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Anti-takeover Statutes in Pennsylvania, among Other Provisions, Give Target Shareholders a Put, Impose a Moratorium on Mergers with Interested Shareholders, and Prohibit Voting of Control Shares. In Addition, in Change-of-control Situations, the Target's Board May Consider the Interests of Corporate Stakeholders Other than Stockholders, and Its Decisions Will Not be Subject to Enhanced Scrutiny under the Business Judgment Rule.

As a response to the 1980s wave of hostile takeovers, many state legislatures adopted or strengthened anti-takeover statutes. Today, virtually all states have such laws, but only a few, including Massachusetts, Ohio, Virginia and Wisconsin, rival Pennsylvania in terms of breadth and complexity (and to some cynics, opacity) of their statutes.

The Pennsylvania anti-takeover statutes enacted in 1990 were considered so draconian that they ignited a nationwide firestorm of shareholder protest. CalPERS chief executive Dale Hanson summed it up for many investors when he wrote at the time of passage: "Although the Pennsylvania antitakeover legislation has been characterized as 'protective' of corporations, we believe the bill will actually have an 'anti-business' effect by discouraging investors from entrusting their assets in Pennsylvania companies."[1] Many public Pennsylvania companies took note of the shareholder protests. By July 26, 1990, the deadline for Pennsylvania companies to opt out of the new statutes, approximately 300 companies said 'no thanks' to some or all of the new provisions.[2] The academic debate about the statutes' effect on shareholder wealth continues unabated.[3]

From an M&A perspective, there is no question that these Pennsylvania laws have deterred some hostile activity. But just how much is hard to say. It is clear from the most recent takeover battles involving Pennsylvania companies that the universal law of M&A--market forces--does not respect the state's boundaries. And the statutes' broad scope can sometimes invoke the law of unintended consequences.

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1. *Pennsylvania Companies Opt Out of New Antitakeover Statutes*. Corporate Control Alert Vol.7, No. 8, Aug. 1990.

2. According to one study, slightly more than half of Pennsylvania's registered corporations opted-out of at least one of the antitakeover statutes. *See* Janjigian and Trahan, *An Analysis of the Decision to Opt Out of Pennsylvania Senate Bill 1310*, 19 Journal of Financial Research 1 (1996).

3. See, e.g., Guhan Subramanian, *Bargaining in the Shadow of Takeover Defenses*, 113 Yale L. Rev. 621 (2003); P.R. Chandy et al., *The Shareholder Wealth Effects of the Pennsylvania Fourth Generation Anti-takeover Law*, 32 Am. Bus. L. J. 399 (1995).

The CSX-Norfolk Southern-Conrail takeover saga in 1998 is an exemplar.[4] Conrail and CSX designed what they touted as a "bulletproof" takeover of Conrail by CSX, aggressively applying Pennsylvania's liberal fiduciary duty and poison pill provisions as both a sword and shield. Conrail and CSX knew there was another suitor waiting in the wings for Conrail, Norfolk Southern, and that Norfolk Southern might be in a position to offer Conrail shareholders a more attractive deal. To counter this looming threat, CSX chose to maximize the use of the aggregate consideration it was willing to pay for Conrail by structuring the proposed transaction as a front-end loaded, two-tier bid. CSX set out to purchase 40% of Conrail's stock for cash in the front-end stage. CSX would have then been in a position to cram down the lower valued, back-end stock merger at a Conrail shareholders' meeting. Conrail committed to use its poison pill against any deal except CSX's, and it subsequently agreed not to sign up a merger agreement with anyone else for two years. It would be this deal or no deal, come hell or high water.

There was one fly in the ointment. A provision of Pennsylvania antitakeover law--applicable to friendly as well as hostile deals--gave Conrail shareholders a fair value cash put of their shares if someone purchased more than 20% of Conrail's voting stock. To get around this, CSX structured its 40% front-end as two successive tender offers. First, CSX agreed to tender for up to 19.9% of Conrail's shares. Then, with this voting leg-up, Conrail agreed to hold a special shareholders' meeting to vote on a proposed amendment to its charter removing the put right. Following a successful vote, CSX would tender for another 20.1% of Conrail's shares.

