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by
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The recent evolution of the judicial articulation of the duties of corporate directors during hostile battles for corporate control has placed corporate law at a crossroads between guiding directors to exploit their business experience and expertise on the one hand, and mechanically dictating their decision-making on the other. Although some directors might prefer the security of mechanical rules amid the turmoil of a hostile takeover bid, it is clear that such rules are not a preferable goal for corporate law.

The business judgment of independent corporate directors is arguably the shareholders' best protection from abuses of the corporate machinery from both within and without. The exercise of that judgment is seriously impaired if rendered mechanical by rigid legal doctrine imposed by courts applying 20/20 hindsight.

This crossroads is creating a dilemma for counsel as well. It is fundamental that corporate decisions should be made by the directors elected by shareholders. The role of corporate counsel should be to guide, not dictate, a board's application of business judgment. As the courts have looked at boardroom tactics in the takeover context, decisions have come dangerously close to altering the traditional and proper role of directors and their counsel.

A good example of these cross-currents is the application of the "level playing field" concept to hostile takeover bids and the negotiations with "friendly" bidders that often result from threatened hostile takeovers. The courts have created and applied the level playing field con-

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cept to require that, once a company is for sale, all bidders be given equal opportunity to buy control.[1] The concept arose in an effort to assure shareholders of a target company of receiving optimal value for their shares by deterring boards of directors from favoring management-connected bidders over less friendly bidders.[2] The level playing field was apparently designed as a corollary to the directors' duty to maximize shareholder value in the sale of a target company, not as a mechanical rule to be applied at the commencement of bids for the target.

I. Evolution of the Level Playing Field Concept

A board of directors, faced with an unsolicited takeover offer, has a right to reject the offer and to adopt defensive measures that are appropriate under the circumstances.[3] The mandates of the level playing field come into play only if the target board decides that the company is for sale and begins dealing with one or more interested bidders.[4]

The requirement of equal treatment of bidders was clearly articulated in *Revlon, Inc. v. MacAndrews & Forbes Holdings*,[5] when the battle for control of Revlon spilled over into the courtrooms of Delaware. In the litigation between Revlon and Pantry Pride, the Delaware Supreme Court endorsed a variety of defensive measures adopted by the Revlon board at a time when the board believed, in good faith and upon reasonable investigation, that the price offered by a hostile bidder was grossly inadequate.[6] That decision thus reaffirmed the view that directors may *reject* inadequate bids and refuse to negotiate with hostile bidders. Indeed, as was the case recently with Lucky Stores' rebuff to Asher Edelman or Newmont Mining's recent refusal to deal with T. Boone Pickens, a board may decline to negotiate with a hostile bidder and at the same time substantially restructure the corporation through a sale of assets, a self-tender offer, or through other business strategies.[7]

1. *See, e.g.*, Hanson Trust PLC v. ML SCM Acquisition, Inc., 781 F.2d 264 (2d Cir. 1986); Edelman v. Fruehauf, 798 F.2d 882, 886-87 (6th Cir. 1986); Samjens Partners I v. Burlington Industries, Inc., 663 F. Supp. 614, 623-24 (S.D.N.Y. 1987); Revlon, Inc. v. MacAndrew & Forbes Holdings, 506 A.2d 173, 184 (Del. 1986).

2. *See Revlon*, 506 A.2d at 182-84.

3. *See, e.g.*, Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985) (self-tender); Moran v. Household Int'l, Inc., 500 A.2d 1346 (Del. 1985) (shareholder rights plan).

4. *Revlon*, 506 A.2d at 182; Ivanhoe Partners v. Newmont Mining Corp., Civ. No. 9281 at 43 (Del. Ch. Oct. 15, 1987).

5. *Revlon*, 506 A.2d at 182-85.

6. *Id.* at 180-81.

