

COMMENT

PAC-MAN TENDER OFFERS

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The newly developed Pac-Man¹ strategy demonstrates once again the persistence and striking ingenuity of target companies in contested tender offers. In the Pac-Man gambit, the target or object of a tender offer makes a bid for the original offeror. By becoming the aggressor, the target may dissuade the original offeror from pursuing its bid and may even obtain control of the original offeror. However elegant this move from the standpoint of grand corporate strategy, its legal consequences are highly uncertain. This legal uncertainty may explain why the Pac-Man defense has not been used more extensively. This comment identifies the legal problems likely to attend the Pac-Man defense and ventures some suggestions for their resolution. Although it eschews much consideration of the economic or societal desirability of such transactions, this Comment also examines possible incentives that might influence the use of Pac-Man strategies.

In the typical case, one party, *O*, offers to buy all the shares, or at least a majority of the shares, of a target corporation, *T*. *T*'s management does not welcome *O*'s bid and, to defend against it, makes a bid for all or for a majority of *O*'s shares. Assume that *T* makes its bid for *O* while *O*'s bid for *T* is still outstanding and that the closing dates of the two offers are relatively close. Assume further that each corporation offers cash rather than its own securities for the other corporation's

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1. The Pac-Man defense, named for a popular video game, has been used in at least four takeover attempts in the past year. See *Martin Marietta Corp. v. Bendix Corp.*, 549 F. Supp. 623 (D. Md. 1982); *American Gen. Corp. v. NLT Corp.*, [1982 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 98,808, at 94,129-31 (S.D. Tex. July 1, 1982); *Cities Serv. Co. v. Mesa Petroleum Co.*, [1982 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 98,744, at 93,747 (D. Del. June 14, 1982); *Wall St. J.*, Mar. 2, 1982, at 17, col. 1 (takeover battle between General Cinema Corp. and Heublein); see also *Martin Marietta Corp. v. Bendix Corp.*, No. 298, slip op. (Del. Sept. 21, 1982); *Martin Marietta Corp. v. Bendix Corp.*, No. 6942, slip op. (Del. Ch. Sept. 19, 1982); *Wall St. J.*, Mar. 3, 1982, at 14, col. 3. In addition, Pabst Brewing Co. and Olympia Brewing Co. agreed to make offers for portions of each other's stock to repel a third party's unwanted offer for Pabst. *Wall St. J.*, July 7, 1982, at 8, col. 1; see *infra* text accompanying notes 26-45.

stock,² and that both *O* and *T* make their purchases after the expiration of the shareholders' right to withdraw the tendered shares.³ Suppose both offers are successful: a majority of *T*'s stockholders tender their shares to *O*, and a majority of *O*'s stockholders tender their shares to *T*. Suppose also that in both corporations, ownership of a simple majority of the stock confers the power to elect all members of the corporation's board of directors.

This outcome, a successful bid followed by a successful Pac-Man defense, raises at least two perplexing questions under state corporate statutes, and the answers may determine the ultimate victor of the takeover battle. First, it is questionable whether the shares that each corporation owns in the other are eligible to vote; second, assuming that these shares are eligible to vote, it is not clear through what mechanisms that voting power may be used. Because these questions concern state corporate law, their resolution is further complicated when *O* and *T* are incorporated in states that have corporate statutes that vary somewhat in their relevant provisions.

I. THE APPLICABILITY OF CROSS-OWNERSHIP STATUTES

Most corporate statutes prevent corporations from voting treasury stock and prohibit majority-owned subsidiaries from voting stock they hold in the parent corporation. These cross-ownership provisions may make it illegal for the parties to a Pac-Man defense to vote the stock that they have acquired in each other. The language of section 160(c) of the Delaware statute is typical:

Shares of its own capital stock belonging to the corporation or to another corporation, if a majority of the shares entitled to vote in the election of directors of such other corporation is held, directly or indirectly by the corporation, shall neither be entitled to vote nor be counted for quorum purposes. Nothing in this section shall be construed as limiting the right of any corporation to vote stock, including but not limited to its own stock, held by it in a fiduciary capacity.⁴

Because a successful tender offer that provokes a successful Pac-Man defense makes each corporation the owner of a majority of the shares in the other, in reciprocal parent-subsidiary relationships, section

2. This assumption simplifies the analysis. If *O* and *T* offer their own voting securities as consideration in the offers, it may be difficult to determine who has voting control of the two companies when the offers are completed.

3. Securities Exchange Act of 1934, § 14(d)(5), 15 U.S.C. § 78n(d)(5) (1976).

4. See DEL. CODE ANN. tit. 8, § 160(c) (1975). The equivalent portion of the Model Business Corporation Act provides:

Neither treasury shares, nor shares held by another corporation if a majority of the shares entitled to vote for the election of directors of such other corporation is held by

160(c) and its counterparts in other states may be thought to disenfranchise both control blocks, creating a corporate form of gridlock.

