Dual Standards for the Use of Employee Benefit Plans in Corporate Takeovers: ERISA and the Business Judgment Rule

Melany R. Gray

Follow this and additional works at: https://scholarship.law.stjohns.edu/lawreview

This Note is brought to you for free and open access by the Journals at St. John's Law Scholarship Repository. It has been accepted for inclusion in St. John's Law Review by an authorized editor of St. John's Law Scholarship Repository. For more information, please contact selbyc@stjohns.edu.
NOTE

Dual Standards for the Use of Employee Benefit Plans in Corporate Takeovers: ERISA and the Business Judgment Rule

As contests for corporate control have become more frequent, the techniques for facilitating takeover attempts as well as the methods for defending against them have become more creative. While commentators have debated the propriety of these techniques, courts have attempted to solve some of the unique legal

---


problems they create. Innovative uses of employee benefit plans (EBPs) in corporate takeovers have contributed considerably to litigation in the area. A target company can create an EBP and then transfer its own stock to the plan to defend against a hostile takeover. An existing EBP can play an important role as a reser-

See Easterbrook & Fischel, Takeover Bids, supra, at 1741-43, and, therefore, managers of target companies should acquiesce when confronted by a tender offer, see id. at 1750; Easterbrook & Fischel, The Proper Role, supra, at 1201-04. The Easterbrook-Fischel approach has been dubbed the “pure passivity” theory. See Harrington, If It Ain’t Broke, Don’t Fix It: The Legal Propriety of Defenses Against Hostile Takeover Bids, 34 SYRACUSE L. REV. 977, 978 (1983). At the opposite pole, Lipton contends that management should have broad discretion to employ defensive tactics during a takeover attempt, limited only by the business judgment rule. See Lipton & Brownstein, Takeover Responses, supra, at 1404; Lipton, Takeover Bids, supra, at 124, 130-31; Lipton, Update, supra, at 1017; Lipton, Response, supra, at 1231-35. Other commentators have taken positions between these two extremes. See, e.g., Bebchuck, The Case for Facilitating Competing Tender Offers, 95 HARV. L. REV. 1028, 1054 (1982) (target management should be assigned “auctioneering role” of expanding number of offers before shareholders); Gilson, A Structural Approach to Corporations: The Case Against Defensive Tactics in Tender Offers, 33 STAN. L. REV. 819, 865-75 (1981) (target management should serve as information provider and as scout for more beneficial offers from “white knights”); Harrington, supra, at 1020-27 (business judgment rule should apply to defensive tactics only where disinterested directors involved; otherwise, management has burden to prove inherent fairness of transaction by clear and convincing evidence). The courts have followed the Lipton approach. See infra note 64 and accompanying text.


An employee benefit plan is defined as “an employee welfare benefit plan or an employee pension benefit plan or a plan which is both an employee welfare benefit plan and an employee pension benefit plan.” 29 U.S.C. § 1002(3) (1982). The term embraces plans that provide medical, disability, unemployment, and similar benefits, as well as plans that provide retirement income or deferred income to employees. See id. § 1002(1)-(2). Almost all employee benefit plans are covered by the Employee Retirement Income Security Act of 1974 (ERISA), as amended, 29 U.S.C. §§ 1001-1461 (1982). See 29 U.S.C. § 1003 (1982).

See infra notes 6-9.

See, e.g., Norlin Corp. v. Rooney, Pace Inc., 744 F.2d 255, 258 (2d Cir. 1984) (ESOP created to concentrate voting control in hands of directors of target); Klaus v. Hi-Shear Corp., 528 F.2d 225, 228-33 (9th Cir. 1975) (employee stock ownership trust (ESOT) created to dilute voting strength of minority shareholder attempting to gain control); Herald Co. v. Seawell, 472 F.2d 1081, 1094-97 (10th Cir. 1972) (employee stock trust plan prevented minority stockholder from gaining control of newspaper); McPhail v. L.S. Starrett Co., 257 F.2d 388, 398, 394-95 (1st Cir. 1958) (minority stockholder sought to enjoin corporation from implementing ESOP since it diluted his voting power). Employee stock ownership plans (ESOPs) have become particularly important tools for defending against hostile takeover
voir of employer stock, or as a friendly purchaser of additional stock. EBPs can also be used to purchase stock in other corporations, and therefore, can serve as offensive tools in takeovers.

Employee benefit plans are governed by the provisions of the Employee Retirement Income Security Act of 1974, (ERISA or the Act), a comprehensive remedial statute designed to protect pensions and other employee benefits. One of the primary objectives of ERISA is the establishment of standards of fiduciary responsibility for persons who “control” such plans. To this end, the stat-
ute provides "a comprehensive scheme of both general and specific provisions regulating the conduct of fiduciaries." In addition, it creates an express cause of action against a fiduciary for a breach of statutory standards. Standing to sue under the Act, however, is expressly limited to the Secretary of Labor and plan participants, beneficiaries, or fiduciaries. Therefore, a bidder whose offer is frustrated by a fiduciary's defensive action involving EBP resources must either persuade a party with standing under ERISA to bring suit, or seek an alternate remedy under state law.

This Note will discuss the fiduciary standards governing the use of EBPs in corporate takeover attempts. By examining several recent decisions, the Note will also attempt to delineate guidelines for the proper use of EBPs in corporate takeovers when either ERISA or state law would apply.

FIDUCIARY DUTIES UNDER ERISA

The legislative history of ERISA indicates a congressional intent to impose upon fiduciaries a duty of care and a duty of loyalty similar to, but stricter than, that which is imposed upon fiduciaries by the common law of trusts. Section 404(a) of ERISA requires a fiduciary to discharge his duties "with the care, skill, prudence, and diligence" that a prudent fiduciary would employ, "solely in

S. Ct. 3533 (1984); ERISA § 2(b), 29 U.S.C. § 1001(b) (1982). Congress declared the policy of the Act to be:

to protect interstate commerce and the interests of participants in employee benefit plans and their beneficiaries, by requiring the disclosure and reporting to participants and beneficiaries of financial and other information with respect thereto, by establishing standards of conduct, responsibility, and obligation for fiduciaries of employee benefit plans, and by providing for appropriate remedies, sanctions, and ready access to the Federal courts.