This shareholder vote, combined with any investor's ability to purchase up to 9.9% of Conrail's stock under Conrail's poison pill, proved the deal's undoing. Norfolk Southern launched a higher, all-cash, all-shares bid and said it would buy up to 9.9% of Conrail's stock at the higher price as a reward to Conrail's shareholders if they voted down the proposed charter amendment. Conrail's shareholders meeting became a referendum on the competing deals. Despite CSX's leg-up, the Conrail shareholders revolted *en masse* against what they perceived to be CSX's and Conrail's coercive deal structure and rejected the charter amendment.

The result was the precise opposite of what Conrail wanted. It was carved up into pieces by Norfolk Southern and CSX in a negotiated settlement.

The Pennsylvania Regime At A Glance

Most of Pennsylvania's antitakeover statutes apply only to "registered corporations"[5] under the Pennsylvania Business Corporation Law (the "BCL"), defined as Pennsylvania incorporated companies having a class of shares entitled to vote in the election of directors registered under the Securities Exchange Act of 1934 (the "Exchange Act").[6]

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4. Dechert LLP represented Norfolk Southern in the matter.

5. BCL § 2501.

6. BCL § 2502(1)(i)(A). Companies subject to the reporting obligations of the Exchange Act pursuant to Section 15(d) of the Exchange Act are also registered corporations. BCL § 2502(1)(ii)(A). In addition, certain management companies registered under the Investment Company Act of 1940 can be registered corporations. BCL § 2502(1)(i)(B); § 2502(1)(ii)(B). A Pennsylvania corporation that is a subsidiary of another publicly traded corporation (domestic or foreign) can be a registered corporation for purposes of the BCL. BCL § 2502(2).

Some key statutory features include:

- *Subchapter E Put Right.* Shareholders have the right to "put" their shares at "fair value" to any person who acquires at least 20% of the voting power of the target company's shares, whether or not the acquisition was approved by the board of the target.[7]

- *Subchapter F Merger Moratorium.* A five-year prohibition on certain business combinations between a target company and an "interested shareholder," unless the shareholder's acquisition of shares makes it an interested shareholder or the business combination itself was pre-approved by the target's board.[8]

- *Subchapter G Control Share Acquisitions.* A shareholder acquiring "control shares"[9] may not vote its control shares unless and until voting rights to the control shares are restored by a majority vote of all the disinterested shares and a majority vote of all voting shares.[10]

- *Subchapter H Anti-Greenmail Disgorgement.* Any person who has recently acquired or disclosed its intention to acquire at least 20% of the voting power of a target company's shares, or is otherwise seeking control of the target, must disgorge any profits in connection with the sale of shares during the subsequent eighteen months.[11]

- *Subchapter I Severance Compensation and Subchapter J Labor Contracts.* Employees who are severed in connection with a control share acquisition (as defined in the control share statute) are entitled to certain minimum severance payments.[12] In addition, a business combination within five years of a control share acquisition will not result in the termination or impairment of an existing labor contract, unless the terms of the labor contract expressly provide for termination or impairment of rights or benefits as the result of a control share transaction.[13]

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7. BCL §§ 2541-2548.

8. BCL §§ 2551-2555. Generally, an "interested shareholder" is a person who beneficially owns 20% or more of the voting stock of the target. The term also covers affiliates and associates. BCL § 2553. The moratorium does not apply to business combinations (i) with persons who became interested shareholders with the target board's approval, (ii) approved by the target board prior to the date the other party to the business combination became an "interested shareholder" and (iii) with an interested shareholder that beneficially owns 80% of the voting stock outstanding where the transaction is approved by a majority of the disinterested shareholders and certain "fair price" provisions are met. BCL § 2555.

9. The control share acquisition statute is triggered by acquisitions that put a shareholder over the 20%, 33 1/3% or 50% voting share ownership threshold. BCL § 2562.

10. BCL §§ 2561-2568.

11. BCL §§ 2571-2576.

12. BCL §§ 2581-2583.

13. BCL §§ 2585-2588.

- *Transactions With Interested Shareholders*. Section 2538 of the BCL requires disinterested shareholder approval of a merger of a registered corporation with an "interested shareholder," unless there is pre-approval by the target's board or other exceptions are met.

- *Limited Opportunities to Exercise Franchise*. Pennsylvania default rules eliminate the ability of shareholders to call a special meeting[14] or act by written consent.[15]

- *Fiduciary Duties and Poison Pills.* At the heart of the Pennsylvania anti-takeover scheme are the provisions dealing with a target company board's fiduciary duties, including its use of poison pills. They largely inform the application of the other statutes as well. We discuss these provisions in more detail below.

