Panter v. Marshall Field & Co.: Unbridled Discretion of Management to Resist Hostile Tender Offers

In *Panter v. Marshall Field & Co.*,[1] the Court of Appeals for the Seventh Circuit reaffirmed the viability of the use of the business judgment rule[2] to govern the actions of corporate boards of directors during hostile takeover attempts. In so doing, the court sanctioned practically unbridled discretion on the part of directors in their attempts to thwart unwelcome tender offers.[3] *Panter* illustrates the extreme lengths to which courts will go to insulate directors from liability to complaining shareholders in hostile tender offer situations.

In *Panter*, nineteen shareholders brought a class action on behalf of all of the shareholders of Marshall Field & Company (Field) against the company and its ten directors.[4] Field was a Delaware corporation engaged in the operation of retail department stores. In early October 1977, Carter Hawley Hale (CHH), a California corporation, expressed a desire to negotiate a merger with Field. The management of Field was not in favor of the merger and the offer to negotiate was rejected. CHH persisted in its attempts to acquire Field and ultimately issued a press release which stated that CHH intended to make an offer for shares of Field's stock.

---

1. 646 F.2d 271 (7th Cir. 1981).

2. The court accepted the definition of the business judgment rule adopted by the lower court, which stated that

> [d]irectors of corporations discharge their fiduciary duties when in good faith they exercise business judgment in making decisions regarding the corporation. When they act in good faith, they enjoy a presumption of sound business judgment, . . . which courts will not disturb if any rational business purpose can be attributed to their decisions. In the absence of fraud, bad faith, gross overreaching or abuse of discretion, courts will not interfere with the exercise of business judgment by corporate directors.

Panter v. Marshall Field & Co., 486 F. Supp. 1168, 1194 (N.D. Ill. 1980)(citations omitted).

3. A general definition of tender offer is found in E. Aranow & H. Einhorn, Tender Offers for Corporate Control 70 (1973):

> [a] public offer or solicitation by a company, an individual, or a group of persons to purchase during a fixed period of time all or a portion of a class or classes of securities of a publicly held corporation at a specified price or upon specified terms for cash and/or securities.

4. The facts were exhaustively reviewed in the district court's opinion, 486 F. Supp. at 1172-84 and 646 F.2d at 277-81.

Field had been the target of merger attempts several times in the pas and had always rejected them.[5] Also, in the past, Field had made acquisi tions contemporaneous with the potential merger bids which would hav caused antitrust problems for the bidders.[6] When CHH announced it plan to make a cash tender offer, Field again resisted. In execution of th board's mandate to take "such action as they deemed necessary"[7] to de feat the offer, Field filed suit in federal court against CHH and allege that the acquisition of Field by CHH would violate securities and anti trust laws. Field then embarked on its own program of defensive acquisi tions which would exacerbate potential antitrust problems, thus makin itself less attractive to CHH. Subsequently, CHH withdrew its propose exchange offer, whereupon the shareholders of Field brought suit agains Field and alleged that Field's conduct in defeating the takeover violate the antifraud provisions of the Securities Exchange Act of 1934[8] and als

---

5. 646 F.2d at 278. For example, in 1969, Field was approached by Associated Dr Goods. While considering the merger offer, Field acquired Halle Brothers, which had store in communities in which Associated already had stores. The offer was ultimately rejecte Similarly, in 1975, Field was approached by Federated Department Stores. Field's couns advised that a merger would involve antitrust problems in light of Field's proposed acquis tion of Wanamaker Company. The same pattern was followed in 1976 when Dayton-Hudso contacted Field with a merger proposal. Field launched a program to acquire Liberty Hous which had stores in Portland and Tacoma, areas in which Dayton-Hudson also had stores. is important to note that when Dayton-Hudson withdrew its proposal, Field's acquisitio program stopped.

6. *Id.*

7. 486 F. Supp. at 1180-84.