15 See ERISA § 502(a), 29 U.S.C. § 1132(a) (1982); see also Pitt & Miles, The Use of Corporate Benefit Plans in Hostile Takeovers, in NEW TECHNIQUES IN ACQUISITIONS & TAKEOVERS 556-57 (1983) ("courts uniformly have refused to grant standing under Section 502(a) to persons who fall outside [the] enumerated classes").

16 See Pitt & Miles, supra note 15, at 558.

17 See infra notes 54-61 and accompanying text.

the interest of the participants and beneficiaries,” for the “exclusive” purposes of providing the specified benefits and defraying reasonable administration expenses. Section 406 supplements the general provisions of section 404(a) by expressly prohibiting certain transactions that offer a high potential for loss or misuse of plan assets. Section 406 subsection (a) is directed at transactions involving parties in interest, while subsection (b) addresses the problem of fiduciary self-dealing.

An exception to section 406’s literal prohibition against self-dealing and conflicts of interest is found in section 408(c)(3), which provides that section 406 shall not be construed to prohibit any fiduciary from also serving as an officer, employee, agent, or other representative of a party in interest. An officer or director of a

---

20 See ERISA § 406, 29 U.S.C. § 1106 (1982). Section 406 reads in pertinent part: (a) Except as provided in section 1108 of this title:
   (1) A fiduciary with respect to a plan shall not cause the plan to engage in a transaction, if he knows or should know that such transaction constitutes a direct or indirect—
      ... (D) transfer to, or use by or for the benefit of, a party in interest, of any assets of the plan; ... (b) A fiduciary with respect to a plan shall not—
      (1) deal with the assets of the plan in his own interest or for his own account,
      (2) in his individual or in any other capacity act in any transaction involving the plan on behalf of a party (or represent a party) whose interests are adverse to the interests of the plan or the interests of its participants or beneficiaries, ... .

Id.

Congress intended § 406 to be a per se prohibition against enumerated transactions. See Cutaiar v. Marshall, 590 F.2d 523, 529 (3d Cir. 1979); McDougall v. Donovan, 552 F. Supp. 1206, 1215 (N.D. Ill. 1982). The existence of a violation of one of the provisions does not depend on whether any harm results from the transaction. See McDougall, 552 F. Supp. at 1215; Marshall v. Kelly, 465 F. Supp. 341, 354 (W.D. Okla. 1978). In the complex setting of EBPs, such bright-line rules are advantageous because they assure protection of beneficiaries and provide clear notice of responsibility to fiduciaries. See Donovan v. Cunningham, 716 F.2d 1455, 1465 (5th Cir. 1983), cert. denied, 104 S. Ct. 3533 (1984).

company, therefore, can properly serve as a trustee to the company's EBP, as long as he complies with the fiduciary standards of section 404 and does not engage in transactions prohibited by section 406. 23

Any purchase of employer securities by an EBP can be viewed as a direct or indirect use of plan assets for the benefit of the employer—a party in interest. 24 In recognition of the "symbiotic relationship" between an employer and its EBP, Congress specifically provided that most plans may hold up to ten percent of fund assets in employer-issued securities as long as the acquisition is for "adequate consideration." 25 However, the payment of adequate consideration does not, by itself, insulate the trustee from the fiduciary requirements of section 404. 26

The leading case involving the application of ERISA fiduciary standards to the use of EBPs in corporate takeovers is Donovan v. Bierwirth. 27 In Bierwirth, corporate officers serving as trustees of the Grumman Corporation Pension Plan declined to tender the plan's stock holdings to tender offeror LTV Corporation, and in-

23 See Donovan v. Bierwirth, 538 F. Supp. 463, 468-69 (E.D.N.Y. 1981) (Congress intended fiduciaries with dual loyalties to comply with §§ 404 & 406), modified on other grounds, 680 F.2d 263 (2d Cir.), cert. denied, 459 U.S. 1069 (1982); S. Rep. No. 127, supra note 18, at 4867 ("even with respect to transactions expressly allowed [by § 408], the fiduciary's conduct must be consistent with the prudent man standard").

24 See Note, The Duties of Employee Benefit Plan Trustees Under ERISA in Hostile Tender Offers, 82 Colum. L. Rev. 1692, 1700 (1982). In the normal course of business, a purchase of securities by a plan helps the employer by maintaining a ready market for employer securities. Id. at 1700 & n.37. This discourages tender offers because it allows the price to be maintained at a level high enough to render a premium offer less feasible. Id. The market created by a plan also reduces the cost of capital for the corporation. Id. In the wake of a tender offer, the purchase of employer stock by a plan may play a critical role in frustrating the offer. See supra notes 6-8 and accompanying text.


Employee stock ownership plans (ESOPs) are exempt from the ten percent limitation of § 407(a) of the Act and may hold all fund assets in the form of employer-issued securities. ERISA § 407(d)(3)(B), 29 U.S.C. § 1107(d)(3)(B) (1982); see Pitt & Miles, supra note 15, at 528-29.

26 See, e.g., Donovan v. Cunningham, 716 F.2d 1455, 1467-68 (5th Cir. 1983) (fiduciaries remain subject to § 404 duties even though consideration paid); S. Rep. No. 127, supra note 18, at 4867, (even with respect to transactions expressly allowed, fiduciary's conduct must be consistent with prudent-man standard).

stead purchased additional stock for the plan.\textsuperscript{28} The Court of Appeals for the Second Circuit affirmed the district court order enjoining the trustees from taking any action with respect to the pension plan.\textsuperscript{29} The court rejected the Secretary of Labor’s contention that the trustees had violated section 406(b) of ERISA, concluding that the acts in question did not constitute “a transaction between the plan and a party having an adverse interest.”\textsuperscript{30} Nevertheless, the court held that the trustees had failed to satisfy their duty of prudence in deciding not to sell the stock,\textsuperscript{31} and had created a no-win situation for their beneficiaries by purchasing additional shares.\textsuperscript{32} While expressing doubt as to whether a director-

\textsuperscript{28} See id. at 264, 268-69. After deciding not to tender the 525,000 Grumman shares held by the plan, the trustees purchased an additional 1,158,000 shares of stock in Grumman, id. at 264, an amount just short of the maximum number of employer shares it was permitted to hold by ERISA, id. at 269; see ERISA § 407(a)(2), 29 U.S.C. § 1107(a)(2) (1982) (prohibiting EBPs from holding employer stock, fair market value of which exceeds 10% of fair market value of assets of plan).