The Tender Offer Dilemma

All things being equal, a bidder generally prefers a two-step transaction structure--a tender offer followed by a clean-up merger--over a one-step merger. Under current rules and review procedures of the Securities and Exchange Commission a tender offer often allows a bidder to assume control of the target more quickly than a one-step merger.[16] Many of Pennsylvania's anti-takeover statutes, such as BCL Section 2538 and Subchapter F mentioned above, contain target board approval exemptions and therefore are not applicable to friendly tender offers. However, the Subchapter E put statute and the Subchapter G control share statute, both applicable to tender offers, do not contain board approval exemptions.

Subchapter E. Completion of the front-end tender offer at thresholds at or above 20% of the voting power of the target may trigger Subchapter E, which gives non-tendering shareholders the ability to put their shares to the bidder, as the "controlling person," for "fair value" in cash. Subchapter E is not triggered by a one-step merger. However, a merger, including a clean-up or short-form merger following the completion of a tender offer, may trigger Pennsylvania dissenters' rights for "fair value".[17] Though

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14. BCL § 2521 provides that shareholders of a registered corporation do not have a statutory right to call a special meeting unless otherwise provided by the articles. *See also* BCL § 2501(c). *Cf.* BCL § 1755(b)(2) applicable to non-registered corporations where 20% of the shares may call a special meeting unless otherwise provided by the articles.

15. BCL § 2524(b) permits action by shareholder written consent only if authorized by the articles. Delaware corporate law requires express prohibition of action by written consent. DGCL § 228.

16. Allowing for preparation of tender materials and completion of a short-form merger immediately following completion of the offer, a relatively straightforward cash deal that doesn't involve regulatory or other delays can be completed in as few as 35 to 45 calendar days. Although tender offers using stock as consideration ("exchange offers") involve more elaborate SEC disclosure, under the SEC's expedited review procedures implemented in 2000 in connection with the promulgation of Regulation MA, a stock deal can be done in as little as 50 to 60 calendar days. On the other hand, cash or stock one-step mergers often take 75 to 120 calendar days to complete, principally because of the elongated SEC review period and additional disclosure requirements for mergers.

17. BCL Subchapter 15D. Shareholders may be entitled to dissenters rights in a merger if (i) prior to the merger (A) the shares are no longer designated as a national market system security on an interdealer quotation system by the National Association of Securities Dealers, Inc. or listed on a national securities exchange and (B) the shares are beneficially and of record held by less than 2,000 persons or (ii) the bidder

the fair value determinations under the respective statutes are not necessarily commensurate,[18] many bidders take the position that as a practical matter the valuations will not diverge. As a result, if the deal as structured is likely to result in the availability of dissenters rights, many bidders will not be deterred from a tender offer structure even though it would trigger Subchapter E put rights. The statute does pose issues where dissenters' rights would not exist, or where a bidder is offering a stock or other non-cash component in its tender offer and is concerned that a dissident shareholder could use the Subchapter E put mechanism as a backdoor means to monetize the consideration.

Subchapter E provides a mechanism for coordinating a tender offer with the put procedure, and a bidder sensitive to the put right could add a condition to its offer that Subchapter E is not used by more than a specified number of target shareholders. However, a target may object to this condition, and in any event the elaborate notice procedures under Subchapter E may add timing complications that defeat the very purpose of the tender offer structure.

Some bidders will simply ignore the Subchapter E put risk on the assumption that it is unlikely to be invoked by target shareholders, just as dissenters rights are not usually used by shareholders. Importantly, Subchapter E is not applicable to "control shares" subject to Subchapter G which have not yet been accorded voting rights under that Subchapter.[19] As we will see, this creates a key opening for the tender offer structure in Pennsylvania.

Subchapter G. The completion of a tender offer resulting in the ownership by the bidder of at least 20% of the voting power of the target will ordinarily trigger Subchapter G. The voting rights of the tendered shares--"control shares" in the parlance of Subchapter G--will be denuded in the hands of the bidder unless the remaining target shareholders approve the voting rights at a shareholders' meeting. The bidder could eliminate this risk by adding a shareholder approval condition in its tender offer, but this again will defeat the timing advantage of the tender offer *vis-a-vis* a merger because SEC proxy rules will apply to the control share vote.