8. There are two broad antifraud provisions of the Securities Exchange Act of 1934: se tion 14(e) of the Williams Act, 15 U.S.C. § 78n(e) (1976), which prohibits deception in co nection with any tender offer, and section 10(b) of the Securities Exchange Act of 1934, 1 U.S.C. § 78j(b) (1981), SEC Rule 10b-5, 17 C.F.R. § 240.10b-5 (1981), which similarly pr hibits deceptive statements or conduct in connection with the purchase or sale of any secu ity. While there is still some interpretive difficulty concerning what activities of manag ment will amount to violations of these provisions, there is general agreement that there no federal cause of action under these sections for conduct of the management which alleged to be fraudulent and a breach of fiduciary duty unless such conduct could be viewe as manipulative or deceptive, according to their commonly accepted meanings. Santa F Indus., Inc. v. Green, 430 U.S. 462 (1977). *See also* Oscar Gruss & Son v. Natomas, C-7 1869-CFP (N.D. Cal. Dec. 17, 1976), a pre-*Green* decision reaching the same conclusion wi respect to Rule 10b-5. Also, in Altman v. Knight, 431 F. Supp. 309 (S.D.N.Y. 1977), the cou held that the ruling in *Green* applied to § 14(e) as well as to Rule 10b-5 since the purpose the two sections is the same: assuring adequate disclosure so that the shareholder can mal an informed decision whether to tender his shares. *Id.* at 314.

In accord with the cases to date, the court in *Panter* held that since the tender offer nev became effective, shareholders of the target could not state a cause of action under sectic 14(e) for alleged misstatements since there was no reliance on the part of the shareholder 646 F.2d at 284. *See* Lewis v. McGraw, 619 F.2d 192 (2d Cir.), *cert. denied*, 101 U.S. 3 (1980). The court also failed to find a cause of action under section 10b-5 of the Securiti Exchange Act of 1934 and Rule 10b-5 based on Field's undisclosed policy of independen

alleged that such actions constituted a breach of fiduciary duty under state law. The district court granted defendant's motion for directed verdicts, and held that there were no violations of the Securities Exchange Act, nor was there any breach of fiduciary duty on the part of the directors.[9] Plaintiffs appealed from the directed verdict and the Court of Appeals for the Seventh Circuit affirmed.

State law claims against corporate management's actions in a corporate control situation are invariably bottomed on the concept of fiduciary duty.[10] However admirable this concept may be, decisions show that it is so ambiguous and ill-defined that it is practically meaningless.[11] Courts' opinions are in hopeless disarray on the question of what fiduciary duty entails. Even when one can find an acknowledgement of the question, there is no agreement on the basic considerations of fiduciary duty, such as to whom the duty is owed.[12]

The ambiguity of the term "fiduciary duty" is aptly illustrated by the fact that both plaintiffs and defendants commonly invoke it in support of

---

since that cause of action required proof of deception, which was lacking in the Field situation. Further, the section did not provide a remedy for the breach of fiduciary duty under state law. 646 F.2d at 287. *See generally* with respect to causes of action under the securities laws, Chris-Craft Indus., Inc. v. Piper Aircraft Corp., 480 F.2d 341 (2d Cir.), *cert. denied*, 414 U.S. 910 (1973); Electronic Specialty Co. v. International Controls Corp., 409 F.2d 937 (2d Cir. 1969); Berman v. Gerber Prods. Co., 454 F. Supp. 1310 (W.D. Mich. 1978).

9. 486 F. Supp. at 1195.

10. *See, e.g.*, Pepper v. Litton, 308 U.S. 295, 306-07 (1939).

> A director is a fiduciary. . . .So is a dominant or controlling stockholder or group of stockholders . . . . Their powers are powers in trust. Their dealings with the corporation are subjected to rigorous scrutiny and where any of their contracts or engagements with the corporation is challenged the burden is on the director or stockholder not only to prove the good faith of the transaction but also to show its inherent fairness from the viewpoint of the corporation and those interested therein.

Id. at 306 (citations omitted). *See also* Guth v. Loft, 23 Del. Ch. 255, 270, 5 A.2d 503, 510 (Sup. Ct. 1939).

11. *See, e.g.*, SEC v. Chenery Corp., 318 U.S. 80, 85-86 (1943), in which Justice Frankfurter discussed the fiduciary analysis.