\textsuperscript{29} See Bierwirth, 680 F.2d at 277. In addition to granting the preliminary injunction, the district court directed the appointment of a receiver to serve as an investment manager for the Grumman stock held by the plan. See Donovan v. Bierwirth, 538 F. Supp. 463, 476 (S.D.N.Y. 1981), aff’d, 680 F.2d 263 (2d Cir.), cert. denied, 459 U.S. 1069 (1982). The Second Circuit, however, struck that part of the order providing for a receiver, see 680 F.2d at 277, determining that the preliminary injunction was adequate protection, see id. at 276. Reasoning that the trustees could neither tender nor refuse to tender the stock under the injunction, the court concluded that the appointment of a receiver was unnecessary. See id. at 277.

\textsuperscript{30} 680 F.2d at 270. The court summarily concluded that the only specific prohibition that was “arguably applicable” was § 406(b)(2), which prohibits a fiduciary from acting in a transaction involving the plan on behalf of a party whose interests are adverse to the interest of the plan or of its participants or beneficiaries. See id. Concluding that § 406(b)(2) did not apply, the court stated that there was “no reason to think Congress intended the expansive interpretation of the various specific prohibitions of § 406 urged by the Secretary, particularly in light of the inclusion of the sweeping requirements of prudence and loyalty contained in § 404.” Id. However, the court further determined that the trustees had violated the fiduciary duties of § 404. See id. at 276; infra notes 31-32 and accompanying text.

\textsuperscript{31} See 680 F.2d at 272. The Bierwirth court noted that the Grumman trustees, all of whom were officers of Grumman, see id. at 267, failed to consult independent counsel, id. at 272, failed to do a thorough job in determining the potential danger to the Grumman pension fund, see id. at 273, and failed to consider alternative protective action in the event that the acquisition by LTV was successful, id. at 273-74. In a later proceeding, the court held that the losses suffered by the plan should not be determined strictly by comparing the sale and purchase prices of the stock. See Donovan v. Bierwirth, 754 F.2d 1049, 1064 (2d Cir 1985). Noting that the fund actually earned a net average profit of $11.41 a share, Judge Pierce wrote that “the measure of loss applicable under ERISA section 409 requires a comparison of what the Plan actually earned on the Grumman investment with what the Plan would have earned had the funds been available for other Plan purposes.” Id. at 1056.

\textsuperscript{32} See 680 F.2d at 275. According to the Bierwirth court, if the LTV tender offer succeeded, the plan would be left in the undesirable position of a minority stockholder, and if
trustee could ever act impartially in the face of a hostile takeover attempt.\textsuperscript{33} the court declined to require the resignation of all officer-trustees in such situations.\textsuperscript{34}

At least one commentator has argued, however, that the purchase of employer stock by an EBP during a hostile takeover attempt constitutes a per se violation under section 406 of ERISA when the trustees of the plan are also corporate officers.\textsuperscript{35} It does not appear that this analysis has yet been adopted by any court with regard to the defensive use of an EBP. Recently, however, the Court of Appeals for the Seventh Circuit in \textit{Leigh v. Engle}\textsuperscript{36} held that trustees who used the assets of an employee profit-sharing trust to purchase stock in companies targeted for potential control contests violated the prohibited transactions and fiduciary standards sections of ERISA.\textsuperscript{37}

In \textit{Leigh}, approximately thirty percent of the plan’s assets were used to purchase stock in three outside companies to help a control group of officer-fiduciaries gain leverage within the companies.\textsuperscript{38} Writing for a unanimous court, Judge Cudahy determined that the prohibited transactions rules of ERISA should be read broadly in light of Congress’ concern with the protection of plan

\begin{itemize}
\item[33] See id. at 272 (it was “almost impossible to see how [the director-trustees] . . . could have voted to tender or even to sell the Plan’s stock”).
\item[34] See id. The \textit{Bierwirth} court noted that there was “much to be said” for the Secretary’s arguments that the trustees’ participation in defensive activities “precluded their exercising the detached judgment required of them as trustees of the Plan,” and that the only proper course for the trustees was to resign immediately so that a neutral trustee could be appointed for the duration of the tender offer. See id. at 271-72. However, upon finding specific instances of the trustees’ failure to observe the high standard of duty placed upon them by § 404(a), id. at 276, the court stated that it need not decide whether an officer-trustee could ever make the careful and impartial investigation necessary to meet the statutory standards, see id.
\item[35] See Note, supra note 24, at 1702-06 (ERISA § 406(b)(2) should be interpreted to preclude purchase of employer stock during tender offer by trustees who are also directors of target company).
\item[36] 727 F.2d 113 (7th Cir. 1984).
\item[37] See id. at 132. The \textit{Leigh} court’s holding was based upon alternative grounds: that the trustees had violated § 404 of ERISA as well as §§ 406(a)(1)(D) and 406(b)(1). See id.
\item[38] See id. at 116. Investments in one company, Berkeley, were allegedly made to prevent the defendants from being “locked in” as minority shareholders under hostile management. Id. at 119. Investments in a second company, OSI, were made to aid defendants in their struggle to replace the company’s existing management, id. at 120, and a third set of investments were made to assist the defendants in gaining control of the Hickory Furniture Company, id. at 121.
\end{itemize}
beneficiaries. The court found that the trustees had possessed "divided loyalties with clear potential for conflicts of interests," had failed to seek "independent, disinterested advice" concerning the plan investments, and had used the trust assets throughout the control contests in a manner that "dovetailed at all times with the interests of the [control] group." Notwithstanding this determination, the court emphasized that it was not "per se impermissible" for plan trustees to invest in companies involved in control contests or to align with one side during a takeover battle. Similarly, potential conflicts of interest were not deemed "per se impermissible" by the court.

Thus, a careful reading of Leigh reveals that it is largely in accord with the Second Circuit's decision in Bierwirth. Although it gave a more expansive construction to the prohibited transactions rules, the Leigh court applied an overall review similar to

---

59 See id. at 128; accord Gilliam v. Edwards, 492 F. Supp. 1255, 1261 (D.N.J. 1980) ("[t]o fulfill its curative aim, ERISA should be given a liberal construction . . . .").

40 727 F.2d at 132.

41 Id. at 132 n.29. The Leigh court noted that the independence of the trustees was the primary issue. See id. The congruence between the investments of the plan and those of the control group was cited as one factor to be considered in reviewing the fiduciaries' loyalty, along with any conflicts of interest and the independence of the investments. See id. Significantly, however, the court stated that "congruence alone would not demonstrate a breach of that duty of loyalty." Id.

