms eventually sink back to their pre-offer levels, and thus inflict heavy opportunity costs on target shareholders. This general pattern of results has been demonstrated by two major investigations of failed tender offers.⁵⁵ It has been replicated in parallel studies of failed mergers (as distinct from tender offers).⁵⁶ In

55. See Bradley, Desai, & Kim, The Rationale Behind Interfirm Tender Offers, 11 J. Fin. Econ. 183 (1983); R. Ruback, Do Target Shareholders Lose in Unsuccessful Control Contests, In Corporate Takeovers: Causes and Consequences 137 (A. Auerbach ed. 1988). Bradley, Desai and Kim examined 26 targets of failed tender offers that were not subsequently acquired by a second offeror, and found that the shareholders of these targets lost all gains associated with their initial offers over a two-year period. Bradley, Desai & Kim, *supra*, at 194. Ruback confirmed these results employing a different study design and looking at a three year period. R. Ruback, *supra*, at 147-50. As many firms that resist first offers are later acquired, however, these results cannot confirm the apparent view of the market that successful resistance is a poor gamble. See *id.* at 150. For a critical review of the principal effort to show that shareholders benefit from remaining independent after defeating a hostile offer, see Pound, Takeover Defeats Hurt Stockholders: A Reply to the Kidder Peabody Study, Midland Corp. F.J., Summer 1986, at 33.

56. See Dodd, Merger Proposals, Management Discretion, and Stockholder Wealth, 8 J. Fin. Econ. 105 (1980); Asquith, Merger

addition, it has emerged in other narrower investigations of particular defensive tactics. Thus, Jarrell's well-known study of defensive litigation,⁵⁷ Mikkelson and Ruback's investigation of greenmail payments,⁵⁸ and recent SEC analyses of poison pills⁵⁹ all indicate that successful target defenses may indeed make shareholders better off -- but only if target firms are subsequently acquired in a later transaction.⁶⁰

Bids, Market Uncertainty, and Stockholder Returns, 11 J. Fin. Econ. 51 (1983). Both studies find that the announcement of a merger termination dissipates all price gains associated with initial merger announcements.

57. See Jarrell, *supra* note 44, at 171-72.

58. W. Mikkelson & R. Ruback, Targeted Repurchases and Common Stock Returns, Sloan School of Management Working Paper No. 1707-86 (1986). Consistent with the general literature, Mikkelson and Ruback find that offer withdrawals following greenmail payments leave shareholders with some gains over pre-offer prices but that these gains are eventually lost by the subset of firms that retain their independence. *Id.* at 30.

59. Office the the Chief Economist of the SEC, The Effect of Poison Pills on the Wealth of Target Shareholders (Oct. 1986).

60. One caveat relates to leveraged recapitalizations and other restructuring defenses in which target management attempts to defeat a hostile offer by pursuing its own reorganization plan -- recall, for example, management's offer in Anderson, Clayton. Shareholders are likely to benefit in these cases even if management's "offer" succeeds because management plays, in effect, the role of a second bidder. See Kleiman, Shareholder Gains From Leveraged Cash-Outs, 1 J. Applied Corp. Fin., Fin., Spring 1988, at 46. In these cases, then, the question is not whether shareholders will benefit at all relative to pre-bid share prices, but whether they will gain as much as they would have gained if the hostile offer had succeeded. To us, management's preference for its own restructuring plan over a hostile offer implicates precisely the same concerns that provoked Revlon's auctioneering norm in bidding contests between two offerors. See note 26 *supra*. This point emerges with peculiar force on the facts of the recent Robert M. Bass Group decision, where the acquirer -- the Bass Group -- offered to match the exact terms of management's recapitalization plan and pay a higher price to target