> But to say that a man is a fiduciary only begins analysis; it gives direction to further inquiry. To whom is he a fiduciary? What obligations does he owe as a fiduciary? In what respect has he failed to discharge these obligations? And what are the consequences of this deviation from duty?

Id. at 85-86. *See also* Northwest Indus., Inc. v. B.F. Goodrich Co., 301 F. Supp. 706 (N.D. Ill. 1969), in which management's defensive issuance of shares was upheld since plaintiff failed to prove fraud.

12. *Compare* Heit v. Baird, 567 F.2d 1157, 1161 (1st Cir. 1977)(asserting that the duty is owed to the target corporation) *with* Weiss, *Tender Offers and Management Repsonsibility*, 23 N.Y.L. SCH. L. REV. 445, 446-47 (1978)(contending that the duty is owed to the shareholders). Others have recognized duties to employees as well as creditors of the target. Herald v. Seawell, 472 F.2d 1081 (10th Cir. 1972).

their conflicting positions. Shareholders sue on the basis of the fiduciai duty and claim that the duty is breached when an offer is thwarted whic would have resulted in their economic enrichment. Management counte that the duty makes it incumbent upon the directors to resist offers th they determine to be detrimental to the interests of the corporation. Opinions of courts and commentators range in extremes, from the vie that management should maintain a purely passive stance in the face of tender offer,[14] to the view that the duty has been complied with as long there is no evidence of fraud or gross overreaching.[15]

While courts, claiming to subject actions taken by directors to rigoro scrutiny, consistently espouse high fiduciary duty and make reference the duty of honesty and fair dealing with shareholders, their actual anal ses are under the business judgment rule, which contains a presumptic in favor of management.[16] Courts use the business judgment rule as tl standard by which they measure compliance with fiduciary duty.[17]] practical application, there are only the rudiments of limits placed on tl discretion of management to pursue whatever courses of actions directo deem necessary. Actions that have been found to be impermissible a those that involve fraud, gross overreaching,[18] or self-perpetuation in o fice.[19] Even when self-perpetuation is shown to be a motive for resisting tender offer, it must be further proved that the desire of management retain their positions is the sole or primary purpose for their actions. It not sufficient that it be *a* motive.[20]

---

13. Heit v. Baird, 567 F.2d at 1161.

14. Easterbrook & Fischel, *The Proper Role of a Target's Management in Respondi to a Tender Offer*, 94 HARV. L. REV. 1161 (1981).

15. Northwest Indus., Inc. v. B.F. Goodrich Co., 301 F. Supp. 706 (N.D. Ill. 1969).

16. *See, e.g.*, Berman v. Gerber Prods. Co., 454 F. Supp. 1310, 1319 (W.D. Mich. 197

17. *See id.* at 1319: "There can be no doubt that corporate officers and directors have high fiduciary duty of honesty and fair dealing with shareholders. . . . Nevertheless, it also well established that corporate management may not be held liable for good faith erro in judgment."

18. Kalmanask v. Smith, 291 N.Y. 142, _, 51 N.E.2d 681, 687 (1943)("Nor may judici process be invoked to challenge the judgment of directors except when fraud is alleged conduct so oppressive as to be its equivalent, and facts are pleaded which afford a basis f such allegations.")

19. Cheff v. Mathes, 41 Del. Ch. 494, 199 A.2d 548, 554 (1964), was a stockholder's deri ative suit to hold certain directors liable for loss allegedly resulting from improper use company funds to purchase its own shares. The court found that if the board was acti solely or primarily because of a desire to perpetuate itself in office, use of corporate fun was improper.

20. In Johnson v. Trueblood, 629 F.2d 287, 292 (3d Cir. 1980), the Third Circuit pu ported to recognize the "realities of corporate life" by upholding a jury charge that, "so lo as other rational business reasons support a director's decision, the mere fact that a busine decision involves a retention of control does not constitute a showing of bad faith to reb the business judgment rule." *Id.* at 292.

In effect, then, an examination under the business judgment rule is tantamount to nonexamination.[21] In order for the shareholder to provoke a stricter test of compliance with fiduciary duty, he must first prove that the actions taken by directors were undertaken for the "sole or primary" purpose of perpetuating themselves in office,[22] or were the result of fraud. Only then will the plaintiff survive a directed verdict and the burden shift to the directors to show that their actions were justified by a valid corporate business purpose.[23] This is the prevailing view today, and it places an almost unbearable burden of proof on plaintiffs.