42 See id. at 132 n.31. The court noted that it did not have to reach the question of whether the potential conflicts of interest were per se impermissible because the other breaches of fiduciary duty were severe enough by themselves to violate the statute. See id. The court explicitly refused, however, to reject the per se standard. See id.

43 See infra notes 44 & 45 and accompanying text.

44 See 727 F.2d at 126-27. The Leigh court noted:

We do not believe that Congress intended the language "use by or for the benefit of, a party in interest," and "deal . . . in his own interest," to be interpreted narrowly. The entire statutory scheme of ERISA demonstrates Congress' overriding concern with the protection of plan beneficiaries, and we would be reluctant to construe narrowly any protective provisions of the Act.

Id. at 126 (citations omitted).

The court stated that § 406(a)(1)(D) "should be read to cover the actions of a trustee who buys shares in a target corporation in order to assist either the target's management or the raider in its quest for corporate control or a 'control premium.'" Id. Giving an equally broad construction to § 406(b)(1), the court construed a trustee's "own interest" to reach non-financial interests, citing concern with retaining one's own position and maintaining good relations with one's superiors as illustrations. See id. at 127. It is suggested that such constructions are inconsistent with the position taken by the Bierwirth court. In Bierwirth, the court concluded that there was "no reason to think Congress intended the expansive interpretation . . . of § 406 urged by the Secretary [of Labor]." 680 F.2d at 270; see supra note 30. However, the Secretary had argued that § 406(b) is "designed to disqualify fiduciaries from even acting in a transaction when they have interests which may conflict with the
that in *Bierwirth* in determining whether the fiduciaries had breached their duties. It is submitted that the *Bierwirth* court's reading of section 406 may have been more restricted because of the symbiotic relationship that existed between Grumman and the EBP; such a relationship was not in evidence between the plan and the outside companies in *Leigh*.

In recognition of the special relationship that exists between an employer and its plan, Congress expressly permits an EBP to purchase employer stock and allows an officer to serve as trustee. Since acquisition of employer securities during a hostile takeover attempt may be in the best interest of the employee benefit plan, it is submitted that such an acquisition should not be per se prohibited merely because it may incidentally help the target company defend against the takeover or assist the officer-trustees in retaining their positions.

interests of the plan for which they act.” *Pitt & Miles, supra* note 15, at 572-73 (quoting Brief for Department of Labor at 21 n.8, Donovan v. Bierwirth, 680 F.2d 263 (2d Cir.), cert. denied, 459 U.S. 1069 (1982)). The Secretary of Labor urged that the trustees committed a per se violation of § 406(b) “by acting on behalf of the Plan when they had dual loyalties.” *Id.* It is submitted that such an interpretation of the section would have been rejected by the *Leigh* court as well. Cf. *supra* notes 41 & 42 and accompanying text. However, by dismissing the Secretary's contentions, the *Bierwirth* court summarily dismissed all considerations of § 406(b). *See supra* note 30. But cf. *supra* note 33 (*Bierwirth* court noted difficulty Grumman director-trustees would have in selling plan's stock).

46 See 727 F.2d at 128. Applying the criteria set forth in *Bierwirth*, the Seventh Circuit attempted to ascertain whether the plan administrators had acted with an “‘eye single to the interests of the participants and beneficiaries.’” *See id.* (quoting *Bierwirth*, 680 F.2d at 271). Moreover, the court considered whether the trustees had undertaken any independent investigation or had sought independent advice. *See 727 F.2d* at 129. Indeed, the Seventh Circuit endorsed, as “the preferred course of action,” the Secretary's suggestion that an officer-trustee of a plan holding or acquiring stock of a target resign in favor of a neutral trustee. *Id.* at 132; *see supra* notes 33 & 34 and accompanying text (similar analysis by the *Bierwirth* court).

47 *See supra* note 25 and accompanying text.

48 *See supra* note 22 and accompanying text.

49 *See Donovan v. Bierwirth*, 680 F.2d 263, 271 (2d Cir.), cert. denied, 459 U.S. 1069 (1982). The *Bierwirth* court noted that:

[although officers of a corporation who are trustees of its pension plan do not violate their duties as trustees by taking action which, after careful and impartial investigation, they reasonably conclude best to promote the interests of participants and beneficiaries simply because it incidentally benefits the corporation or, indeed, themselves, their decisions must be made with an eye single to the interests of the participants and beneficiaries.

*Id.* at 271; *see also* G. Bogert, *The Law of Trusts and Trustees* 543 (2d ed. 1978).
Although the trustees in *Bierwirth* claimed that the purchase of employer stock was largely motivated by concern for the welfare of the fund in the event LTV gained control, they failed to convince the court that they had thoroughly weighed the risks to the fund presented by the stock purchase with the risks potentially arising from a successful takeover. However, it is possible that the trustees could have decided that such an investment was in the best interests of the plan beneficiaries after a thorough investigation and careful consultation with independent counsel. Since the fiduciary guidelines of section 404 adequately protect plan participants and beneficiaries if a purchase is not in their best interests, it is submitted that section 406, the prohibited transaction section of ERISA, should not be interpreted to preclude the purchase of employer-issued securities by an EBP during a takeover attempt solely because the plan's trustees are also directors or officers of the target employer company. However, because loyalty to the fund is the only loyalty that may affect one's judgment when acting on behalf of the plan, a trustee should thoroughly investigate all alternatives to the purchase and carefully consider the advice of qualified experts who are independent of the takeover attempt.

---

40 See 680 F.2d at 267-68, 274, 276 & n.17. The Grumman trustees in *Bierwirth* were concerned that the plan could be merged with one of LTV's underfunded plans or that the financial condition of LTV might preclude favorable treatment for the plan. See id. at 276 n.17.

50 See id. at 274, 276. The *Bierwirth* court emphasized the trustees' failure to seek the advice of independent counsel, see id. at 272, their failure to ascertain thoroughly the facts with respect to the LTV pension funds, see id. at 273, and their cavalier treatment of statements by LTV that it did not intend to touch the plan, see id. at 274. The court noted that assurances could not provide protection against the potential financial difficulties of LTV, but suggested that the trustees should have investigated the degree of protection LTV was willing to guarantee formally. See id.