This apparent gridlock is not indissoluble, however. If both *O* and *T* are ineligible to vote the shares they hold in each other, the shares eligible to vote will be those held by shareholders who did not tender in response to *O*'s bid for *T* and *T*'s counter-bid for *O*. Some of these residual shareholders may be the archetypal small shareholder in rural Iowa, who is disabled by the slowness of communications and mail service from promptly learning about tender offers and responding to them within tight deadlines. Other residual shareholders may be sophisticated investors who predicted this complex legal scenario and refrained from tendering in the prospect of exercising voting control. Still others may be shareholders who thought the price offered was too low and who hoped to receive a higher bid from *O* or *T* or from other offerors joining in the fray. Considering the acumen and cleverness of those who plan and execute tender offer strategies, it is ironic that the right to vote may ultimately belong to uninformed, uninterested, unpersuaded, or remote residual shareholders.⁵ The statute would disenfranchise the shareholder with the greatest investment and the most to protect while those entitled to vote, although not utterly disinterested, would have much less at stake.⁶

Further, if a cross-ownership statute in a target corporation's state disenfranchises an offeror after a Pac-Man defense, an offeror (either an original offeror or a target using the Pac-Man strategy) is in a stronger position if its target is incorporated in a state with no cross-ownership provision. In the absence of such a provision, the offeror may presumably vote the shares it acquired through the offer. Suppose that *O* is incorporated in Delaware and that *T* is incorporated in New Hampshire, which does not have a counterpart to Delaware's section 160(c), and suppose that *O* and *T* each acquire a majority of the other's shares. The statutes of *T*'s home state permit *O* to vote its shares in *T*

the corporation, shall be voted at any meeting or counted in determining the total number of outstanding shares at any given time.

MODEL BUSINESS CORP. ACT § 33 (1971). Most jurisdictions have adopted identical or comparable language. *Id.* at 663. These statutes do not permit corporations to countermand their effect through charter provisions.

5. Somehow this part of the final dialogue in Eric Ambler's *A Coffin for Dimitrios* seems apposite: "I was thinking," said Dimitrios, "that in the end one is always defeated by stupidity. If it is not one's own, it is the stupidity of others." E. AMBLER, *A COFFIN FOR DIMITRIOS* 208 (1977).

6. Of course, the disenfranchised majority will attempt to exercise its control by soliciting the proxies of the residual shareholders. It seems anomalous that one barred by statute from voting his own shares may vote the shares of others, but a proxy holder need not have an independent right to vote.

even though the acquired corporation owns a majority of the acquiror's shares. *T*, however, has acquired shares in a Delaware corporation, and section 160(c) appears to disqualify *T* from voting its shares in *O* because *O* holds a majority of the shares of *T*.⁷ These possibilities are not among those traditionally taken into account in choosing a situs for incorporation.

However, one ought not to conclude too quickly that cross-ownership provisions unquestionably apply to the parties to a Pac-Man defense. Cross-ownership statutes prevent a subsidiary from voting stock that it owns in its parent.⁸ In the aftermath of a Pac-Man defense, each corporation is a subsidiary of the other, but each is also the other's parent. Therefore, application of a cross-ownership statute to such corporations produces the unacceptable result that a parent cannot vote the stock that it owns in its subsidiary. It follows that such statutes ought not apply to the parties to a Pac-Man defense.

This argument has a more formal analogue that stems from the structure of some of the disenfranchisement statutes. Some of the statutes are self-referential and thus self-defeating when applied to the Pac-Man scenario. Section 160(c) prevents a subsidiary from voting stock it owns in its parent "if a majority of the shares entitled to vote in the election of directors of such other [subsidiary] corporation is held, directly or indirectly, by the [parent] corporation."⁹ Such a provision disqualifies both *O* and *T*, as subsidiaries, from voting the stock each owns in the other. Therefore, neither *O* nor *T* owns stock "entitled to vote" in the other, and the statute does not apply.¹⁰ Double disqualification, in short, might mean that neither block of stock is disqualified and that the two disenfranchisements simply cancel each other out; paradoxically, if the statute applies, it does not apply.¹¹

7. The argument that section 160 would disenfranchise the shares an offeror acquires in a Delaware corporation through a Pac-Man defense was apparently persuasive to the Chancellor in *Martin Marietta Corp. v. Bendix Corp.*, No. 6942 (Del. Ch. Sept. 22, 1982) (order granting preliminary injunction).

8. See *supra* text accompanying and preceding note 4.

9. DEL. CODE ANN. tit. 8, § 160(c) (1975).

10. This result does not occur unless each corporation is both the parent and a subsidiary of the other. As the statute normally operates, it bars a subsidiary from voting its shares in its parent, but there is no effect on the parent's entitlement to vote its shares in the subsidiary. It is the parent's entitlement to vote the majority of the subsidiary's shares that triggers the applicability of section 160.

11. This derives from the underlying contradiction that if the statute applies, each corporation both is and is not entitled to vote the shares it holds in the other. If *O* and *T*, as parents, are entitled to vote their majority shares in their respective subsidiaries *T* and *O*, then the statute applies. The statute bars *T* and *O*, as subsidiaries, from voting any stock they own in their respective parents *O* and *T*. Hence the contradiction: if they are entitled to vote, the statute applies; and if the statute applies, they are not entitled to vote (and the statute does not apply). The initial

This result may be avoided if "entitled to vote" means "entitled to vote but for the effects of this section," but this is a question of interpretation that, like many posed by the Pac-Man scenario, has not been addressed by the case law.¹² Similarly, this particular interpretive problem can be obviated by statutory provisions that are worded somewhat differently. For example, section 703(b) of California's General Corporation Law provides that "shares of a corporation owned by its subsidiary shall not be entitled to vote on any matter,"¹³ and the California statute defines "subsidiary" in terms of "possessing more than a [stated] percent of the voting power."¹⁴ When applied to the Pac-Man scenario, the Delaware statute produces a logical contradiction because it is triggered by the same "entitlement to vote" that it constrains.¹⁵ The California statute creates no such contradiction because although it too constrains an entitlement to vote, it is triggered by a parent's possession of voting shares, rather than by entitlement to vote them.¹⁶