An alternative used by some bidders recently to circumvent both Subchapter E and Subchapter G is to structure the tender offer so that the Pennsylvania short-form merger statute applies upon completion of the tender offer. Under BCL Section 1924(b), a shareholder "owning" at least 80% of each class of shares of a Pennsylvania target's shares can effect a merger of the target solely through the approval of the board of the 80% shareholder. This short-form merger can be done promptly upon completion of the tender offer, and there are usually no special SEC disclosure rules which would necessitate any delay. Subchapter E would not apply because the shares purchased in the tender offer have not been accorded

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owns 80% of the shares and the merger is consummated as a short-form merger pursuant to BCL § 1924(b)(1)(ii).

18. For instance, "fair value" under Subchapter E effectively creates a floor value for a dissident shareholder. It is defined as a value not less than the highest price paid by the controlling person for shares during the 90 day period ending on the trigger date, plus an increment representing any value, including a control premium, not reflected in that price.

19. BCL § 2543 (b)(2)(iv).

voting rights under Subchapter G. Subchapter G applies to the tendered shares, but the bidder is not concerned because it can close the clean-up merger without a shareholder vote.

Bidders using this approach must feel comfortable that the absence of voting rights under Subchapter G does not vitiate the "ownership" of the shares for purposes of the 80% rule under BCL Section 1924. In addition, it would normally be important to the bidder that the hiatus between the completion of the tender offer and the short-form merger is very brief, given the absence of voting rights attaching to the shares purchased by the bidder. Although most friendly tender offers result in over 90% of the target shares being tendered in an offer, an 80% minimum condition is usually added by bidders to their offers to assure the availability of the short-form statute. Some targets may object to this high a minimum tender condition because the usual minimum condition involving Pennsylvania targets is a majority of the outstanding shares. But other targets view the likelihood of achieving the 80% minimum condition as so high that the trade off of a quicker deal--and quicker receipt of the deal consideration by the target shareholders--is worth the risk of not achieving the condition.[20]

Disgorgement of Profits

Subchapter H, relating to "Disgorgement by Certain Controlling Shareholders," provides that certain persons who acquire 20% or more of a corporation's shares or seek to acquire control of a corporation must disgorge any profits in connection with the sale of shares during the subsequent 18 months. The disgorgement statute, which was intended to prevent bidders from profiting by putting a corporation "in play," reduces the incentive for a hostile suitor to acquire a toehold stake when initiating a proxy contest for control. If a higher bidder emerges the suitor will not have the consolation provided by selling the toehold stake. In addition, the disgorgement provision is a potential trap for the unwary in situations where a purchase is approved by a Pennsylvania target's board of directors, but not ratified by shareholders, such as where an acquiror is granted an option to purchase shares in connection with a negotiated merger agreement. The statutory exception for approved transactions requires both board and shareholder approval, which is unlikely if the initial deal is ultimately lost to a higher bidder, raising the possibility that Subchapter H will negate the economic benefit of the option.

Proxy Fights and the Control Shares Statute

Bidders or dissident shareholder groups seeking either to elect a competing slate of directors or to remove an incumbent board need to be wary of foot-faulting on the control shares provisions of Subchapter G. Under Subchapter G, one acquires "control shares" by acquiring "voting power over such shares."[21] Voting power derived as a result of the solicitation of revocable proxies or consents with respect to voting shares is exempted if (i) the proxy is given without consideration in response to a proxy solicitation that complies with the Exchange Act and (ii) the proxy does not give the proxyholder the power to vote on anything other than the specific matters described in the proxy, in accordance with the instructions of the shareholder giving the proxy.[22]

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20 The parties could further protect the deal by agreeing to hold a conventional shareholders meeting to vote on a one-step merger if the 80% minimum condition is not satisfied in the tender offer.