51 See id. at 274, 276. The unfunded liabilities of the LTV plans in question in *Bierwirth* were much greater than the trustees had suspected. See id. at 273-74.

It is submitted that because of the symbiotic relationship between a company and its EBP, the plan trustees must be concerned with the financial well-being of a tender offeror, as well as with its intentions with respect to the plan. Undoubtedly, a pension plan with surplus assets might encourage a takeover attempt by a raider seeking to cancel the plan and recapture the surplus or to merge the plan with an underfunded pension plan of its own. Cf. Walsh v. Great Atl. & Pac. Tea Co., 726 F.2d 956, 959 (3d Cir. 1983) (concern that excess assets in plan fund were alluring to corporate raiders who might obtain control and syphon off funds or merge plan with one of their own less generously funded pension plans).


53 See supra notes 49-50 and accompanying text.
Because the provisions of ERISA may be enforced only by the Secretary of Labor or by a participant, beneficiary, or fiduciary of an employee benefit plan, it is submitted that during an attempt to defend against a hostile takeover, the creation of such a plan may escape the scrutiny to which existing EBPs are subjected. In a hostile takeover attempt, the bidder has no standing under ERISA to bring an action against the parties responsible for the creation of the plan. Moreover, it is suggested that participants and beneficiaries are unlikely to bring an action challenging the adoption of a plan which, regardless of the reasons for its creation, is likely to benefit them. Motivated, perhaps, by a similar desire to benefit employee interests, the Secretary of Labor apparently has failed to question the creation of an EBP in the corporate takeover context. Challenges to such plans, therefore, are initiated by the party seeking to obtain control of the employer company, and are based upon state common law fiduciary principles.

The fiduciary principles of state common law impose upon corporate directors a duty of care and a duty of loyalty. In most jurisdictions, a director’s standard of care is measured in terms of the business judgment rule, which protects good-faith actions taken through the exercise of honest judgment for the legitimate furtherance of corporate purposes. Due to the presumption of

---

64 ERISA § 502(a), 29 U.S.C. § 1132(a) (1982); see supra note 15 and accompanying text.
65 See infra notes 56-57 and accompanying text.
68 See id. at 264. The duties of care and loyalty require corporate fiduciaries to exercise the care that a reasonably prudent person in a similar position would use under similar circumstances. See id.; Siegel, Tender Offer Defensive Tactics: A Proposal for Reform, 36 Hastings L.J. 377, 379 (1985).
prudence afforded by the business judgment rule, fiduciaries bear a much less stringent burden of proof under common law than under ERISA, which requires EBP fiduciaries to prove that their actions were undertaken "with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use . . . ." As a result, it is submitted that an anomalous situation exists: a corporate fiduciary who causes an EBP to be created and to be issued shares to defend against a takeover may be protected by the business judgment rule, while a fiduciary to an existing EBP under the same circumstances may be precluded by ERISA from causing the plan to purchase employer-issued shares.

Generally, courts have held that the business judgment rule governs fiduciaries only when they are shown to lack a self-interest in the transaction at issue. Once prima facie proof of self-interest is shown, the burden of proving that the transaction was fair and reasonable shifts to the board of directors.

---

60 See, e.g., Morrissey v. Curran, 650 F.2d 1267, 1274 (2d Cir. 1981) (business judgment rule presumes reasonableness of fiduciary's decision); Treadway Cos. v. Care Corp., 638 F.2d 357, 382 (2d Cir. 1980) (“directors are presumed to have acted properly and in good faith”); Johnson v. Trueblood, 629 F.2d 287, 292 (3d Cir. 1980) (corporate directors “are presumed to exercise their business judgment in the best interest of the corporation”), cert. denied, 450 U.S. 999 (1981).


The majority of courts that have addressed the issue have held that actions taken to defeat a takeover attempt should be subject to the same presumption of reasonableness that applies to other corporate actions. However, it has been argued that the business judgment rule should not apply in such a context because corporate takeover attempts almost always threaten the existing corporate management.

As long as directors are not "afflicted" with conflicts of interest, adopting a course of action or refusing to adopt another is to retain control.

44 Jewel Cos. v. Pay Less Drug Stores Northwest, Inc., 741 F.2d 1555, 1560 (9th Cir. 1984); Siegel, supra note 58, at 384; see, e.g., Gearhart Indus. v. Smith Int'l, Inc., 741 F.2d 707, 712, 718 (5th Cir. 1984) (rule applied to sale of discounted subordinated debentures accompanied by "springing warrants" authorizing purchase of target shares at low price if hostile tender offer occurred); Panter v. Marshall Field & Co., 646 F.2d 271, 295 (7th Cir. 1981) (rule applied when directors made defensive acquisitions to defeat tender offer), cert. denied, 454 U.S. 1092 (1981); Crouse-Hinds Co. v. InterNorth, Inc., 634 F.2d 690, 701 (2d Cir. 1980) (rule applied when directors allegedly had agreed to exchange offer to defeat tender offer); Johnson v. Trueblood, 629 F.2d 287, 289-91, 292 (3d Cir. 1980) (rule applied when director-defendants rejected financially-beneficial proposals that would have required change of control), cert. denied, 450 U.S. 999 (1981).

55 See, e.g., Lipton & Brownstein, Takeover Responses, supra note 2, at 1408 (entire takeover process is being examined, both from offensive and defensive standpoints); Siegel, supra note 58, at 408-11 (suggesting that states should enact legislation requiring shareholder approval of target management defensive tactics); Sommer, The Norlin Case and Business Judgment Rule, 17 REV. Sec. REG. 799, 803 (1984) (quoting John H. Huber, Director of SEC Division of Corporate Finance) (burden of proof in contested tender offer should be on directors to justify their actions); supra note 2 (discussing contentions that business judgment rule should not apply in hostile takeover context). Legislative reforms of perceived abuses in the area of tender offer defenses appear to be imminent. Representative Timothy Wirth has suggested several reforms, including a bill "[t]o permit shareholders and the [SEC] to seek injunctive relief from harmful defensive tactics by management in corporate takeover situations," which would require target management to establish that the defensive tactic "is both prudent for the [target] and fair to the [target's] shareholders." H.R. 5695, 98th Cong., 2d Sess. (1984); see also S. 2777, 98th Cong., 2d Sess. (1984) (similar measure altering business judgment rule). The House Energy and Commerce Committee has approved many of Representative Wirth's reforms. See H.R. Rep. No. 1028, 98th Cong., 2d Sess. 1 (1984) (hereinafter cited as H.R. Rep. 1028); see also H.R. 5693, 98th Cong., 2d Sess. (1984) (forbidding, inter alia, certain self-tender offers and issuances of additional stock during tender offer). The Committee, however, concluded that "if the courts in their interpretation of the business judgment rule show increased judicial sensitivity to the conflicts of interest in takeover situations, additional Federal protection along these lines may not be necessary." H.R. Rep. 1028, supra, at 15-16 (citing Norlin Corp. v. Rooney, Pace Inc., 744 F.2d 255 (2d Cir. 1984) as an encouraging judicial dismissal of "rote application of the business judgment rule"). For further discussion of SEC and congressional initiatives in the tender offer arena, see Lipton & Brownstein, supra note 2, at 1426-29.

