Just Say No To Hostile Takeovers In Massachusetts

BY SEAN T. CARNATHAN

FOCUS ON Corporate Law

Hostile takeover? No, thank you!

In Massachusetts, a corporation with an independent board of directors is entitled to "just say no" to a hostile takeover, and its board will enjoy the protection of the business judgment rule.

So says Judge Allan Van Gestel of the Superior Court Business Session, who issued an important opinion to that effect this past June, *Seidman v. Central Bancorp*, 16 Mass. L. Rep. 383, 2003 Mass. Super. LEXIS 188 (June 30, 2003).

Van Gestel obviously recognized the importance of the issue as well; he decided the substantive question before concluding that the issue was moot in the *Seidman* case. See *id.* at 19 ("If the matters in issue are of public importance and they are likely to arise again, or if they are of general concern to corporations formed in Massachusetts, a Court may address those issues even in the face of some degree of mootness.").

Because van Gestel *is* 50 percent the state court business session, his opinion on these topics is important. He also happens to have gotten the answer right.

Massachusetts has a statutory scheme that is protective of its corporations, some say overly so. See, e.g., Lucian Bebchuk et al., "Does the Evidence Favor State Competition in Corporate Law?" 90 Cal. L. Rev. 1775, 1782 (2002) (describing Massachusetts' anti-takeover statutes as "extreme" and claiming that studies show it is detrimental to shareholder value).

History buffs may recall that the state Legislature enacted its anti-takeover measures in order to protect the Gillette Corp. from unwelcome advances from Revlon, and then Gov. Michael Dukakis announced the enactment of the legislation at Gillette headquarters. See Alan E. Garfield, "State Competence to Regulate Corporate Takeovers: Lessons from State Takeover Statutes," 17 Hofstra L. Rev. 535, 561 (1989); Gary M. Holihan, "Note, Pennsylvania's Antitakeover Statute: An Impermissible Regulation of the Interstate Market for Corporate Control," 66 Chi-Kent L. Rev. 863, 899 n.249 (1990); see generally Rita Ricardo-Campbell, "Resisting Hostile Takeovers: The Case of Gillette" (1997).

It perhaps bears noting that, today, Gillette's stock has appreciated significantly and Revlon is struggling.

Hostile takeovers and defenses against them evolved rapidly in the 1980s and early 1990s. A common defense today is to adopt a shareholder's rights agreement, or "poison pill," and have a "staggered board."

In broad strokes, a poison pill issues contingent rights to all shareholders to buy additional shares. In the event of a hostile takeover, the board has the option to "trigger the pill," or announce the fulfillment of the contingency permitting the shareholders to buy more shares. The trick is that the hostile bidder is disqualified from exercising the rights otherwise appurtenant to its shares. So its interest in the corporation is badly diluted, and the takeover becomes prohibitively expensive.

No hostile bidder has ever absorbed the effect of a poison pill and completed a hostile takeover. See Lucian Arye Bebchuk et al., "The Powerful Antitakeover Force of Staggered Boards: Theory, Evidence and Policy," 54 Stan L. Rev. 887, 904-05 (2002) ("no bidder has ever done so in our fifteen-plus years of experience with the pill") ("Staggered Boards").

The classic response to a poison pill is to wage a proxy fight to take control of the board before launching the tender offer to buy a controlling interest in the corporation's stock. See *id.* at 899. The hostile bidder installs friendly directors on the company's board, who redeem the pill and permit the bidder to buy shares unimpeded.

When the board is "staggered," however, this tactic becomes harder to execute. In a

Continued on page 28

Sean T. Carnathan is a principal of Rubin, Hay & Gould in Framingham. He focuses his practice on corporate and commercial litigation.

Just Say No To Hostile Takeovers In Massachusetts

Continued from page 11

staggered board, only a portion of the directors is elected each year (one-third each year is a common structure).

Accordingly, the hostile bidder must win two elections, separated widely in time, before it can redeem the pill. See *id.* at 912-14.