C. Proportionality and Substantive Coercion

The empirical literature poses a difficult challenge for the proportionality test because it presents a mixed message: Shareholders have good reason to be skeptical about preclusive defensive tactics, even though their skepticism is often mistaken. The implication of this message differs depending on whose perspective one adopts. From the external perspective of shareholders and the market, which cannot distinguish when management's representations about future value are correct from when they are self-serving, hostile offers that are structurally non-coercive cannot pose a threat; and defensive tactics that preclude such offers can only be harmful.⁶¹ From the internal perspective of well-intentioned managers whose representations about value really are correct, however, some offers may nevertheless threaten shareholder welfare. Adopting the market's external perspective naturally leads to proscribing defenses against structurally non-coercive offers. But the price of such a rule is to abandon judicial deference to managers' business

shareholders if the Bass Group were permitted to purchase the equity position that management had reserved for itself under the recapitalization plan. See ___ A.2d at ___ (Del. Ch., July 14, 1988).

61. Recall that share prices drop dramatically whenever hostile offers are defeated, thus inflicting a significant loss on shareholders. This loss is offset by even greater gains when a second offer follows and is followed by even larger losses when no second offer materializes. See *supra* notes 55-60 and accompanying text.

judgment -- in this context a presumption that management's representations about future value are more often than not correct -- on the basis of share prices and aggregate statistical data that support the opposite presumption.⁶² On the other hand, adopting the internal perspective and acceding to defensive tactics solely on the basis of managers' claims of intrinsic value imposes large and easily measurable agency costs on shareholders in aggregate. Such a permissive rule would render the proportionality test meaningless whenever managers alleged that hostile offers were underpriced.

It follows that a meaningful application of the proportionality test to substantive coercion must recognize that management's representations about future value will sometimes be wrong and sometimes be right. For the game to be worth the candle, courts applying the proportionality test must be able to improve on the market's efforts to distinguish when management is right and when it is wrong. Otherwise, the aggregate market data would support a total ban on defensive responses to structurally non-coercive offers.

62. The ex ante response of share prices strongly suggests a presumption against management. Ex post statistical analysis can only be suggestive. See note 55 supra.

IV. DEVELOPING AN EFFECTIVE PROPORTIONALITY TEST

The preceding analysis demonstrates that the most difficult part of developing an effective proportionality test is the challenge of offers that are assertedly substantively -- but not structurally -- coercive, and that the central problem in applying the proportionality test to substantive coercion is suspect information. If management can correctly claim that the company is worth more than the value of a hostile offer, then there is a real threat of substantive coercion that may support preclusive defensive tactics under an intermediate standard of review. By contrast, if management's claims about value are incorrect, there is no threat to target shareholders and preclusive tactics are inappropriate. The premise of an intermediate standard of review is that the courts must exercise independent judgment in balancing the reasonable skepticism of shareholders (which considered alone would suggest prohibiting preclusive tactics) against the presumptive expertise of managers (which considered alone would suggest blanket business judgment protection of preclusive tactics). The hard question is: Can judges screen management's claims about value more accurately than the market? The answer, we believe, lies in how an effective proportionality test might elicit more careful analysis by the courts and, as a result, more accurate representations by target managers about the bases of their valuation claims in the first instance.

A. The Elements of an Effective Proportionality Test

The elements of an effective test of the proportionality of

defensive tactics to an allegedly threatening hostile offer follow from the ambiguities in the Delaware Supreme Court's exegesis of existing doctrine. First, if the test is to serve as a true intermediate standard -- that is, as a test more stringent than Cheff but less rigorous than the intrinsic fairness test -- it must clearly identify the nature of the threat that fixes the permissible range of defensive tactics. Second, an effective proportionality test must be more than a threshold test: it must explicitly link the range of permissible tactics to the scope or magnitude of the identified threat. And finally, an effective test must offer courts meaningful guidance in evaluating the likely accuracy of management's representations about both the magnitude of the threat posed by a hostile offer and how, given that threat, management's particular defensive response would serve shareholder interests.