21. BCL § 2562.

22. BCL § 2563(b)(3).

In *Committee for New Management of Guaranty Bancshares Corporation v. Dimeling*,[23] an insurgent shareholder committee solicited proxies for a competing slate of directors. The insurgent group included on its proxy card a general authorization giving the appointed proxies discretionary authority to vote on such other business as might come before the shareholder meeting. Upon a challenge from the company, a federal district court held that the safe harbor from the application of Subchapter G did not apply when the proxy holder receives a standard grant of discretionary authority to vote on any additional matters that may come before the meeting.[24] Accordingly, the proxies in the hands of the dissident group represented control shares which were disenfranchised under the terms of Subchapter G until a shareholder meeting was held for the specific purpose of granting voting rights to the control shares.[25]

The SEC's Best Price Rule

Until recently, a bidder making a tender offer for a Pennsylvania corporation also had to wrestle with the differing interpretations by two Pennsylvania federal district courts regarding the reach of the SEC's "all-holders/best price" rule. SEC Rule 14d-10, implementing Section 14(d)(7) under the Exchange Act, requires bidders to open the tender offer to all shareholders and to pay each tendering shareholder the highest price paid to any other shareholder during the tender offer.[26] The best price rule has been subject to various interpretations by federal district and circuit courts around the country, and the SEC has yet to clarify the scope of the rule in the face of the judicial split. Some courts, including the Ninth Circuit, have adopted the "integral part of the tender offer" functional interpretation. They have permitted suits challenging executive compensation and other payments to management as disguised premiums in connection with a tender offer, even though the payments were not made during the technical period the tender offer is open.[27] In *Millionerrors Investment Club v. General Electric Co. P.L.C.*,[28] a federal district court in the Western District of Pennsylvania permitted plaintiffs to proceed with a claim that the bidder violated Rule 14d-10 because the merger agreement provided for the cash-out of management stock options at the spread between the tender offer price and the strike price--even though the options in

23. 772 F. Supp. 230 (E.D. Pa. 1991).

24. *Id.* at 239. The court noted that while legislative history suggests that "the legislature never intended to prohibit revocable proxies which grant discretionary authority unless the proxy contest is accompanied by a takeover attempt," the control shares statute "unequivocally applies to all proxy contests."

25. The court also held that the disenfranchised shares were to be included in the number of outstanding shares entitled to vote (because shareholders could have revoked their proxies and attended the meeting in person to vote their shares) but deemed absent from the meeting for purposes of determining a quorum (because in the hands of the dissidents, the shares were denuded of voting rights for the time being). *Id.* at 240.

26. Rule 14d-10(a) provides that "[n]o bidder shall make a tender offer unless: (1) the tender offer is open to all security holders of the class of securities subject to the tender offer; and (2) the consideration paid to any security holder pursuant to the tender offer is the highest consideration paid to any other security holder during such tender offer."

27. *Epstein v. MCA, Inc.*, 50 F.3d 644, 652-53 (9th Cir. 1995), *rev'd on other grounds*, 516 U.S. 367 (1996).

28. No. 99-781, 2000 U.S. Dist. LEXIS 4778 (W.D. Pa. Feb. 8, 2000). *See also Gerber v. Computer Assocs. Int'l, Inc.*, 303 F.3d 126 (2nd Cir. 2002).

question were granted prior to the tender offer commencement and the cash-out occurred more than three months after the tender offer closing.

Other courts, including the Seventh Circuit, interpret Rule 14d-10 literally and with a "bright line." They refuse to find a violation where the agreement to pay the additional consideration is signed before the tender offer formally commences and any payments are made after the offer period has formally expired.[29] In *Susquehanna Capital Group v. Rite Aid Corporation*,[30] the federal district court in the Eastern District of Pennsylvania followed the Seventh Circuit's "bright line" test and permitted payments that were not agreed to or paid while the tender offer was formally pending. More recently, in *In re Digital Island Securities Litigation*,[31] the Third Circuit also adopted the "bright line" test. The court dismissed the plaintiff's pleadings in connection with the cash-out of management options and restricted stock, and the entering into a new employment agreement with the bidder, conditioned upon the completion of the tender offer.

Although the *Digital Island* decision should be controlling precedent within Pennsylvania and the rest of the Third Circuit, tender offers in Pennsylvania are not out of the woods under the best price rule. Barring clarification from the U.S. Supreme Court or the SEC, plaintiffs seeking to attack payments to managers and other shareholders of Pennsylvania targets can be expected to forum shop for "integral part of the tender offer" jurisdictions. And *Digital Island* itself contains language giving strike suit plaintiffs an opening if they can adequately characterize the payments as designed to conceal fraudulent share premiums. Nevertheless, this exception will be construed narrowly, and in their pleadings, the plaintiffs must meet the rigorous particularity requirements applicable to federal securities fraud claims.