The most persuasive argument against the application of any cross-ownership statute to the aftermath of a Pac-Man defense is the unlikelihood that the drafters of cross-ownership provisions had such a novel situation in mind. The cross-ownership provisions were preceded by statutory bans on voting treasury stock. Treasury stock, it was thought, ought not be voted because it represents no investment in the corporation, and the function of the franchise is to enable the shareholder to protect his investment.¹⁷ Some courts interpreted the statutory disenfranchisement of treasury stock to apply to stock in the parent corporation held by a subsidiary, reasoning that permitting such stock to vote would enable persons in control of the parent to disenfranchise or at least to dilute the voting rights of the parent's shareholders. For example, the statute at issue in *Italo Petroleum Corp. v. Producers Oil Corp. of America* provided that "shares of its own capital

assumption that the statute applies must be false because the assumption produces a contradiction. See I. COPI, *SYMBOLIC LOGIC* 55 (1954) (indirect proof by *reductio ad absurdum*).

12. As another commentator observed of a related question, "this area of the law is complex and virtually unexplored." Note, *The Voting of Stock Held in Cross Ownership*, 76 HARV. L. REV. 1642, 1643 (1963), quoted in Yoran, *Advance Defensive Tactics Against Takeover Bids*, 21 AM. J. COMP. L. 531, 550-51 (1973).

13. CAL. CORP. CODE § 703(b) (West 1977).

14. *Id.* § 189(a), (b) (West 1977).

15. See *supra* note 10.

16. It is arguable that to possess voting power is the same as being entitled to vote the shares that one possesses, in which case the California statute is subject to the same logical flaws as is the Delaware statute. This is irrelevant, however, to the possibility of drafting around the logical conundrum.

17. H. BALLANTINE, *CORPORATIONS* § 176 (Rev. ed. 1946). In contrast, the stock acquired pursuant to a tender offer does represent an investment in the corporation.

stock belonging to the corporation shall not be voted upon directly or indirectly . . . ,”¹⁸ and the court held that this ban applied to shares in the parent corporation held by a subsidiary in which the parent had a ninety-nine percent interest. As the *Italo Petroleum* court explained, “a subsidiary stockholder wholly owned, controlled, dominated and therefore dictated to” by the parent is a corporate entity insufficiently distinguishable from the parent so that the shares in question “belong” to the parent.¹⁹

Of course, not all parents own or control their subsidiaries to the degree present in *Italo Petroleum*; in other cases it is more difficult to determine whether the parent’s control over the subsidiary is sufficient to establish the parent as the true owner of the stock nominally held by the subsidiary. This is, in effect, a decision whether to disregard the formal separation between the two corporate entities.²⁰ In *Dal-Tran Service Co. v. Fifth Avenue Coach Lines, Inc.*,²¹ the parent corporation owned sixty-eight percent of its subsidiary, which in turn held a sizable minority block in the parent. The trial court in *Dal-Tran* concluded that such a dominated subsidiary could not vote the shares it owns in its parent.²² The appellate division apparently did not regard the parent’s sixty-eight percent ownership as conclusive on the issue of domination; it held that the parent and the subsidiary were “separate corporate entities.”²³ The appellate court did not reach the question whether the subsidiary would be entitled to vote its shares in the parent,²⁴ although this entitlement follows from the court’s decision that

18. 20 Del. Ch. 283, 288, 174 A. 276, 278 (1934) (interpreting former General Corporation Law section 31).

19. *Id.* at 290, 174 A. at 279.

The court in *Continental-Midwest Corp. v. Hotel Sherman, Inc.*, 13 Ill. App. 2d 188, 195-96, 141 N.E.2d 400, 403-04 (1957), followed *Italo Petroleum* and held that the Delaware statute would prohibit the voting of “indirect” treasury stock. *Italo Petroleum* was distinguished on its facts in *Tennessee ex rel. Washington Industries, Inc. v. Shacklett*, 512 S.W.2d 284 (Tenn. 1974). In that case the subsidiary held no stock in the parent; rather, the issue was whether the parent could vote stock it held in its subsidiary. The *Shacklett* court held that *Italo Petroleum* was factually inapposite and that to disenfranchise the parent would improperly confer “absolute voting rights” on the small minority interest in the subsidiary. *Id.* at 287.

20. In many such cases, the allocation of the burden of proving domination is vigorously contested and outcome determinative. See Note, *supra* note 12, at 1646-50.

21. 30 Misc. 2d 236, 217 N.Y.S.2d 193 (Sup. Ct.), *rev’d*, 14 A.D.2d 349, 220 N.Y.S.2d 549 (1961).

22. 30 Misc. 2d at 243, 217 N.Y.S.2d at 200.

23. 14 A.D.2d at 355-56, 220 N.Y.S.2d at 556.