7. *See, e.g.*, SEC v. Carter Hawley Hale Stores, Inc., 587 F. Supp. 1248 (C.D. Cal. 1984) (sale of assets and purchase of own shares in open market while hostile offer outstanding); Pogo Producing Co. v. Northwest Indus., Inc., No. H-83-2667, slip op. (S.D. Tex. May 24,

The court in *Revlon* also addressed the issue of equal treatment of bidders. It reasoned that, when it becomes inevitable that a company must be sold, the duty of the board changes

> from the preservation of [the company] as a corporate entity to the maximization of the company's value at a sale for the stockholders' benefit . . . . The whole question of defensive measures [becomes] moot. The directors' role change[s] from defenders of the corporate bastion to auctioneers charged with getting the best price for the stockholders at a sale of the company.[8]

The court went on to invalidate key "no-shop" and "lock-up" provisions of a friendly deal negotiated between Revlon and the Forstmann leveraged buy-out firm.[9] Ruling against provisions that halted, rather than enhanced, bidding for Revlon, the court identified preferential treatment given the friendly suitor (Forstmann) over the hostile bidder (Pantry Pride). "Forstmann was given every negotiating advantage that Pantry Pride had been denied: cooperation from management, access to financial data, and the exclusive opportunity to present merger proposals directly to the board of directors."[10] The court went on to hold that such unequal treatment was impermissible under the circumstances:

> Favoritism for a white knight to the total exclusion of a hostile bidder might be justifiable when the latter's offer adversely affects shareholder interests, but when bidders make relatively similar offers or dissolution of the company becomes inevitable, the directors cannot fulfill their enhanced *Unocal* duties by playing favorites with contending factions.[11]

The level playing field concept further evolved in 1986, when arbitrageur Asher Edelman sought to acquire control of Fruehauf Corpora-

1983) (self-tender); *Unocal Corp.*, 493 A.2d 946 (self-tender); *see also Ivanhoe Partners*, Civ. No. 9281 at 42-43 (*Revlon* duties do not arise even when target announces large dividend, restructures company, and enters into standstill agreement allowing third party to acquire 49% of target's stock); Buckhorn, Inc. v. Ropak, 656 F. Supp. 209, 228 (S.D. Ohio 1987) (*Revlon* duties do not arise if directors do not commit to selling any part or all of corporation); Gelco v. Coniston Partners, 652 F. Supp. 829, 847 (D. Minn. 1986) (*Revlon* duties do not arise with an all cash offer or restructuring plan including self-tender and sale of preferred stock to target corporation's financial officer). The author and his firm were counsel to Lucky Stores, Inc. in connection with the Edelman offers and subsequent litigation.

8. *Revlon*, 506 A.2d at 182. *But see* Jewel Cos. v. Payless Drug Stores Northwest, 741 F.2d 1555, 1562 (9th Cir. 1984) (California has rejected the "auction model in regulating negotiated acquisitions").

9. *Revlon*, 506 A.2d at 182-84.

10. *Id.* at 184.

11. *Id.* The court's allusion to "enhanced *Unocal* duties" refers to the holding of the *Unocal* court that, when directors are confronted with an inherent conflict of interest (as in the purchase of shares with corporate funds to remove a threat to corporate policy), they must show reasonable grounds for their belief "that a danger to corporate policy or effectiveness existed because of another person's stock ownership." *Unocal Corp.*, 493 A.2d at 954-55.

tion. The Fruehauf board of directors refused to talk to Edelman and hastily negotiated a friendly leveraged buy-out (LBO) with a group consisting of Fruehauf management and Merrill Lynch. Edelman again asked to negotiate and promised to better his offer. The board continued to snub him. Edelman filed suit in federal court, claiming that the board's tactics were a breach of fiduciary duty.[12] The court agreed, and the lower court enjoined consummation of the friendly LBO pending direct negotiations with Edelman. The court reasoned that

> [b]y simultaneously willy-nilly approving the management leveraged buy-out, erecting barriers to alternative offers, and refusing to negotiate two offers from the Edelman group . . . the Fruehauf directors unquestionably all have breached their fiduciary duties of loyalty and care.[13]