66 See supra note 2.
est, their actions should not be subject to judicial scrutiny because the expertise of the directors is likely to be greater than that of the courts. It is submitted, however, that application of the business judgment rule is also appropriate to some decisions made to defend against a takeover attempt. In light of the increased potential for conflicts of interest in hostile takeovers, it is suggested that the burden of proving the reasonableness of defensive tactics should shift once it appears that the corporate directors are at all concerned with retaining control.

Recently, in Norlin Corp. v. Rooney, Pace Inc., the Court of Appeals for the Second Circuit examined the propriety of the issuance of shares to a wholly-owned subsidiary and to a newly-created employee stock ownership plan (ESOP) in the face of a potential takeover attempt and affirmed an injunction preventing the di-

67 Panter v. Marshall Field & Co., 646 F.2d 271, 300 (7th Cir. 1981) (Cudahy, J., concurring and dissenting), cert. denied, 454 U.S. 1092 (1981); see also supra note 59 (policies supporting business judgment rule); cf. Heit v. Baird, 567 F.2d 1157, 1161 (1st Cir. 1977) ("management has not only the right but the duty to resist by all lawful means persons whose attempts to win control of the corporation, if successful, would harm the corporate enterprise"). But cf. Siegel, supra note 58, at 393-94 (questioning assumption that management has right to take corporate action in response to tender offer). The business judgment rule was intended to prevent courts from second-guessing the judgment of those vested with the managerial responsibility of corporations, in order to avoid imposing upon directors who acted in good faith disastrous liability for simple mistakes, which would clearly discourage all but the judgment-proof from serving on boards." Sommer, supra note 65, at 799; see Harrington, supra note 2, at 1021; Siegel, supra note 58, at 380; see also Easterbrook & Fischel, The Proper Role, supra note 2, at 1196 ("[t]here is no reason to think that courts generally could improve the performance of managers"); Gilson, supra note 2, at 823 (broader judicial role in evaluating actions of management is difficult to justify); supra note 59.

68 Cf. Harrington, supra note 2, at 1021. Professor Harrington posits that "[d]isinterestedness—the requirement that the duty of loyalty first be discharged and that the decision-maker be free of the taint of conflicting interest—is a condition precedent to the business judgment rule's application." Id.; see supra notes 62-63 and accompanying text.

In Treadway Cos. v. Care Corp., 638 F.2d 357 (2d Cir. 1980), the Second Circuit appeared to shift the burden of proof once an interest in retaining control was demonstrated. See id. at 382. The court stated:

In nearly all of the cases treating stock transactions intended to affect control, the directors who approved the transaction have had a real and obvious interest in it: their interest in retaining or strengthening their control of the corporation. It is this interest which causes the burden of proof to be shifted to the directors, to demonstrate the propriety of the transaction.

Id. But see infra notes 92-94 and accompanying text (Second Circuit subsequently held that burden does not shift solely because directors are to remain in control if defensive tactic succeeds).

69 See supra note 6 (discussion of ESOPs).

70 See supra note 6 (discussion of ESOPs).

71 See 744 F.2d at 258. On January 6 and 12, 1984, Piezo Electric Products, Inc., in
rectors from voting those shares. The court rejected the directors’ argument that the transfers of the newly issued shares were within the discretion of the corporate directors once they had determined that the takeover was not in the company’s best interest. Judge Kaufman, writing for the court, determined that although the business judgment rule affords directors “wide latitude in devising strategies to resist unfriendly advances,” the evidence constituted a prima facie showing of self-interest on the part of the board and shifted the burden of proof to the directors. The court noted that “[w]hen an ESOP is set up in the context of a contest for control . . . it devolves upon the board to show that the plan was in fact created to benefit the employees, and not simply to further the aim of managerial entrenchment.” The Norlin directors failed to prove that the transaction was fair and reasonable, leading the court to find that the ESOP was created solely as a tool for man-

conjunction with Rooney, Pace Inc., an investment banking firm, purchased approximately 32% of Norlin’s common stock in several separate transactions. Id. at 259. Alleging various violations of the federal securities laws, Norlin sought to enjoin Piezo from acquiring any additional Norlin stock, to force divestitures of stock already purchased, and to bar voting of Norlin stock owned by Piezo. Id. Immediately after Norlin’s motions for a temporary restraining order and expedited discovery were denied, Norlin’s board transferred 28,395 shares to a wholly-owned subsidiary, purportedly in consideration of the subsidiary’s cancellation of a Norlin promissory note. Id. Five days later, the Norlin ESOP was created and 185,000 common shares were transferred to it in return for a promissory note. Id. Three Norlin board members were appointed as trustees. Id. The Norlin board also transferred an additional 800,000 shares to the subsidiary in return for an interest-bearing note. Id.

Norlin acknowledged in its filings with the Securities and Exchange Commission that it would be the beneficial owner of all the transferred shares. Id. The Norlin directors’ control of the company’s outstanding stock eventually reached 49%. Id.

See id. at 269.

See id. at 265-66; see also Lipton, Takeover Bids, supra note 2, at 130 (discussing bounds within which directors may respond to potential takeover bids); Lipton, Update, supra note 2, at 1017 (“once the board of directors has in good faith and on a reasonable basis determined to reject a takeover bid, the target may take any reasonable action to accomplish this purpose”) (emphasis added).

74 744 F.2d at 264. Although directors are required to investigate all possible threats to the company and must act in the best interests of the shareholders, they must demonstrate that their actions are fair and reasonable to satisfy their duty of loyalty. Id.