24. *Id.* at 352, 220 N.Y.S.2d at 553. The issue in *Dal-Tran* was whether the minority shareholder in the subsidiary could vote its proportionate share of the subsidiary’s stock in the parent after the revocation of a provision in a voting trust that purported to confer such a right. The trial court invalidated the trust but invoked equitable considerations to permit the subsidiary’s minority shareholder to retain his alleged voting rights in the parent. 30 Misc. 2d at 243, 217 N.Y.S.2d

the two corporations were distinct entities.

Against this case law background statutes like Delaware's section 160(c) were enacted. These statutes establish a bright-line test for domination based on the parent's percentage ownership of the subsidiary. The statutes may embody a legislative decision to permit a subsidiary to vote stock in the parent when the parent's interest in the subsidiary falls short of the statutory percentage. This interpretation could conflict with prior case law establishing that the court may disenfranchise the subsidiary's holdings in the parent if the parent so dominates its subsidiary that the disputed stock effectively belongs to the parent. In the alternative, the statutes may simply place the burden of establishing parental domination and control on the party seeking disenfranchisement when the parent owns less than the statutory percentage of the subsidiary.

Regardless of the statutes' specific effect, it is clear in light of the cases preceding them that they address the problem of cross-ownership patterns insulating management from the shareholders' effective use of their voting franchise. It strains credulity to suggest that this problem attends Pac-Man defenses. The parties to such tender offers are adversaries, organized into unquestionably separate and independent corporate entities; their relationship is fraught with hostility, not domination or connivance. If the parent had placed some of its shares in the safe hands of its subsidiary as a device to defend against unwanted tender offers, disenfranchisement would be consistent with the policies that cross-ownership statutes represent, but parent-subsidiary relationships that are the product of Pac-Man strategies do not create this kind of insulation.²⁵

at 200-01. The appellate court held that the parent's grant of voting rights to the minority shareholder was unilaterally revocable for want of consideration, 14 A.D.2d at 356, 220 N.Y.S.2d at 556-57, and that because the parent and the subsidiary were distinct corporations, a shareholder of the subsidiary had no direct right to vote any of the subsidiary's stock in the parent, *id.* at 355-56, 220 N.Y.S.2d at 556. Because the subsidiary had not attempted to vote its stock in the parent, the appellate division declined to decide whether the subsidiary was entitled to vote. *Id.* at 352, 220 N.Y.S.2d at 553. The trial court's extensive discussion of this issue, *see* 30 Misc. 2d at 243, 217 N.Y.S.2d at 200, is perhaps an elaborate dictum, but it indicates the state of the case law in New York at the time of the enactment of that jurisdiction's cross-ownership statute.

25. *See* Yoran, *supra* note 12, at 551-55. Some commentators advocate passing through the subsidiary's voting rights in the parent to the subsidiary's outside shareholders as a remedy for cross-ownership. *See* Note, *supra* note 12, at 1651-55; Comment, *Voting Rights In the Stock of a Parent Corporation Held By a Subsidiary*, 28 U. CHI. L. REV. 151, 153-54 (1960). The rationale for pass-through relief does not apply if the two corporations' parent-subsidiary relationship is simply the by-product of a Pac-Man defense. Indeed, the efficacy of the voting franchise may be weakened by reallocating the subsidiary's voting rights in the Pac-Man setting.

II. THE TIMING AND MECHANICS OF VOTING

A successful tender offer followed by a successful Pac-Man defense also raises curious legal problems that concern the timing and mechanics of the parties' ability to use the voting power they have acquired in each other. State corporation statutes differ widely on these matters, and these differences may significantly affect the outcome of the takeover battle. Suppose again that both *O* and *T* have acquired a majority of each other's shares; assume initially that neither block of shares would be disenfranchised from voting by a cross-ownership statute. It is unlikely that the board of either acquired company would voluntarily cooperate with the acquiror. Therefore, in order for either party to translate its shareholdings into effective control of the other company, it will obviously need to vote its shares to remove the acquired company's incumbent directors (assuming that they have not resigned) and elect new directors to the board. The acquiror must also vote its shares to secure approval of a proposal to merge the two companies on terms agreeable to the management of the acquiring company after such a proposal has been duly approved by the newly-elected directors of the acquired company or to dissolve the acquired company after the merger and dispose of its shares in the acquiring company in a way that will be attractive to the acquiring company. The nature of these issues makes it clear that the party first to vote its shares scores a preemptive strike. Thus, priority in voting is crucial.

In most states, unless the corporation's shareholders unanimously agree to a given proposition, the majority shareholder may vote its shares only at a shareholders' meeting.²⁶ Corporation statutes typically require that after the shareholder meeting is duly called,²⁷ all shareholders of record entitled to vote must receive advance notice of the

26. See, e.g., MODEL BUSINESS CORP. ACT § 145 (1971).

27. Unless the corporation has already scheduled an annual meeting that happens to coincide with the takeover struggle, it will be necessary to call a special meeting of shareholders. Section 28 of the Model Business Corporation Act provides that special meetings "may be called by the board of directors, the holders of not less than one-tenth of all the shares entitled to vote at the meeting, or such other persons as may be authorized in the articles of incorporation or the by-laws." *Id.* § 128. Note that if the cross-ownership statutes disenfranchise the shares held by the new majority shareholder, that shareholder's shares are not "entitled to vote at the meeting," and its ability to call the special meeting is consequently doubtful. In that case, if the incumbent directors and officers resist calling the meeting, the new majority shareholder must patiently await the next annual meeting or must appeal to the unaffiliated shareholders and persuade a sufficient number of them to join in the call. (Query whether this effort at persuasion should be treated as a solicitation of a proxy to which the SEC's proxy rules would apply.) It is also possible to seek judicial intervention to call a meeting. See W. CARY & M. EISENBERG, CORPORATIONS 227-29 (5th ed. unabr. 1980).