Opting Out

At the time the antitakeover statutes were adopted, Pennsylvania companies had the opportunity to opt out of some or all of their provisions.[32] Today, a Pennsylvania corporation may generally opt out of the effects of the statutes either in its original articles of incorporation or via an amendment to the articles. Given the costs and the uncertain outcome of a proxy solicitation to obtain the votes necessary to amend a public company's charter, as well as potential entanglements involving sales of stock by controlling shareholders, Pennsylvania corporations that contemplate becoming public companies typically consider opting out of some or all of the antitakeover laws in connection with any initial public offering.

Although most of the statutes can be eliminated by a quick charter amendment prior to the IPO, the five-year moratorium on business combinations with 20% shareholders contained in Subchapter F requires an extra degree of advance planning. A charter amendment opt-out of the business combination moratorium

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29. *Lerro v. Quaker Oats Co.*, 84 F.3d 239 (7th Cir. 1996).

30. *Susquehanna Capital Group v. Rite Aid Corp.*, 2002 U.S. Dist. LEXIS 18290 (E.D. Pa. Sept. 18, 2002).

31. 357 F.3d 322 (3d Cir. 2004).

32. *See infra*, p.1. The transition provisions for existing Pennsylvania corporations were complex. In many instances, companies could opt out of a particular antitakeover statute via a bylaw amendment adopted by the board of directors during a specified window period. *See* BCL §§ 1711(b), 2541(a), 2551(b), 2561(b) and 2571(b).

statute must be approved by a majority of the disinterested shares, and it does not take effect for eighteen months.[33] If the opt-out amendment is adopted at the time of an IPO, the prospect of restrictions on the ability of a 20% shareholder to engage in a wide range of business combinations with the target without prior board approval is likely to depress the market value and liquidity of any control blocks that may be retained by the pre-IPO investor group.

Consequently, it often makes sense for a new Pennsylvania corporation to opt out of Subchapter F in its original charter, especially if there is any possibility of a future IPO or other liquidity event. A future decision to opt in to Subchapter F coverage can be accomplished prior to the IPO by a charter amendment that takes effect at the time of the IPO--the 18 month waiting period applies only to opt-out charter amendments. If the original charter does not contain an opt-out, the controlling shareholders of a Pennsylvania corporation contemplating an IPO may be able to effect an opt-out by merging the target into a newly created IPO vehicle, subject to any applicable dissenters rights.

Fiduciary Duties and Poison Pills

Shareholder Interests and Alternative Constituencies. Traditionally, corporate law in the United States has identified the interests of the shareholders as the sole, or at least primary, focus of the board of directors. Under Pennsylvania law, the fiduciary duties of directors run directly to the corporation, and not to any particular constituency or stakeholder, such as the shareholders.[34] The fiduciary duty of a Pennsylvania board is governed by a two-tiered regime, which departs from the historic norm in ways that, when taken to the theoretical extreme, raise the potential for shareholder interests to be minimized, or even ignored, by the board.[35]

Pennsylvania law generally provides the board with wide discretion to consider the interests of corporate stakeholders other than the shareholders, and expressly provides that maximizing shareholder value is not necessarily the primary duty of the board. Under BCL Section 1715, the default rule governing fiduciary duties, the directors may, in considering the best interests of the corporation, consider the impact on a number of corporate stakeholders, including shareholders, employees, suppliers, customers, creditors of the corporation and communities in which the corporation is located. The board need not regard any corporate interest or the interest of any stakeholder as dominant, essentially allowing the board to determine whether, and the extent to which, shareholder interests should be factored into the equation.

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33. The opt-out amendment to the articles would not be effective for 18 months and would not apply to any business combination of the corporation with an interested shareholder whose share acquisition date is on or prior to the effective date of the amendment. BCL § 2551(b)(3).

34. BCL § 1712.

35. Under the 1990 amendments to Pennsylvania corporate law, corporations have the ability to opt-out of certain anti-takeover provisions of the BCL, including the enhanced fiduciary duty standards. Corporations that opt-out of the default constituency provision of BCL § 1715 are governed by the earlier formulation of the rule embodied in BCL § 1716, which, as is more typical for constituency statutes, provides that the directors may consider the effects on various constituencies but does not include the enhanced protections. As discussed above, after opting-out of the default standard it is unclear whether a Pennsylvania corporation can opt in to take advantage of the enhanced protections.