The court also enjoined the use of corporate assets to pay commitment fees or otherwise to further the management-connected bid. The order was affirmed on appeal.[14]

II. The Level Playing Field in Practice

Unwelcome bidders for corporate control have seized the level playing field doctrine as a means of exerting pressure on target directors. They cite the court rulings in an attempt to force reluctant boards to come to the bargaining table and negotiate a deal or to surrender confidential corporate information concerning the value of the target's business—data that is often crucial to the structuring of highly leveraged takeovers, in which financing commitments are predicated on the ultimate sale of corporate assets as the projected means of paying down debt. These bidders argue that the only way to induce them to increase the per-share price of their offers is to provide them with such information and to deal with them on the same basis as other bidders.

These situations raise the problematic question of whether the doctrine of the level playing field should have a mechanical application, or whether it should be only a corollary to the directors' overriding duty of maximizing shareholder value. Stated another way, should the commencement of bids for the target company mechanically trigger application of a duty to disclose to and to deal equally with all bidders?

While the concept is alluringly simple and seemingly equitable, it is debatable whether a level playing field is the best place to score points for shareholders. In the real world, shareholders may actually be better

12. Edelman v. Fruehauf, No. 71,332, transcript op. at 1-13 (E.D. Mich. July 24, 1986).
13. *Id.* at 18.
14. *Fruehauf,* 798 F.2d at 889-91.

served if the playing field appears to be tilted away from a raider. A target board may, for example, actually induce better offers for the target company by refusing to discuss an unreasonably low offer, by publicly announcing friendly negotiations with others, or by announcing an intent to look for "alternatives," while seemingly ignoring the option of negotiating with the hostile raider. Indeed, in the attempted takeover of Safeway in 1986, the Dart Group unilaterally indicated that it would raise its hostile bid by some six dollars per share (over $300 million) when the Safeway board refused to talk to Dart and publicly announced that it was looking for alternatives.[15]

These are only a few of many well-accepted negotiation tactics used outside the takeover arena. Their wide use and potential for success argue strongly that the level playing field concept should not be interpreted to preclude such tactics so long as the board's honest objective is consistent with its duty to protect the shareholders' right to the highest achievable value in a sale of the company.

Perhaps even more fundamentally, one needs to ask whether the level playing field concept should be applied to teams armed with different weapons. It matters little how level the playing field is if one team has tanks and the other only bows and arrows. If the level playing field concept ignores certain common differences between friendly suitors and hostile bidders, shareholders may well be victimized.

Two such differences are particularly significant. First, friendly suitors commonly agree to protect the confidentiality of inside corporate information and to refrain from using such information to launch an offer not approved by the board (a hybrid confidentiality and standstill agreement). Second, friendly suitors rarely have acquired a large stake in the target prior to negotiations.

These distinctions can play out in a variety of important ways. For example, a hostile bidder, unrestrained by a promise of confidentiality, may use the disclosure of sensitive information not to negotiate, but rather to circulate financiers in order to obtain financing commitments for an offer considered unfair or inadequate by the target board. In an extreme case, such disclosure may result in termination of a tender offer and acquisition of a stock position threatening a stalemate and preventing a sale of the target company.[16] In other cases, the information may

15. The author and his firm represented Safeway in connection with the Dart proposals and subsequent litigation.

16. Some states require by statute that a merger be approved by at least 66% of the outstanding shares of the company. *See, e.g.*, N.J. STAT. ANN. § 14A:10-3(2) (West 1969); NEB. REV. STAT. § 21-2027(i) (1983); OHIO REV. CODE ANN. § 170.78(F) (Anderson 1985).

even dampen the raider's enthusiasm for bidding higher.