meeting.²⁸ Further, if the notice is accompanied by a solicitation of proxies from the shareholders, the SEC's proxy rules require advance filing of the proxy statement with the SEC if the securities to be voted are registered with the SEC pursuant to section 12 of the Securities Exchange Act of 1934.²⁹

In a minority of states, however, the corporation statutes permit shareholders to act with non-unanimous consent and without a meeting if the number of shares consenting to the action equals the minimum number that would be required to authorize the action at a meeting at which all shares entitled to vote were present and voting.³⁰ These statutes also permit the corporation to opt out of non-unanimous consent through a provision in its articles of incorporation. (This discussion presupposes that neither party has taken the appropriate steps prior to the tender offer to amend its charter.) Although the consent statutes require that notice be given at some point to the non-consenting shareholders, a party that acquires a majority of the shares of a corporation organized in a state with a non-unanimous consent provision may more expeditiously exercise its control because no shareholder meeting is required.

This advantage may be vitiated somewhat if the acquired securities are registered with the SEC. Even in the absence of a proxy solicitation, section 14(c) of the Securities Exchange Act requires that "prior to any annual or other meeting . . . information substantially equivalent to the information which would be required to be transmitted if a solicitation were made" be furnished to all stockholders of record.³¹ Applying section 14(c), rule 14c-2(a) requires that an information statement be furnished to shareholders "[i]n connection with every annual or other meeting . . . including the taking of corporate action with the written authorization or consent of the holders of a class of securities. . . ." ³² Rule 14c-2(b) requires that the information statement be sent at least twenty days before either the meeting date or "the earliest date on which the corporate action may be taken."³³ Finally, rule 14c-5(a) requires that the SEC receive preliminary copies of the information statement at least ten days before the statement is sent

28. For example, the Model Business Corporation Act requires that notice of a shareholder meeting be delivered at least ten and no more than fifty days in advance of the meeting. MODEL BUSINESS CORP. ACT § 29 (1971).

29. Securities Exchange Act of 1934, § 12(b), (g), 15 U.S.C. § 78l(b), (g) (1976).

30. See, e.g., DEL. CODE ANN. tit. 8, § 228(a), (c) (1975).

31. Securities Exchange Act of 1934, § 14(c), 15 U.S.C. § 78n(c) (1976).

32. 17 C.F.R. § 240.14c-2(a) (1982). The scope of the rule appears to somewhat exceed that of the statute, which on its face is limited to shareholder meetings.

33. 17 C.F.R. § 240.14c-2(b) (1982).

to the shareholders, although the Commission may shorten this advance filing period on a showing of good cause.³⁴ The import of these rules is that if shares are acquired in a corporation within the SEC's ambit under the Exchange Act, an advance information statement must be furnished to shareholders even if proxies are not solicited and even if a shareholder meeting is not held. Nonetheless, if a non-unanimous consent statute is available, compliance with the section 14(c) requirements may still result in less delay than compliance with the formalities attendant to a shareholder meeting.

The non-unanimous consent statutes themselves differ in some ways that bear on the timing question. Section 228 of the Delaware statute permits shareholder action on non-unanimous consent without prior notice if non-consenting stockholders are given prompt notice of the corporate action taken.³⁵ Notice given *after* the action has been taken could thus be "prompt" under section 228. Other statutes, although differing somewhat in their details of mechanics and timing, essentially require that advance notice of the proposed action be given to all stockholders. For example, the California statute requires that notice be given ten days in advance of the action unless the consent of all shareholders has been solicited in writing,³⁶ and the Florida statute requires that notice be given to non-consenting shareholders within ten days of obtaining non-unanimous consent.³⁷ New Jersey differentiates between types of actions in its notice requirements: notice must be given twenty days in advance of taking action to merge, consolidate, sell or exchange assets, but ten days' notice suffices for all other shareholder actions.³⁸ Although most such statutes permit non-unanimous consent to authorize any action that may be taken by shareholders, Nevada and New Jersey except the election of directors, for which a meeting would be required.³⁹

All things considered, then, an offeror is in a strong position if its target is incorporated in Delaware, which is the most permissive jurisdiction in the use of non-unanimous consent for shareholder action. If the target responds with a successful Pac-Man defense, the initial offeror will be in an even stronger position if it is incorporated in a state

34. *Id.* § 240.14c-5. Indeed, in the Bendix-Martin Marietta transaction, the SEC permitted the information required by section 14(c) to be included in the tender offer documents.

35. DEL. CODE ANN. tit. 8, § 228(a), (c) (1975). The omission of a non-unanimous consent provision in the Model Business Corporation Act may explain the substantial variation among statutes.

36. CAL. CORP. CODE § 603(a), (b) (West 1977).

37. 18 FLA. STAT. ANN. § 607.394 (West 1977).