No Enhanced Scrutiny of Board Actions. In change-of-control situations, courts have interpreted the Pennsylvania constituency and fiduciary duty provisions to provide great latitude and discretion to the board. Pennsylvania law expressly rejects any special burden or standard of judicial review applicable to the board's conduct in change-of-control situations, generally granting the strong presumption that any board action approved by a majority of the disinterested directors is in the best interests of the corporation under the business judgment rule. In contrast to the *Unocal* doctrine under Delaware law,[36] where enhanced scrutiny is applied to board action in evaluating and negotiating change of control transactions, Pennsylvania courts have held that a board's decision in a merger or acquisition context is entitled to "even greater deference than in the ordinary course of business."[37] In addition, Pennsylvania law explicitly rejects the *Revlon* doctrine, which imposes a duty to seek the highest possible price for the corporation in a change of control situation under Delaware law.[38]

Rebutting the Presumption: Clear and Convincing Evidence. Under Pennsylvania's version of the business judgment rule, absent breach of fiduciary duty, lack of good faith, or self-dealing, any act of the board of directors is presumed to be in the corporation's best interests. To rebut the presumption, a plaintiff must present "clear and convincing evidence that the disinterested directors did not assent to such act in good faith after reasonable investigation."[39] Rather than subjecting board action to the enhanced scrutiny dictated by Delaware law, Pennsylvania law explicitly rejects any altered standard and holds dissident shareholders to an unusually high burden of proof to rebut the presumption afforded by the business judgment rule. When combined with the Pennsylvania constituency provision, shareholders pursuing derivative suits alleging a breach of fiduciary duty face the difficult task of proving that the board of directors failed to satisfy a duty that is, in large part, defined by the board itself.

Poison Pill. Pennsylvania law explicitly authorizes corporations to enact shareholder rights plans, and the statute expressly provides that the fiduciary duties of Pennsylvania directors do not require the board to redeem the pill or take other actions to facilitate a change of control transaction.[40]

Courts have granted Pennsylvania boards great deference with respect to shareholder rights plans, including in one instance approving a limited "no-hand" plan. A "dead-hand" poison pill, designed to thwart redemption of the pill via a proxy contest, prevents insurgent shareholders from removing an incumbent board of directors and replacing it with directors willing to redeem the poison pill by providing that the plan may be redeemed only by the incumbent members of the board. A "no-hand" poison pill further provides that once the insurgents have replaced a majority of the board, the pill becomes non-redeemable either for the life of the pill or for a designated period of time. Such a plan was utilized by AMP Incorporated as part of its defense against a hostile offer by Allied Signal Corporation in a 1998 takeover battle.[41] These dead-hand and no-hand provisions are especially controversial because of the

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36 *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946 (Del. 1985)

37 *Simmons v. Sutherland*, No. 80-E, slip op. at 12 (Luzerne Cty. C.P. Nov. 25, 1998).

38 *See Revlon Inc. v. Mac Andrews & Forbes Holdings Inc.*, 501 A.2d 1239 (Del. Ch. 1985).

39 BCL § 1715(d).

40. BCL § 1715(c)(1).

41 Dechert LLP represented AMP in the matter.

chilling effect they have on proxy contests and consent solicitations. They have been held to be generally unenforceable under New York and Delaware law. However, AMP's no-hand rights plan, which had a limited life, was upheld under Pennsylvania law by a federal district court in Philadelphia.[42] It remains to be seen whether Pennsylvania courts would uphold a dead-hand or no-hand provision of longer or unlimited duration.

Board Discretion and "Just Say No." The broad discretion afforded to the board of directors under Pennsylvania law empowers the board to base its decisions on interests other than the welfare of the corporate shareholders, and generally provides the board with the ability to "just say no" to an unwanted transaction. Subject to market pressures and the potential for a proxy contest, a Pennsylvania board is free to unilaterally refuse to agree to, or even negotiate, a change of control transaction. As with any board act relating to or affecting an acquisition of control of the corporation to which a majority of the disinterested directors have assented, the decision to thwart an acquisition is presumed to satisfy the board's fiduciary duties under the business judgment rule unless it is proven by clear and convincing evidence that the disinterested directors failed to act in good faith after reasonable investigation. As illustrated by the Draftsmen's Comment to Section 1715 of the BCL, the Pennsylvania statute evidences an unambiguous legislative intent that board decisions in favor of or in opposition to particular acquisition bids should not be second-guessed by the courts: "the directors' business conclusions with respect to the actions covered by the subsection would ordinarily not be subject to review."