1. A typology of threats

The first element of an effective test concerns the nature of threats posed by hostile offers. Merely limiting relevant threats to threats to shareholder interest -- as Revlon already does within the limited confines of bidding contests⁶³ -- would stress that Unocal's litany of relevant circumstances rests on the fundamental, and seemingly unobjectionable, norm that shareholder interests are primary. Target management may take other corporate constituencies into account in framing defensive plans, but only insofar as shareholders are benefited by doing so.⁶⁴

63. See supra note 41 and accompanying text (discussing Revlon).

Beyond this, our analysis suggests that the variety of "threats" discussed by the courts might be usefully grouped into three categories: 1) opportunity loss, or the Anderson, Clayton dilemma that a hostile offer might deprive target shareholders of the opportunity to select a superior alternative offered by target management; 2) structural coercion, or the risk that disparate treatment of non-tendering shareholders might distort shareholders' tender decisions; and finally, 3) substantive coercion, of the risk that shareholders will mistakenly accept an underpriced offer because they disbelieve management's representations of intrinsic value.

Of these three classes of threats, only a claim of substantive coercion requires that a court do very much more than review a simple statement of management's immediate plans and the terms of a hostile offer. Where management responds to the threat of opportunity loss from a hostile offer by proffering an alternative transaction, a court need only determine, as in Anderson, Clayton, whether management's alternative is itself structurally coercive.⁶⁵ Similarly, analysis of whether a hostile offer (or

64. We read Revlon's stress on the primacy of shareholder interests in framing the duties of corporate directors as a specific application of a fundamental norm of corporate law. See note 41 *supra* and accompanying text. Management is no more free to sacrifice shareholder interests to those of other corporate constituencies in responding to a hostile offer than it is free to favor one participant over all others in an ongoing bidding contest. Any different understanding of management's fiduciary obligation to shareholders would render most of corporate law incoherent.

65. A problem may develop in distinguishing a preclusive defensive tactic from management's proffer of an alternative

management alternative) is structurally coercive does not require detailed review, especially since Anderson, Clayton provides offerors a safe harbor by identifying the characteristics of an offer that is not structurally coercive.⁶⁶ An allegation of substantive coercion, however, places a more demanding burden on both the target's management and the reviewing court.

To support an allegation of substantive coercion, a meaningful proportionality test requires a coherent statement of management's expectations about the future value of the company. From

transaction. For example, defensive restructurings can be cast in a form that requires shareholder approval, whether by tender or vote, or in a form that may be implemented on management's authority alone. From our perspective, the distinguishing characteristics is the presence of shareholder choice. See R. Gilson, *supra* note 13, at 751-52. If shareholders retain the option of selecting either the hostile offer or management's alternative transaction (or rejecting both), then management's transaction is an alternative that a judge need review only for structural coercion. If, by contrast, the transaction is effected by management without allowing shareholders the opportunity to reject it, the threat must lie in the coercive character -- whether structural or substantive -- of the hostile offer with a resulting difference in the nature of the court's review.

The same dilemma -- whether a management restructuring plan is merely a defensive tactic or an alternative proposal for the sale of the company -- is also central to the Delaware Supreme Court's exegesis of proportionality review. Under Revlon, target management's duty to secure the highest price for the company is triggered by a conclusion that the company will be sold. If a management restructuring is viewed as an alternative control transaction, then a decision has been made to sell the company and Revlon is triggered; if management action is only a defensive response, the proportionality test remains applicable. Compare *Ivanhoe Partners v. Newmont Mining Corp.*, 535 A.2d 1334 (1987) with *Black & Decker Corp. v. American Standard, Inc.*, 682 F. Supp. 772 (D.Del. 1988). See note 72 *infra*.