In areas of corporate law other than that of the tender offer, when there exist opportunities for self-dealing on the part of directors, the business judgment rule is held inapplicable as a standard of review.[24] Occasionally, a stricter standard has also been used in the tender offer situation. In *Klaus v. Hi-Shear Corp.*,[25] the Ninth Circuit Court of Appeals used the "compelling business purpose" standard.[26] Under this test, the burden is placed upon the directors to establish the compelling business purpose of any transaction that would have the effect of consolidating or retaining the directors' control.[27] This view recognizes the opportunity for abuse inherent in the business judgment rule and tends toward the fairness analysis.[28] The fairness standard, as embodied in the "compelling business purpose" test, has not won approval in other jurisdictions and it appears that its utility may be limited to the Ninth Circuit.[29]

21. *See* Gelfond & Sebastian, *Reevaluating the Duties of Target Management in a Hostile Tender Offer*, 60 B.U.L. Rev. 403, 434 (1980).

22. Johnson v. Trueblood, 629 F.2d at 293.

23. *Id.*

24. The purpose of the business judgment rule is to protect decisions made by a director exercising honest, *unbiased* judgment. In Sinclair Oil Co. v. Levien, 280 A.2d 717 (Del. 1971), the court found that when self-dealing was coupled with a fiduciary duty, intrinsic fairness was the proper standard by which to judge the transaction. Under the intrinsic fairness standard, the corporation must prove that its conduct was intrinsically fair to minority stockholders. The court found, however, that the actions involved did not constitute self-dealing. Therefore, the proper test was the business judgment rule.

Similarly, in the freezeout merger area, in Singer v. Magnavox, 380 A.2d 969 (Del. 1977), the Delaware Supreme Court held that even a freezeout merger with a valid buisness purpose must be "entirely fair" to the dissenting stockholders. The shareholders in *Singer* alleged that the directors had breached their fiduciary duty by effectuating a merger for the sole purpose of eliminating the minority shareholders. While "entire fairness" and "intrinsic fairness" are still inadequately defined, it is clear from these decisions that they embody something more than just a valid business purpose.

25. 528 F.2d 225 (9th Cir. 1975).

26. *Id.* at 234.

27. *Id.* at 233-34.

28. *Id.* The court states that this standard balances the good to the corporation agaiast the disproportionate advantage to the majority shareholders and incumbent management.

29. Panter v. Marshall Field & Co., 646 F.2d at 295 (noting that as a general matter,

The majority in the *Panter* decision addressed the state law claims o breach of fiduciary duty individually in light of the business judgmen rule. Plaintiffs had alleged that defendants had breached their fiduciar duty in four respects: first, by the adoption of a secret policy to resis acquisitions regardless of benefit to the shareholders or the corporation second, by the failure to disclose the existence of such a policy; third, b the defensive acquisitions; and fourth, by the filing of an antitrust sui against CHH.[30]

The court first analyzed the business judgment rule and basicall adopted the lower court's formulation, which imposed the presumption i favor of management and which insulated board members from liabilit when their acts were undertaken in good faith.[31] The court relied on th analysis of the rule in the tender offer context found in the Third Cir cuit's decision in *Johnson v. Trueblood*.[32] The charge in the *Johnson* cas was similar to that in *Panter*, that is, that the directors were acting out o a motive of self-perpetuation. Plaintiffs in *Johnson* contended that th allegation of the purpose of self-perpetuation was enough to shift the bur den to defendants. The court rejected plaintiffs' contention and hel that, in light of the business judgment rule's purpose—the validation o certain acts which would otherwise involve a conflict of interests for th ordinary fiduciary—"the plaintiff must make a showing from which factfinder might infer that impermissible motives predominated in th making of the decision in question."[33] The court recognized that in real ity, a corporate director has a certain amount of self-interest in every thing he does. Were he held to the same standard as ordinary fiduciaries he would be forever justifying his actions. The business judgment rule is therefore, necessary to allow his discretion to function without the con stant threat of suits alleging breach of duty by reason of self-interest.