38. N.J. STAT. ANN. § 14A:5-6 (West Supp. 1982-1983).

39. NEV. REV. STAT. § 78.320(1) (1979); N.J. STAT. ANN. § 14A:5-6 (West Supp. 1982-1983).

requiring that a meeting precede stockholder action⁴⁰ or if it has amended its charter to require such a meeting.⁴¹ Even if the initial offeror were incorporated in a state with a non-unanimous consent provision, it could use that route to amend its charter to opt out of the statute and to require a shareholders' meeting for some types of corporate action. Obviously, the success of this defensive maneuver will turn on the timing of the proposed amendment, which must be adopted before the target's Pac-Man defense captures a majority of the shares in the initial offeror. Finally, either party's ability to vote the shares it has acquired is determined in part by the time at which it purchases the shares, which in turn depends on the timing of the offer and the expiration of the shareholders' right under the Williams Act to withdraw shares they have tendered.

The scenario in which the original offeror or its target (turned Pac-Man aggressor) seeks to exercise its newly acquired control grows more complicated if a cross-ownership provision prevents either or both corporations from voting their blocks of stock in the other.⁴² If it is disenfranchised, the acquiror can take advantage of a non-unanimous consent statute only by persuading a majority of the residual stockholders to lend their consent. Efforts to persuade these stockholders may well be viewed as the solicitation of proxies, and it may be necessary to comply with the SEC's proxy rules,⁴³ which will delay the exercise of control on which the outcome of the takeover battle depends. If an acquiror does not or cannot resort to a non-unanimous consent statute, its success depends on the outcome of a shareholder meeting at which the shares voting will be those other than the shares held by the majority stockholder.⁴⁴ Realistically, such a shareholder meeting would fea-

40. The court in *Martin Marietta Corp. v. Bendix Corp.*, 549 F. Supp. 623, 633 n.5 (D. Md. 1982), recognized that the law of the original offeror's state of incorporation may determine the efficacy of a Pac-Man defense. *Martin Marietta*, a Maryland corporation, made a Pac-Man offer for Bendix, a Delaware corporation. Delaware has a non-unanimous consent provision, but Maryland does not. The *Martin Marietta* court observed that Marietta's directors need not assume that their continued tenure in office would be very brief after Bendix acquired a majority of the Marietta shares. The court noted that "due to differences in Maryland and Delaware state law, Marietta's directors 'knew' that if they proceeded with Marietta's offer, they would probably not be displaced by Bendix in a day or even in the foreseeable future." *Id.*

41. See *supra* text following note 30.

42. See *supra* text accompanying note 4.

43. Rule 14a-1(d) defines "proxy" to include "every proxy, consent, or authorization," including those that take the form of a failure to act. 17 C.F.R. § 240.14a-1(d) (1982).

44. See *supra* text accompanying note 5.

Disenfranchisement of the majority shareholder under a cross-ownership statute would not make it impossible to obtain a quorum for a shareholders' meeting because the calculation of the number of shares outstanding for purposes of determining the quorum number does not include disenfranchised shares. See, e.g., DEL. CODE ANN. tit. 8, § 160(c) (1975).

ture a quite vigorous proxy contest waged by the new majority shareholder against incumbent management.⁴⁵

III. THE FIDUCIARY DUTIES OF THE TWO BOARDS OF DIRECTORS

In the aftermath of a successful Pac-Man defense, the new majority shareholders will be in an especially awkward position with respect to the incumbent directors. Conflict between new owners and old directors is not unusual in the wake of a takeover; the problem is exacerbated here by the prolongation of the struggle for control. Until one corporation succeeds in exercising its newly acquired control over the other, it is not clear which is in control, and in each corporation the interests of the new majority and the current directors are directly opposed. The problem arises even before the Pac-Man defense begins. Once *O* acquires a majority of the shares in *T*, *T*'s directors are conceivably bound by their fiduciary duty to do nothing inconsistent with *O*'s wishes, which presumably do not encompass a Pac-Man offer for *O*'s shares. Similarly, if *T* undertakes a Pac-Man defense and acquires a majority of the shares in *O*, *O*'s directors may be bound to abide by *T*'s desires. If *T* must act in accordance with *O*'s wishes while *O* is bound to obey *T*, the situation is not only awkward, it is viciously circular.

Again, an appeal to the residual shareholders solves the conundrum. *T*'s directors owe their fiduciary duty to all of the shareholders of *T*, not simply to the majority shareholder. Indeed, the interests and wishes of *O* as the majority stockholder may be so inconsistent with the interests of *T*'s minority stockholders that it would be improper for *T*'s directors to pursue the majority's goals exclusively. Furthermore, to the extent that *T*'s directors owe deference to *O* as a majority stockholder, they owe this deference to *O*'s shareholders, not simply its management, because *O*'s shareholders are the beneficial owners of *O*'s majority holding in *T*. *O*'s principal shareholder is *T*, but there will also be minority shareholders in *O*, to whom *T*'s directors now owe a fiduciary duty. In the mirror-image world of the Pac-Man defense, what is true of *T* is equally true of *O*. Therefore, the directors of each corporation owe their fiduciary duty to the same set of shareholders: the minority shareholders of *T* and of *O*. This is no surprise; in effect, there is now only one corporation, not two, and its shareholders are those shareholders of *T* and of *O* who did not sell their stock in the

45. See *supra* note 6.

tender offer and Pac-Man defense.⁴⁶ The only question is which board of directors will control the merged entities.⁴⁷