66. See notes 36-37 *supra* and accompanying text.

the perspective of shareholders, substantive coercion is possible only if management plausibly expects to better the terms of a hostile offer -- whether by bargaining with the offeror, by securing a competitive bid, or by managing the company better than the market expects.⁶⁷ To make such a claim requires more than the now-standard statement that a target's board and its advisers believe the hostile offer to be "grossly inadequate." In particular, demonstrating the existence of a threat of substantive coercion requires a showing of how -- and when -- management expects a target's shareholders to do better.⁶⁸

A statement of management's plans for doing better might look to the role of defensive tactics in providing time or bargaining leverage to support the eventual sale of the firm at a higher price, or it might promise to increase the market price of

67. See notes 42-51 *supra* and accompanying text.

68. An alternative construction of the proportionality test that may be functionally equivalent to requiring management to present detailed plans in order to show a threat of substantive coercion is to require a similarly detailed showing of management plans at the later stage of evaluating management's specific response to the alleged threat of an underpriced offer. At least one recent Delaware decision seems to incline in this alternative direction. See *Robert M. Bass Group v. Evans*, ___ A.2d ___, ___ (Del. Ch., July 14, 1988). Insofar as both of these constructions of the proportionality test would require the same showing from management and reach the same result, these two versions of the test would be practically identical. For the reasons indicated in Part III of this article, however, we prefer to insert management's defense of its plans into the determination of whether a "threat" exists rather than into a subsequent evaluation of management's response to an asserted threat. The proposition that a premium offer might threaten shareholder interests apart from management's specific plans seems to us to be needlessly abstract and vulnerable to manipulation.

the firm's shares by independently managing the firm's operations with a plan to sell assets, cut costs, or follow another strategy to improve the company's performance. Either way, however, management must set forth its plan in sufficient detail to permit the court to evaluate independently the plausibility of management's claim.

The discipline imposed by requiring management to state clearly just how it intends to cause the price of the company's shares to increase is a critical check on knee-jerk resort to assertions that a hostile offer's price is inadequate. For example, if management believes that the price of a hostile offer is inadequate because the market undervalues the company's unused investment tax credits, as the court apparently believed in Smith v. Van Gorkom,⁶⁹ an acceptable statement of the threat would require management to describe the steps that it planned to correct the market's valuation.⁷⁰

69. 488 A.2d 858, 876 (1985).

70. Cf. Terry v. Penn Central, 668 F.2d 188 (3rd Cir. 1981) (Penn Central strategy to use up loss carry-forwards by acquiring profitable companies).

We need not resolve here whether the securities market might, as a theoretical matter, underprice target assets even in the absence of significant non-public information. See Kraakman, *supra* note 49, at 898-901. Under some circumstances, target management might plausibly assert such underpricing and seek to demonstrate that the present value of the company's expected cash flows exceeds the hostile offer. Such a demonstration alone, however, would not justify preclusive defensive tactics without a plan -- as in the Terry case, *supra* -- to assure that shareholders will realize the company's asset values in share prices. The price of the company's shares is an essential check on management's plan, even in instances of apparent underpricing, for two reasons: first, apparent underpricing by the securities market always creates suspicion about management's investment policies

2. Proportionality: the link between threat and response.

After defining the threat posed by a hostile offer, the second element in an effective proportionality test lies in detailing the relationship between the threat and the range of permissible defensive tactics. This relationship follows logically from the nature of the threat. Where the sole threat to shareholder interests is the risk that a hostile takeover might deprive shareholders of a superior management alternative, as in Anderson, Clayton, the only permissible defensive measures will be those that safeguard shareholders' choice between the hostile bid and management's alternative.⁷¹ By contrast, when a hostile offer poses a significant threat of substantive or structural coercion, preclusive defensive tactics may be justified. A showing that some such response is justified, however, cannot mean that management enjoys complete discretion. In particular, some

that is exceedingly difficult for a court to evaluate; and, second, regardless of the origins of apparent underpricing, managers have a fiduciary responsibility to attempt to correct it on behalf of shareholders. For further discussion of these issues, see Kraakman, *supra*, at 933-939.