This protection from judicial review extends to actions blocking an acquisition bid: "in particular, under this subsection, directors have the statutory authority to just say no with respect to a potential or proposed acquisition of the corporation's shares by, for example, maintaining in place a shareholder rights plan, or otherwise taking action that may have an effect on the potential or proposed acquisition of control or the consideration offered shareholders."[43] In addition, the Pennsylvania constituency provision provides the board with discretion to accept less consideration for the shareholders in exchange for benefits to other corporate stakeholders, such as the location of the corporate headquarters, the continuation of employee benefits and other "social" issues.

The Pennsylvania Takeover Disclosure Law

In addition to the interplay of Subchapter E and Subchapter G discussed above, bidders using a tender offer structure in Pennsylvania must be mindful of the Pennsylvania Takeover Disclosure Law (the "PTDL").[44] Adopted in 1976, the PTDL regulates attempts to acquire a corporation that is organized under the laws of Pennsylvania or has its principal place of business and substantial assets located in Pennsylvania. The PTDL imposes disclosure requirements on a bidder and purports to require that a

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42. AMP's rights plan expired by its terms approximately 15 months after the adoption of the no-hand amendment. The AMP board also had determined that it would not renew the rights plan for at least 6 months after its expiration. Consequently, the effect of AMP's no-hand amendment was to impede Allied Signal, but not forever. The court viewed this as important evidence that the independent directors were acting in good faith. *AMP Inc. v. Allied Signal Inc.*, 1998 U.S. Dist. LEXIS 18582 (E.D. Pa. Nov. 18, 1998).

43 *Id.*

44. 70 P.S. § 71 *et seq.*

registration statement be filed with the Pennsylvania Securities Commission (the "PSC") at least 20 days prior to a takeover offer. However, as was the case with other "first generation" takeover statutes, in *Crane Co. v. Lam*[45] the United States District Court for the Eastern District of Pennsylvania preliminarily enjoined, on U.S. constitutional grounds, enforcement of at least the portion of the PTDL involving the pre-offer waiting period.

Despite these constitutional questions, the PSC takes the position that bidders must comply with certain of the statute's provisions. Section 8(a) of the PTDL provides an exemption for friendly deals where the target board has approved the transaction and recommends the transaction to the target shareholders, subject to filing a notice with the PSC, undertaking to notify shareholders of the target that the notice has been filed, and paying the required $5,000 filing fee.

In hostile situations, bidders should consider the following steps to comply with the PTDL.

- *Pennsylvania Registration Statement*. Sections 4 and 5 of the PTDL require that bidders file a registration statement with the PSC. The requirements generally overlap with disclosure found in a Schedule TO, and incorporation by reference is permitted. In light of *Crane*, the PSC expects that the registration statement will be filed concurrently with the Schedule TO (rather than 20 days in advance). Updates to the Schedule TO should also be reflected in amendments to the PSC registration statement.

- *Takeover Offeror Report*. In addition to the registration statement, the PSC requires that a bidder file a Takeover Offeror Report Regarding Participating Broker-Dealer and Affiliate Transactions with the Target Company. The form requires disclosure of any services that the dealer managers of the tender offer provided to the target within three years of the offer.

- *Harmonization Letter*. Recognizing that the PTDL is inconsistent with certain aspects of federal tender offer regulation, the PSC requests that bidders submit a letter seeking "harmonization" of the PTDL to these federal requirements, such as the withdrawal and proration provisions.

- *Consent Order*. In light of *Crane*, the PSC has consented to district court orders that preliminarily enjoin the PSC from enforcing any provision of the PTDL that would interfere with the continuation or completion of the hostile offer as prescribed by federal tender offer regulations in hostile situations.

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The Pennsylvania antitakeover statutes can be daunting, to say the least. For m&a practitioners, they are either your best friend or worst nightmare, depending on which side you represent. Either way, the statutes will continue to present formidable challenges and opportunities for targets and bidders alike. There is little doubt, too, that the courts will need to be called upon to further interpret their complexities and ambiguities.

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45. 509 F. Supp. 782 (E.D. Pa. 1981).