Id. at 265. In concluding that the evidence constituted a prima facie showing of self-interest, the Norlin court noted the following factors: all the newly-transferred shares were to be voted by the Norlin directors; the shares were issued almost immediately after Norlin’s motion for a preliminary injunction was denied; the ESOP was created the same day that the stock was issued to it; and the only rationale the board offered to the shareholders for the transactions was its decision to oppose the takeover “at all costs.” See id. These factors created a “strong inference” that the transactions were designed to solidify management control rather than to benefit the employees. Id.

Id. at 266.
agment self-perpetuation.77

Consistent with prior Second Circuit decisions,78 the Norlin court clearly limited application of the business judgment rule by shifting the burden of proof upon a prima facie showing of the board’s interest in the transaction.79 The earlier decisions, however, do not adequately define “interest” within the context of a takeover contest.80 It is submitted, therefore, that the Second Circuit in Norlin should have clearly defined the “interest” required to shift the burden of proof under the business judgment rule in such a situation.

The Norlin court relied on two earlier decisions in which the Second Circuit had examined actions taken to defend against a hostile takeover.81 In Treadway Cos. v. Care Corp.,82 the directors of Treadway Companies, Inc. (Treadway), to avoid a possible takeover by Care Corporation (Care), entered into negotiations with a third company, Fair Lanes, Inc. (Fair Lanes), regarding a possible business combination.83 Pursuant to those negotiations, Treadway issued a block of shares to Fair Lanes sufficient to reduce Care’s

---

77 See id. at 266.
78 See, e.g., Treadway Cos. v. Care Co., 638 F.2d 357, 382 (2d Cir. 1980) (burden shifts once plaintiff demonstrates that director had interest in transaction); Crouse-Hinds Co. v. InterNorth, Inc., 634 F.2d 690, 702 (2d Cir. 1980) (quoting Treadway, 638 F.2d at 382); Lewis v. S. L. & E., Inc., 629 F.2d 764, 769 (2d Cir. 1980) (“[w]hen a shareholder attacks a transaction in which the directors have an interest other than as directors of the corporation, the directors may not escape review of the merits of the transaction”).
79 See 744 F.2d at 265; supra note 75 and accompanying text.
80 See Crouse-Hinds Co. v. InterNorth, Inc., 634 F.2d 690, 702-03 (2d Cir. 1980) (burden does not shift merely because directors are to remain in control), rev’g 518 F. Supp. 390, 410 (N.D.N.Y.) (board is “interested” and burden shifts if successful defensive tactics will enable them to retain control). In Treadway Cos. v. Care Corp., 638 F.2d 357 (2d Cir. 1980), the court stated that:

In nearly all of the cases treating stock transactions intended to affect control, the directors who approved the transaction have had a real and obvious interest in it: their interest in retaining or strengthening their control of the corporation. It is this interest which causes the burden of proof to be shifted to the directors . . . .

Id. at 382. In Crouse-Hinds, however, the Court of Appeals for the Second Circuit appeared to reject its reasoning in Treadway. See 634 F.2d at 702. But see infra note 94 (distinguishing Crouse-Hinds).
81 See 744 F.2d at 264-65 (discussing Treadway Cos. v. Care Corp., 638 F.2d 357 (2d Cir. 1980), and Crouse-Hinds Co. v. InterNorth, Inc., 634 F.2d 690 (2d Cir. 1980)).
82 638 F.2d 357 (2d Cir. 1980).
83 Id. at 365-66. In late August of 1979, the directors of Treadway received Care’s sixth Schedule 13D amendment, which revealed that Care held 27.1% of Treadway’s stock. Id. at 365. On September 4, the chairman of Treadway first contacted Fair Lanes, explaining that “Treadway was exploring ways of staving off a takeover by Care.” Id. In early October, Fair Lanes raised the possibility of a Treadway-Fair Lanes combination. Id. at 366.
interest in Treadway to less than the number of shares needed to block a merger. Applying the business judgment rule, the court held that it was incumbent upon the plaintiff to demonstrate that the directors had acted in bad faith or in furtherance of their own interests to shift to the directors the burden of proving that the transaction was fair and reasonable. Noting that the majority of the Treadway directors were to lose their positions if the merger with Fair Lanes took place, the court held that there had been no showing that the directors' actions were motivated by self-interest.

Distingushing the facts before it from those of Treadway, the district court in Crouse-Hinds Co. v. Internorth, Inc. granted a tender offeror a preliminary injunction barring a target company from transferring a block of shares pursuant to a merger with a third company. The court concluded that the directors had an interest in the transaction, noting that they were to retain control of the company after the merger. Thus, the court held that the burden of proof shifted and that the directors had failed to establish the fairness of their actions.

---

84 Id. at 370. Fair Lanes had requested the sale, viewing it as "a necessary first step in its dealings with Treadway." Id. at 366. As a result of the stock issuance, Care's interest was reduced from 34% to 28%. Id. at 370.
85 See id. at 382.
86 See id. at 383. The district court found that all of the directors except one expected to lose their positions if the proposed defensive combination with Fair Lanes succeeded. Id. This expectation was reasonable because during negotiations, Fair Lanes had asked that it be allowed to name a majority of the Treadway directors immediately. Id.
87 See id. The court noted that "the consummation of the proposed business combination could not be expected to perpetuate control by [the] directors" and, therefore, concluded that Care had not demonstrated an interest on the part of the Treadway directors sufficient to shift the burden of proof. Id.
88 518 F. Supp. 390 (N.D.N.Y.), rev'd, 634 F.2d 690 (2d Cir. 1980).
89 See id. at 413. The target company, Crouse-Hinds Co., negotiated an exchange offer with a third party, Belden Corp., after InterNorth, Inc. announced a tender offer for control of Crouse-Hinds. Id. at 394. The exchange offer was designed to protect a previously negotiated defensive merger between the two companies intended to block InterNorth's imminent bid for control. Id. at 395-96.
90 See id. at 410. Upon determining that the Crouse-Hinds directors would retain control after the merger, the district court determined that "under the Treadway decision, it cannot seriously be disputed that InterNorth has met its threshold burden of proof with respect to the interests of the board of directors." Id. Additional factors pointed to by the court included: the haste in negotiating the merger once the tender offer had been announced; the assistance in obtaining shareholder approval provided by board maneuvering; and the influence that the Chief Executive Officer of Crouse-Hinds may have exerted to head off a fair consideration of the tender offer. See id. at 411-12.
91 See id.
On appeal, the Court of Appeals for the Second Circuit reversed the decision of the district court, stating that the district court had erroneously extended *Treadway* by inferring that "if the directors are to remain on the board after the merger, perpetuation of their control must be presumed to be their motivation." The court concluded, therefore, that the burden of proof had been improperly shifted, and that the tender offeror had failed to present sufficient evidence to support an injunctive order.