The court also relied upon *GM Sub Corp. v. Liggett Group, Inc.*,[34] a unpublished preliminary ruling by a Delaware trial court. In that case the shareholders alleged a breach of a fiduciary duty by the directors' ac of divesting the company of an important asset in an attempt to make th company less attractive to an offeror. The test formulated by the cour for determining whether actions taken by the directors were pursuant t an improper motive was whether the board was fairly and reasonably ex

California law seems to impose a higher standard of fiduciary care than does Delaware).

30. *Id.* at 293. There was also a state claim alleging that defendants interfered wit plaintiffs' economic advantage. The court found that this claim was foreclosed by th court's finding that actions by the board were not improper. *Id.* at 299.

31. *Id.* at 293.

32. 629 F.2d 287 (3d Cir. 1980).

33. *Id.*

34. No. 6155 (Del. Ch. April 25, 1980).

ercising its business judgment to protect the corporation and its shareholders from an injury likely to occur if the tender offer were successful.[35]

The court in *Panter* merely made reference to the stricter compelling business purpose test embodied in *Klaus*. It declined to follow that rule and noted that the fiduciary duty under California law was a higher standard of care than that imposed in Delaware.[36]

Under this analysis of the business judgment rule, the court then proceeded to dispose of plaintiffs' state law claims against defendant. Although the court addressed each of the charges separately, directed verdicts on all counts were premised on the court's conclusion that plaintiffs failed to present any "evidence of self-dealing, fraud, overreaching, or other bad conduct sufficient to give rise to any reasonable inference that impermissible motives predominated in the board's consideration of the approaches."[37] The court accepted without question the board's enunciated purpose of building value within the company by the technique of acquisition and characterized the desire to expand as reasonable and natural. Likewise, the decision to file the antitrust suit against CHH was also found to be within the parameters of the business judgment rule.[38] The court accepted the evidence as showing that the directors were trying to protect the corporation from a perceived injury, even though the nature of the injury was never divulged. The court seemed to find further comfort in the fact that, even if these actions were taken because of improper motives, since a rational business purpose could also be attributed to them, the acts were permissible.[39] Therefore, based on the extravagant trust the court placed in Field's directors' good faith and an open-armed acceptance of the broadest interpretation of the business judgment rule, the court affirmed the ruling that withheld the case from the jury and directed verdicts in favor of defendants.

The court's opinion in *Panter* contains a thoughtful and well reasoned partial dissent which is helpful in identifying the areas in which the majority donned its judicial blinders with regard to plaintiffs' claims. Judge Cudahy first delivered a scathing denouncement of the majority's application of a most flaccid interpretation of the business judgment rule.[40] He alone seemed to recognize that the effect of this interpretation will be to give directors carte blanche to undertake any form of action they choose, with their sole limitation being the ability of the court to perceive some

35. *Id.*, slip op. at 3.
36. 646 F.2d at 295.
37. *Id.* at 296.
38. *Id.* at 297.
39. *Id.* at 297 (citing Cheff v. Mathes, 41 Del. Ch. 494, 199 A.2d 548 (1964) as requiring improper motive to be the sole or primary purpose).
40. 646 F.2d at 299 (Cudahy, J., dissenting).

rational business purpose which might have been the motive.

In determining the stringency of the test used to ascertain whether d: rectors have breached their fiduciary duty, Judge Cudahy would distir guish between two functions of a corporation: that of managing the bus ness of the corporation and that of acting as a vehicle for the collectio and use of capital and distribution of profits.[41] The latter function ir volves the relationship between the directors and the shareholders, an the fiduciary duty inherent in it. Therefore, a stricter standard should b applicable to actions by board members that affect this relationship.[42]