The Delaware Supreme Court in *Martin Marietta Corp. v. Bendix Corp.*⁴⁸ ventured a very different analysis of the directors' duties in the aftermath of a Pac-Man defense. The court opined that once Bendix became the majority shareholder of Martin Marietta, Martin Marietta would violate "a moral duty to its majority shareholder, Bendix," if it were to acquire a majority of Bendix's shares and use them under Delaware's non-unanimous consent statute to gain control of the Bendix board.⁴⁹ According to the *Martin Marietta* court, this moral transgression might warrant legal or equitable intervention.⁵⁰

No doubt the Bendix management was outraged and surprised by Martin Marietta's Pac-Man defense. The Delaware court, however, exaggerated the magnitude of this outrage when it suggested that Bendix would be entitled to legal or equitable relief. It is also possible that the Delaware court perceived the irony of a foreign corporation such as Martin Marietta being able to use Delaware's non-unanimous consent statute to capture a Delaware corporation such as Bendix, while Bendix, the original offeror, was crippled by the lack of a non-unanimous consent statute in Maryland, Martin Marietta's state of incorporation. At any rate, the Delaware Supreme Court's analysis in *Martin Marietta* ignored the fact that a target corporation's board of directors owes its fiduciary duty to all its shareholders, not simply to the majority shareholder.

Furthermore, the decision of a target's board to retaliate with a Pac-Man defense ought to receive the deference that is customarily management's due. If the decision is made in good faith and in pursuit of what is reasonably believed to be a good corporate purpose, it ought to be protected by the business judgment rule from judicial scrutiny of its correctness.⁵¹ While in the fray of battle, the target's directors are

46. Although after a successful Pac-Man defense there is one corporation for purposes of analyzing the fiduciary duties of the two boards, there are still two corporations for purposes of holding shareholder meetings and electing directors.

47. In the alternative, a white knight may appear and acquire both corporations. See *infra* note 58.

48. No. 298, slip op. (Del. Sept. 21, 1982).

49. *Id.* at 2. Oddly enough, the court's articulation of the Marietta directors' moral duties conflicts sharply with the view of those duties expressed by one Marietta director. He argued at a Marietta board meeting that, having made its tender offer for Bendix, Marietta was under a "moral obligation" to buy the shares tendered. The American Lawyer, Feb. 1983, at 35, 39, col. 2.

50. No. 298, slip op. at 2-3.

51. This analysis follows the reasoning in *Martin Marietta Corp. v. Bendix Corp.*, 549 F. Supp. at 633-34. The court expressly rejected the Sixth Circuit's interpretation of Section 14(e) of the Williams Act in *Mobil Corp. v. Marathon Oil Co.*, 669 F.2d 366 (6th Cir. 1981), that some

not psychologically disinterested in its outcome, but courts thus far have required a more palpable conflict of interest before they will disqualify the directors' decisions from the protection of the business judgment rule.⁵² The directors of the original offeror may well disagree with the target's directors about the best interests of the companies and their shareholders, but this kind of difference in judgment is perfectly consistent with deference to the decisions of both boards under the business judgment standard.

IV. CONCLUSION

Several aspects of the Pac-Man defense present troubling legal questions. Although variations among state corporation statutes sometimes determine the outcome of takeover battles, the applicability of cross-ownership statutes and non-unanimous shareholder consent statutes are not among the factors that traditionally influence the choice of a legal locale for incorporation or the choice of a tender offer target. In advising on incorporation decisions, corporate counsel takes into account considerations such as the level of the state's franchise tax and the overall certainty and flexibility of the state's corporate law. Perhaps counsel will expand its list of relevant state law considerations to include those that bear on the Pac-Man defense, or perhaps it will take care that the corporation's articles are originally drafted or subsequently amended to minimize some of the difficulties identified in this comment. These peculiarities of state corporate law may also become significant in the choice of takeover targets and defensive planning.

It is equally likely, however, that any state law barriers to the use of the Pac-Man defense will simply contribute to the growth of a strong disenchantment with the determinative effect of such statutes on the outcome of takeover contests. While the success of a disputed tender

tender offer defenses, albeit not deceptive, are manipulative interferences with market forces. *Id.* at 630.

52. See, e.g., *Panter v. Marshall Field & Co.*, 646 F.2d 271 (7th Cir.), *cert. denied*, 454 U.S. 1092 (1981); *Treadway Cos. v. Care Corp.*, 638 F.2d 357 (2d Cir. 1980). Some courts have intimated that directors, despite their formal disinterest in a transaction, nonetheless may have strong ties of loyalty to the corporation's managers. See *Joy v. North*, 692 F.2d 880, 888 (2d Cir. 1982); *Zapata Corp. v. Maldonado*, 430 A.2d 779, 787 (Del. 1981). See generally Cox, *Searching for the Corporation's Voice in Derivative Suit Litigation: A Critique of Zapata and the ALI Project*, 1982 DUKE L.J. 959. In *Joy* and *Zapata*, however, the question of director independence arises in the context of nominally independent directors' ability to use a special litigation committee to cause the dismissal of derivative suits brought against corporate officers and other directors. This context may somewhat limit the courts' misgivings about director independence because the courts may view themselves as possessing a special aptitude to evaluate the probable merits of corporate litigation whereas they would be more reluctant to review the merits of more typical business decisions. See *Joy v. North*, 692 F.2d at 888.

offer may turn on many factors, including the relative financial strengths and strategic acumen of the bidders, differences among state corporation statutes should not be crucial to the outcome. Having the good fortune to be an offeror incorporated in Maryland or New Jersey who chooses a target incorporated in New Hampshire is not the kind of quirk on which corporate control should turn, other things being equal. Because variations in state corporation statutes can arbitrarily determine the winner of a takeover battle, corporations may become the surprising new advocates of statutory uniformity.⁵³ Uniformity could be most directly achieved by a federal incorporation statute or by federal statutory provisions that supervene the states' treatment of questions crucial to contested tender offers. Less directly, and short of congressional action, the SEC could attempt to use its rule-making authority under section 14(c) of the Securities Exchange Act of 1934⁵⁴ and under the Williams Act⁵⁵ to achieve greater uniformity, subject to the risk of a successful challenge to such rules as beyond Congress' intention in the Exchange Act.