71. This seems to us the best reading of recent cases that allow target companies to decline to redeem a poison pill to facilitate conducting an auction of the company. See CRTF Corp. v. Federated Department Stores, ___ F. Supp ___ (S.D.N.Y. 1988); Facet Enterprises, Inc., v. The Prospect Group, Inc., ___ A.2d ___ (Del. Ch., Ap. 15, 1988); The Henley Group v. Sante Fe Southern Pacific Corp., ___ A.2d ___ (Del. Ch., Mar. 11, 1988). Although discussed in terms of the board's discretion in conducting a Revlon auction, this issue can be analyzed under with proportionality test without creating another standard -- that is, a separate Revlon auction obligation that multiplies doctrinal labels and creates its own ambiguities.

responses to hostile offers, such as leveraged restructurings, more closely resemble counteroffers than preclusive defenses. When these plans are deployed in conjunction with preclusive defensive tactics, they deprive shareholders of the opportunity to choose not merely the problematic offer at hand, but any future offer as well. Thus, courts might reasonably require an especially probing demonstration of a benefit to shareholder interests before permitting management to execute such insulated restructuring plans. For example, a refusal to redeem a poison pill in the face of a two-tier hostile offer would be reasonably related to the offer's threat of structural coercion, but a leveraged restructuring to thwart the same offer would not be reasonably related to the same threat because the restructuring response would foreclose all future offers, including those that posed no threat at all. Such a preclusive restructuring plan would fail the proportionality test unless management could establish that it was substantively superior to the outsider's best offer.⁷²

72. The hard case, once again, is management's allegation that the hostile offer competing with a restructuring plan is substantively coercive. A broad reading of Revlon or Anderson, Clayton would lead to a total ban on preclusive restructuring plans: Shareholders should always be permitted a choice when the sole issue is comparative value. Arguably, however, management ought to have the opportunity to persuade a court that shareholders might underestimate the real value of its proposed alternative, especially when the recapitalization leaves a hard-to-value equity "stub" in shareholder hands. In addition, the fact that recapitalizations often do generate considerable value for shareholders suggests that the risks of permitting preclusive recapitalizations are smaller than the parallel risks of allowing management to retain the firm's independence without significant change. See notes 55-60 and accompanying text (drop in share

3. The weight of management's burden.

Finally, the third element of an effective proportionality test goes to the heart of meaningful judicial review: the weight of management's burden in persuading the court that its defensive response will make shareholders better off, given the nature and magnitude of the threat posed by a hostile offer. As with confirming the existence of a threat in the first instance,⁷³ courts should have little difficulty in reviewing management's claims of structural coercion or a potential opportunity loss for target shareholders. The terms of a hostile offer or of management's alternative plan will suffice to establish the bona fides of these "threats". The real challenge to judicial review arises when management alleges that a hostile offer is substantively coercive because management -- if only it were allowed to pursue defensive tactics that would provide it with the opportunity -- could better the hostile offer through its own salesmanship or management efforts. Here, the court must be free to exercise its independent judgment in weighing whether management's plans present a plausible story: a goal that improves on the value of the

prices following unsuccessful bids). For recent examples of judicial scrutiny under the proportionality test of defensive tactics to protect a restructuring plan, see Henley Group v. Sante Fe Southern Pacific Corp., ___ A.2d ___ (Del. Chan. Ct., Ap. 18, 1988) (preclusive tactics proportional in part because management's previous efforts to sell the firm made entrenchment unlikely); Robert M. Bass Group v Evans, ___ A.2d ___ (Del Ch., July 14, 1988) (restructuring enjoined when it appeared likely to preclude economically superior offer).

73. See text at notes 60-70 supra.

hostile offer, and a means that is reasonably likely to achieve the goal.

Although a court must obviously credit management's expertise in passing on management's plans, management's word is by no means the only evidence available to the court. The court can also examine the specificity and completeness of management's plan, the deliberations of the target's board, expert testimony from both sides, and, most important, the firm's performance history. In particular, evidence that management had previously alleged substantive coercion in the face of an earlier hostile offer and had already failed to meet its own projections of firm performance would seriously undermine allegations of substantive coercion. So, for example, an effective proportionality test would impose a heavier burden on claims of underpricing by Marshall Field's management in connection with B.A.T.'s hostile offer than would have been appropriate in connection with Carter Hawley Hale's earlier hostile offer, given Marshall Field's lackluster performance during the period between the two offers.