The dissent went further than the majority in recognizing shareholde interests. Any activity that could have the effect of damaging those inte ests should be more closely scrutinized, especially when the activity i tainted by director's self-interests. Under the dissent's view of the bus ness judgment rule, once the plaintiff demonstrates that a director has a interest in the transaction at issue, the burden of proof shifts to the dire tor to prove that the transaction was fair and reasonable to the corpora tion.[43] The basic conceptual difference on this point between the views o the majority and the dissent seems to center on the term "interest. While both the majority and the dissent contended that they were recog nizing the realities of the situation, the majority would argue that sel interest, or more particularly self-perpetuation, is an improper motive fo directors' actions, and that there is *always* an element of self-intere when a director acts. Therefore, to keep all directors' acts from being ir validated, the business judgment rule must be construed to grant immu nity from review of those acts to which a rational business purpose can b attributed.[44]

The dissent's analysis does not appear radically different on its fac What must be noted, however, is that under the majority's view, it wi apparently be the function of the *court* to determine whether, as a matte of law, there could be any rational reason for the acts other than that o self-interest. Under the dissent's view, the *directors* must prove that fai ness and reasonableness of the transaction toward the corporation wa being considered.

In *Treadway Cos. v. Care Corp.*,[45] the Second Circuit was faced with case involving corporate control in which the directors were charged wit *a breach of fiduciary duty*. In *Treadway*, the court allowed the case to g

---

41. *Id.*
42. *Id.* at 300, *see* Note, *Protection for Shareholder Interests in Recapitalizations Publicly Held Companies*, 58 COLUM. L. REV. 1030, 1066 (1958).
43. 646 F.2d at 301 (Cudahy, J., dissenting); *see* Treadway Cos. v. Care Corp., 639 F.2 357, 382 (2d Cir. 1980).
44. *See* note 2 *supra*.
45. 638 F.2d at 357.

to the jury. Factors present in that case were haste of action, avoidance of shareholder scrutiny, and lack of consideration by Treadway to determine whether a takeover would be in the best interest of the corporation.[46] Since these same factors were present in the *Panter* case and the weight of evidence was comparable, the dissent in *Panter* argued that the majority was in error in affirming the lower court's decison to withhold the case from the jury.[47] The dissent further argued that even if the improper motive must be the "sole or primary" purpose for directors' acts, when it is at least *a* motive, it is for the *jury* to determine whether it is the "sole or primary" motive.[48]

In effect, while the dissent conceded that the business judgment rule was the standard by which to measure compliance with fiduciary duty, it would have gone one step further and made the standard for compliance with the business judgment rule more stringent. By so doing, directors' self-interests would be enough to shift the burden to the directors to prove that the fairness and reasonableness of the offer were given due consideration when the activity in question affected shareholder interests. This formulation has the added feature of being a jury question. In this way, shareholder interests would be given more acknowledgement and self-dealing by directors would be discouraged.

The starting point, it seems, in analyzing which view of the rule is the proper one must be an identification of the interests at stake. If it is true that the shareholder interest is due even a modicum of consideration, perhaps a more stringent standard by which to judge directors' acts is indeed in order, since under the present tests, the directors will almost inevitably be insulated from liability.

Proponents of the business judgment rule as it currently stands after *Panter* would applaud the result as giving judicial deference to the relative expertise of directors in corporate matters. The fact of the directors' expertise cannot be seriously questioned. The danger, rather, lies in the presumption of good faith inherent in the rule. The presumption ignores what seems to those concerned for shareholders to be the more "realistic" view of corporate life, that of director self-interest, since it seems reasonable to assume that directors would always be interested in perpetuating their source of income.

Generally, the business judgment rule is *not* applicable in areas of conflict of interest.[49] Therefore, when the interests of directors in maintaining their status and the opportunity for abuse of the business judgment

46. *Id.* at 372.

47. Panter v. Marshall Field & Co., 646 F.2d at 303.

48. 646 F.2d at 304 (Cudahy, J., dissenting); *see* Johnson v. Trueblood, 629 F.2d 287 (3d Cir. 1980).

49. *See* note 24 *supra.*

rule are so apparent under the lax standards presently in use, the unbri dled discretion currently afforded management should be curbed.

Unfortunately, in the wake of *Panter*, it is highly doubtful that strengthening of standards is on even the distant horizon. Instead, it i likely that the direct result of *Panter* will be merely a perpetuation of th confused and ill-defined standards of duty which were present before th Seventh Circuit's decision.

DANA CLAIRE LINDSA