As the law now stands, courts may mistakenly use cross-ownership statutes to disenfranchise one or both of the parties to a Pac-Man defense, and variations among state corporation statutes with respect to the timing and mechanics of voting may arbitrarily determine the outcome of a takeover battle. The resolution of these problems, however, would not answer the more fundamental question of how the legal system is to decide who will win control of two offer-entangled enterprises: The current means of determining the winner is as arbitrary as a coin toss, but if the coin toss is abolished, a new decisionmaking procedure must take its place. The Delaware Supreme Court's confused and moralistic analysis of fiduciary duty in the aftermath of a Pac-Man defense⁵⁶ suggests that courts may find it difficult to resolve the battle for control by recourse to traditional legal principles. Furthermore, this comment's conclusion that the board of directors of each of the entangled corporations owes its fiduciary duty to the same set of shareholders⁵⁷ suggests that traditional principles will fail to guide courts through the mirror-image world of the Pac-Man defense.

This legal infirmity may be tolerable as long as the Pac-Man defense is only a threat. But if tender offer targets continue to make offers

53. Corporations have generally disfavored statutory uniformity, which would preclude the creation of corporate havens.

54. See 15 U.S.C. § 78n(c) (1976).

55. See Securities Exchange Act of 1934, § 14(d)(1), (d)(4), 15 U.S.C. § 78n(d)(1), (d)(4) (1976).

56. See *supra* text accompanying notes 48-50 and text following note 50.

57. See *supra* text preceding note 46.

for control of the original offeror and to purchase the shares tendered, the legal confusion will become intolerable. At present, only the timely arrival of a white knight to purchase both adversaries⁵⁸ can redeem the parties from the chaos they have created. In some cases, however, the rival offerors' balance sheets will be so depleted of cash and so laden with debt after their contest that they will confound the mettle of even the most valiant white knight. The extremity of the situation would then warrant a novel and perhaps even an audacious legal response to the general problem of Pac-Man defenses.

There are a number of different avenues that such a legal response might follow. Although this comment describes them only briefly and in the broadest of terms, it will be apparent that each has its own attractions and drawbacks. Perhaps the simplest to execute is a legislative or administrative prohibition against Pac-Man defenses, or more generally against a range of tender offer defenses. Such a prohibition, however, would deny shareholders of target companies the benefits of larger offer premiums that the threat of a counteroffer may engender. The prohibition would also preclude the possible success of the threat as a deterrent to the original offeror or as a cry for a white knight to come to the rescue.

Another possible legal response would be to give some judicial or administrative body the power to review the merits of each board of directors' claim to control the corporations. The reviewing authority would also determine the capital and management structure that would best serve the interests of the companies' remaining stockholders and would be most likely to further the effective operation of their businesses. As these inquiries are necessarily empirical and complex, an administrative and regulatory agency would be better suited than the courts for this purpose. An analogy of some force is the mandate given to the SEC by section 11 of the Public Utility Holding Company Act of 1935⁵⁹ to "examine the corporate structure" of registered holding companies to determine whether that structure might be simplified to further a fair and equitable distribution of voting rights among holders of securities and to achieve the limitation of the companies' properties and business "to those necessary or appropriate to the operations of an

58. The deal through which the white knight resolves the confusion may not result in the white knight's control of both adversaries. For example, in the denouement of the Martin Marietta-Bendix offers, Allied Corporation agreed to merge with Bendix by buying Martin Marietta's block of Bendix along with the Bendix shares that had not been tendered. To pay for Marietta's block of Bendix shares, Allied relinquished part of Bendix's block of Marietta; Allied retained a thirty-nine percent interest in Marietta but agreed to vote it as the Marietta board directed. See Rowan & Moore, *Behind the Lines in the Bendix War*, FORTUNE, Oct. 18, 1982, at 157.

59. 15 U.S.C. § 79k (1976).

integrated public utility system."⁶⁰ Surely a comparable mandate, of equivalent breadth, could be designed for the SEC to execute in the aftermath of a successful Pac-Man maneuver.

Of course, the risk of falling under the SEC's aegis could discourage ambitious Pac-Man offers, but this might be a desirable side effect. This solution does, however, assume that these situations are so extraordinary that the customary governmental deference to private business decisions should be suspended. As an alternative to such radical governmental interference, legislation could require the SEC to select independent directors in the wake of a Pac-Man debacle, directors whose term in office might well be limited but whose mandate would include the choice of an appropriate management structure for the cross-owned enterprise. This solution minimizes governmental intrusion into decisions about private business corporations, while providing some device lacking at present to resolve rationally the impasse that marks the success of a Pac-Man defense.

60. *Id.* § 79k(a).