Opening a company's books to a raider may deter the bidding process it was intended to foster. A friendly suitor may decide not to spend the time and money needed to prepare a bid if it knows that the raider, who usually has the advantage of having purchased a large block of stock at lower, pre-offer prices, has identical information. Moreover, the raider's stock position usually gives it a locked-in profit no matter whose bid succeeds in obtaining control. A friendly bidder has no such guarantee of a fall-back profit. Thus, if agreements to pay sums to or reimburse expenses of the friendly suitor in return for a firm bid ("hello fees"), or to pay a sum or reimburse expenses if a sweetened bid by the raider exceeds the friendly bid ("break up fees"), are disallowed on the basis of the level playing field concept, then the raider's prior stock position and its jump on obtaining financing for its bid may give it an unchallengeable advantage and serve to deter further bidding.

III. The *Burlington* Decision

The federal court in the Southern District of New York addressed these countervailing considerations in connection with the battle for control of Burlington Industries, which was initiated by a hostile tender offer for Burlington by Samjens Acquisitions Corp., a vehicle of Asher Edelman and Dominion Textile.[17] When Edelman became aware that the Burlington board was exploring alternatives to his offer, he asked to be provided with any information that might justify a higher price for Burlington as well as any other information provided by the Burlington directors to other interested parties. A week later, when Edelman suspected that a competing offer was being considered, he demanded the opportunity to review and improve upon any other bid. Burlington management offered to comply with these requests, but *only if* Edelman signed a confidentiality agreement. He refused. When the board accepted a higher bid from Morgan Stanley, Edelman sought an injunction. Edelman challenged the board's action of signing a merger agreement with Morgan Stanley, which included a break-up fee and a limited no-shop provision.[18]

The court, however, supported the Burlington board, finding that the failure to deal evenhandedly with Edelman was "justified."

In such a case, the raider can create a stalemate by accumulating in the open market more than 34% of the outstanding shares, thus enabling the raider to block any merger that the target's board may try to negotiate with a third party.

17. Samjens Partners I v. Burlington Industries, Inc., 663 F. Supp. 614, 616 (1987).

18. *Id.* at 617-21.

> Management had offered to provide Edelman with the same information it had given other interested parties, but Edelman refused to sign a confidentiality agreement. Edelman wanted to be informed of other bids before he bid, but the board justifiably thought it would be unwise to do so. The board did not deal selectively with Edelman. Instead, he dealt selectively with the board, according to his own rules. Nor did the board freeze Edelman out of the auction. The merger agreement the board signed did not end the auction, it provided a starting point for further bidding. Edelman was free to—and did—raise his bid after it was signed. If the board was unfair with Edelman, it was only because it forced him to dig deeper into his pockets to the benefit of Burlington shareholders.[19]

The court also rejected Samjens' complaints that Burlington had treated Samjens unfairly by denying a break-up fee. Samjens had entered into the bidding process with a nearly $80 million advantage, due to a pretender purchase of thirteen percent of Burlington shares. By refusing to pay Samjens a break-up fee, Burlington had helped even the playing field.

In *Burlington*, the board acted to secure a higher bid that was firm and adequately financed. The board did not preclude other bidders, but recognized that it had to pay a price to obtain a competing bid. The decision in *Burlington* correctly recognizes that the level playing field is not a mechanistic rule, but a principle to be applied only with due regard to the particular circumstances. It recognizes the realities of the marketplace for corporate control and the desirability of giving corporate boards ample room to apply their business judgment.

The decision is also comforting to corporate counsel. It implicitly recognizes that there is no best way to get the best price for shareholders and endorses counsel's role in providing guidance and context. It allows counsel to provide direction without dictating negotiating tactics or strategy or otherwise impeding the board's exercise of its business judgment.

Conclusion

Recent rulings have put enormous pressure on boards of directors. In a hostile takeover contest, boards often feel they are faced with a no-win situation: They must either create a level playing field or risk potential lawsuits brought by either hostile raiders or angry shareholders, to which the courts will apply 20/20 hindsight. Yet the record of boards of directors in securing enormous increases in value for shareholders has been remarkable. Tying the hands of directors and corporate counsel

19. *Id.* at 625-26.

with rigid and mechanistic rules that ignore the realities of the corporate world can only impair that record.