B. Why an Effective Proportionality Test Can Work

To this point, our development of an effective proportionality test remains subject to the same criticism that we leveled at the Cheff test. Particularly in the common case where management alleges substantive coercion because of price inadequacy, we would be hard pressed to demonstrate a necessary benefit from the proportionality test as we have developed it

thus far: A deceptively clever story about future values might seem to be as capable of validating preclusive defensive tactics under the proportionality test as a clever story about policy conflicts was able to do under the old Cheff test. In our view, however, this criticism misses the systemic institutional effects of searching judicial review. A proportionality test that demands serious justifications for defensive tactics -- and examines these justifications through the lens of shareholder interest -- would serve a valuable screening function, even if it could not always guarantee the accuracy of management's representations. Such a test would facilitate planning in the easy cases where hostile offers did not threaten substantive coercion. For targets, the option of providing shareholders with an alternative plan would always be a defense, even to wholly non-coercive offers; for acquirers, the risk of preclusive defensive tactics could be measurably reduced by treating all target shareholders equally. In the harder case where management alleged substantive coercion, the demands of an effective proportionality test would impose a discipline that would reduce management's incentives to resort to preclusive defensive tactics in the first place.

Consider how a searching review under the proportionality test might affect managers who were tempted to veto a hostile offer without a concrete plan to generate greater value, either through continued management of the company or through selling the company at a later, more advantageous time. In other words,

suppose management simply preferred to maintain the company's independence, a not unfamiliar sentiment. The mere task of establishing a plausible claim of substantive coercion -- of framing a credible plan for increasing the company's stock price in the shadow of a probing judicial review -- would itself be a significant deterrent to management entrenchment. If management's initial opposition to the hostile offer were unreflected, the exercise of developing a plan capable of surviving serious review under the proportionality test would provide an occasion to reconsider the decision to resist. But even if management were coolly disposed to resist a hostile offer in full knowledge of its superiority, the duty to frame a plan -- to put implausible expectations on paper -- would tend to deter. The less plausible management's claims actually were, the more difficult management would find the task of constructing a plan. Beyond this, a bogus plan would invite future reputational losses and shareholder conflicts, even if it did not create a risk of liability for its authors. After all, managers would find themselves in the uncomfortable position of having to live with values and timetables that they could not expect to meet.

Under an effective proportionality test, moreover, the difficulty of constructing a plausible but inaccurate account of future value would be increased by the reluctance of secondary participants in a target's decisionmaking to acquiesce in such an effort. Presumably any case for substantive coercion would in-

volve investment bankers as valuation experts and outside directors as formal decisionmakers. For an investment banker, passing on the credibility of a specific management plan would differ from merely opining on the fairness of an offer price because it would involve both greater specificity and an accountability check: Management's plan would eventually either succeed or fail for reasons that would be likely to be discernible at the time and that would have obvious implications for the quality of the investment banker's earlier opinion. Thus, the reputational consequences of supporting ill-conceived plans would encourage a considerable measure of private enforcement by investment bankers.⁷⁴

For independent directors, who must assume formal responsibility for implementing management's plan to generate value, there are even stronger reasons for expecting conscientious self-enforcement under an explicit proportionality test. On the fair assumption that independent directors generally wish to discharge their duties faithfully -- if only their duties are sufficiently clear -- we would expect a searching internal analysis of any management plan that the board would be expected to justify in court. We would also expect that after ratifying such a plan, independent directors would take particular care to assure its

74. As the facts in Anderson, Clayton show, valuations by investment bankers already act as a constraint on preclusive defensive tactics under the proportionality standard. See notes 31-33 and accompanying text (investment banker placed similar values on management plan and hostile offer).

faithful implementation or, if it could not be implemented, to rectify the resulting harm to target shareholders.