'Potent Combination'

For the purposes of the issues raised here, we are interested in three components of the Massachusetts statutes: (1) a codification of the business judgment rule that includes a "nonshareholder constituency" provision; (2) a staggered board statute; and (3) a statutory provision authorizing poison pills. G.L.c. 156B, §65 (director and officer duty of care provision, including a nonshareholder constituency provision); G.L.c. 156B, §50A (requiring staggered boards for Massachusetts corporations unless the corporation opts out by a two-thirds majority shareholder vote); G.L.c. 156B, §32A (providing that poison pills are valid); see also G.L.c. 110C (imposing disclosure obligations and providing for administrative review of takeovers).

Together, these three provisions make for a potent combination in permitting Massachusetts corporate boards to resist a hostile takeover through a poison pill. Massachusetts boards are expressly authorized to adopt poison pills, and Massachusetts boards will generally be staggered. The nonshareholder constituency provision permits boards to consider the impact of the takeover on the corporation's employees, suppliers, creditors and customers, as well as the economic impact on the state, region, nation or society.

Accordingly, the commonwealth's statutes set the stage for Massachusetts boards to "just say no" to a hostile takeover if they believe that a takeover is not in the best short- or long-term interest of the institution, its shareholders or other constituencies set forth in the statute. See G.L.c. 156B, §65.

Seidman is important because it analyzes the impact of the board's fiduciary duties on their statutory power to say no to a hostile party.

In *Seidman*, the takeover bidder argued that a board's decision to turn away a hostile takeover is necessarily tainted by self-interest because the board members have an interest in protecting their own status as the governors of the corporation.

The takeover bidder asked that the court apply heightened scrutiny to the board's decision to refuse the offer before affording the board the protection of the business judgment rule, in the same way that Delaware courts do. See *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 955 (Del. 1985) (providing for "enhanced scrutiny" of decision to resist takeover before application of business judgment rule).

Under the *Unocal* framework, a board must demonstrate that it "had reasonable grounds for believing that a danger to corporate policy and effectiveness existed because of another person's stock ownership." *Id.*

If the board demonstrates a reasonable perception of a threat, the court will still examine whether the "defensive measure ... [is] reasonable in relation to the threat posed." *Id.*

Although the application of this scrutiny by no means dooms a board's decision to trigger a pill, it does require the board to jump through more hoops. See, e.g., *Paramount Comm., Inc. v. Time, Inc.*, 571 A.2d 1140, 1153-54 (Del. 1990) (holding that corporate boards could consider the potential impact of a tender offer on corporate policy and effectiveness in deciding whether to adopt defensive measures); see also *Moore Corp. v. Wallace Computer Servs., Inc.*, 907 F. Supp. 1565 (D. Del. 1995) (applying *Unocal* standard and denying motion for injunction to force board to redeem its pill).

In *Seidman*, van Gestel rejected the application of this heightened scrutiny to a decision by an *independent* Massachusetts board to trigger a shareholder rights plan or "poison pill" as a defensive tactic to fend off a hostile takeover. Rather, van Gestel held that such a board is entitled to the protection of the business judgment rule that presumes the board acted in the best interests of the corporation. *Seidman*, *supra* at *27.

The business judgment rule in effect grants substantial deference to the decisions of the board and shields those decisions from judicial "second-guessing."

In reaching this conclusion, van Gestel stitched together the relevant statutory provisions with the recent Supreme Judicial Court decision, *Harhen v. Brown*, 431 Mass. 838 (2000).

In *Harhen*, the SJC applied the business judgment rule in the context of a shareholder demand prior to bringing a derivative action. *Harhen* established a strong rule that if a corporation's board is made up primarily of outside, independent directors, then the board's actions will ordinarily be entitled to the protection of the business judgment rule.

Van Gestel offered no view on whether the same rule would apply if the board were not made up of independent directors. See *Seidman*, *supra* at *28 n.15 (citing *Houle v. Low*, 407 Mass. 810 (1990)).

After *Seidman*, Massachusetts corporations that build their boards on a solid base of independent, outside directors can be quite confident in their ability to resist an unwanted takeover, based on the existing takeover toolkit.

New ideas are bound to evolve in time. See, e.g., Julian Velasco, "Just Do It: An Antidote to the Poison Pill," 52 Emory L.J. 849 (2003) (proposing strategy to overcome poison pill defense through series of coordinated tender offers); "Staggered Boards," *supra* at 944 (proposing that courts require staggered boards to redeem pills after takeover bidder wins one election).

But for the time being, Massachusetts corporations can "just say no" to hostile takeovers. MLW