Although the holding in *Treadway* did not compel the conclusion reached by the district court in *Crouse-Hinds*, it is suggested that directors who are to remain in control should be considered "interested" for purposes of shifting the burden of proof under the business judgment rule. In such situations, shifting the burden of

---

92 Crouse-Hinds Co. v. InterNorth, Inc., 634 F.2d 690, 692, 704 (2d Cir. 1980).
93 Id. at 702 (emphasis in original); see supra note 90 and accompanying text.
94 See 634 F.2d at 692, 704. It is submitted that *Crouse-Hinds* is distinguishable from most cases involving defenses to takeover attempts since the disputed transfer of stock was designed not only to defend against a hostile tender offer, but was also to occur as part of a merger agreement announced prior to the tender offer. See id. at 703; Brodsky, *Hostile Takeovers* in *IX Sec '81* 153, 156-57 (H. Schlagman & N. Hirsch eds. 1981). Brodsky suggests that the result in *Crouse-Hinds* may have been different if the merger had been negotiated after the tender offer or if the tender offer had not been conditioned on the termination of the merger agreement. See Brodsky, supra, at 156-57; see also Panter v. Marshall Field & Co., 646 F.2d 271, 301 n.6 (7th Cir. 1981) (Cudahy, J., concurring and dissenting) ("[t]he facts in *Crouse-Hinds* are complicated and special"). In *Panter*, Judge Cudahy determined that even though the *Crouse-Hinds* directors were allegedly "interested" in the merger because they would remain in control after its consummation, the Court of Appeals declined to shift the burden of proof for the reasons suggested by Brodsky. See 646 F.2d at 301 n.6 (Cudahy, J., concurring and dissenting). Since the tender offeror had indicated no interest in the target at the time the *Crouse-Hinds*-Belden merger was negotiated, the directors could not have been motivated by a desire to retain control. Id. at 302 (Cudahy, J., concurring and dissenting); see also *Crouse-Hinds*, 634 F.2d at 703. Furthermore, because the tender offer was conditioned on abandonment of the merger, the directors' alleged desire to facilitate the merger was "entirely credible." *Panter*, 646 F.2d at 302 (Cudahy, J., concurring and dissenting); see *Crouse-Hinds*, 634 F.2d at 703.

It is submitted, therefore, that *Crouse-Hinds* actually turns on the determination that the defendant-directors had effectively demonstrated the reasonableness of the stock exchange and not on the plaintiff's failure to prove that the directors were "interested." In other words, it is suggested that the plaintiff in *Crouse-Hinds* failed to rebut the defendants' proof that their actions were reasonable and fair.

95 See *Crouse-Hinds*, 634 F.2d at 702. The Second Circuit noted that the district court's inference (i.e. that if directors are to remain on the board after the proposed merger, perpetuation of their control must be presumed to be their motivation,) had "no basis in either law or logic." Id. The court explained that "[t]he proposition that 'A implies B' is not the equivalent of 'non-A implies non-B,' and neither proposition follows logically from the other." Id. at 702 n.20.

96 Shifting the burden of proof once it is demonstrated that the board of directors will remain in control if the defensive maneuver succeeds will simplify the determination of
proof is consistent with the presumption of disinterested expertise underlying the business judgment rule. As one commentator has noted, "the evidence is overwhelming that directors must necessarily find it exceedingly difficult to act independently in a takeover contest where the incumbent managers to whom they are beholden for their status are to lose both control of the corporation and likely their jobs as well." 

**Conclusion**

The *Leigh* and *Bierwirth* cases demonstrate the difficulty courts are experiencing in delineating clear guidelines for the proper use of employee benefit plans in takeover attempts under ERISA. Similarly, the uncertainty surrounding allocation of the burden of proof under the business judgment rule vitiates the impact of precedent for setting the parameters of permissible conduct. Since the use of ESOPs and other EBPs in the takeover arena can be expected to increase, clear guidelines are essential for corporate directors and trustees who desire to act in the best interests of their companies and beneficiaries, as well as for the courts, which ultimately will be required to settle disputes arising in contests for corporate control. Logically, the standards governing existing and newly created EBPs should parallel one another as closely as the existing statutory and case law will allow.

It is submitted that disallowing the defensive use of EBPs in corporate takeovers by prohibiting defensive tactics altogether or whether the directors were "interested." See Brodsky, supra note 94, at 154; Harrington, supra note 2, at 1021-23. It should not be difficult for the board to prove the existence of a legitimate business reason indicating why a takeover is undesirable. See Siegel, supra note 58, at 386. *Norlin*, in fact, suggests that the burden shifts when directors are to remain in control. See 744 F.2d at 266 (when ESOP is created "in the context of a contest for [corporate] control," directors must demonstrate that plan is designed to benefit employees). Nevertheless, the court based its holding on other evidence deemed sufficient to demonstrate the board's self-interest. See id. One commentary has noted:

*Norlin* may be interpreted to stand for the proposition that, at least in the Second Circuit, the actions of a takeover target's board of directors in issuing new shares, which issuance results in the board's effectively assuring its own voting control, will not normally be entitled to the broad protection of the business judgment rule. . . . Read most broadly, it may mark the beginning of judicial intolerance of the deference given the decisions of target management, particularly when extreme defensive tactics are involved. On the other hand, *Norlin* was an extreme case, and may be narrowly read and limited to its facts.


See supra note 68.

* Harrington, supra note 2, at 1021-22.
by extending the application of the prohibited transaction rules of
ERISA would constitute an unwarranted overreaction. It is sug-
gested that adequate protection for participants in employee bene-
fit plans is ensured by section 404 of ERISA and the fiduciary
principles that will govern once the burden of proof under the bus-
iness judgment rule is shifted to an officer who is to remain in con-
trol. Extending the *Leigh* interpretation of section 406 to preclude
a defensive purchase of employer stock during a hostile takeover
attempt or barring all defensive tactics would unduly inhibit cor-
porate fiduciaries in their attempts to act in the best interests of
the plans they represent.

*Melany R. Gray*