Finally, beyond creating incentives for self-enforcement, an effective proportionality test would harness the acquisitions market itself in screening representations about substantive coercion. If target management misrepresented the prospects for generating future value on behalf of its shareholders, in all probability a second hostile offer would eventually follow.⁷⁵ One reason to expect a second offer is that target share prices would be likely to decline to reflect management's failure to meet its projections.⁷⁶ But a meaningful proportionality test would provide another reason: Given management's unsuccessful past performance, a second hostile offeror would have much less to fear from preclusive defensive tactics based on a claim of substantive coercion. In effect, target management's past failure with its initial plan would undermine its credibility and open the target to the market. As a result, the target's management -- including its independent directors -- would have little incentive to mislead the court knowingly by misrepresenting the firm's prospects in the first instance. At most, misrepresentation at the time of the initial offer would only buy target man-

75. Again, the experience of Marshall Fields & Co. serves as an example. See text at note 73 *supra*.

76. Recall that share prices decline to pre-bid levels when hostile offers for targets fail and no subsequent offer follows. See notes 55-60 and accompanying text.

agement temporary relief from the acquisitions market.

Together, then, the incentive effects of an obligation to document a claim of substantive coercion and the prospect of a market challenge to unrealistic representations make judicial review of management's plans under an explicit proportionality test a potentially powerful check on spurious defensive tactics. Although courts are not better equipped to evaluate management's representations about future value than the market, the important point is that courts do not need to be more expert than the market to play a screening role. Judicial review can force corporate participants themselves to articulate clearly the interests of shareholders, the duties of corporate fiduciaries, and the expectations of management. The processes set in motion by forcing management to articulate the concrete link between its plan and shareholder interests can, by its own force, shift management's institutional incentives enough to provide an effective screen against ill-conceived or self-interested defensive tactics. In the end, if courts require a persuasive showing of a threat to shareholder interests under the proportionality test, they will not have to make close decisions about the feasibility of particular business strategies: Corporate participants, including target managers, will pre-screen strategies for the courts.

V. CONCLUDING REMARKS

Our analysis of how an effective proportionality test might function demonstrates that there is room for the Delaware courts to carve out a workable intermediate standard of review between nominal scrutiny under the old Cheff standard on the one hand, and the intrinsic fairness test or the equally stringent broad reading of Anderson, Clayton on the other. The room for this intermediate standard is defined by the risk of substantive coercion: The prospect that shareholders who mistakenly disbelieve well-intentioned managers' representations about future value may be led to tender to a hostile bidder against their own best interests. This risk is the real threat that underlies the litany of coercive circumstances isolated by Unocal and its progeny as a possible basis for preclusive tactics.

Yet, substantive coercion is a slippery concept. To note abstractly that management might know shareholder interests better than they themselves do cannot be a basis for rubberstamping management's pro forma claims in the face of market skepticism and the enormous opportunity losses that threaten target shareholders when hostile offers are defeated. Preclusive defensive tactics are gambles made on behalf of target shareholders by presumptively self-interested players. Although shareholders may win or lose in each transaction, they would almost certainly be better off on average if the gamble were never made in the ab-

sence of meaningful judicial review. By minimizing management's ability to reflect its self-interest in selecting its response to a hostile offer, an effective proportionality test can raise the odds that management resistance, when it does occur, will increase shareholder value.

Over the next year, the currents of corporate litigation are likely to bring the Delaware courts to a crossroads. A parade of novel defensive tactics, bolstered by the new Delaware takeover statute, have placed the power to defeat a hostile bid within reach of target managements. If the proportionality test lives up to its promise as a meaningful intermediate standard of review, it can do much to correct the widespread view that Delaware law has taken a definitive turn against hostile acquisitions. By contrast, if the proportionality test follows the rhetorical slide seemingly suggested by some aspects of the analysis in Unocal and Newmont, it will become little more than another reminder to business planners to watch what the Delaware courts do and not what they say.