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TAKE-OVER BIDS

Remarks of

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Take-over bids have been receiving considerable publicity in recent months in the newspapers and in financial journals and other publications. This is due both to the increasingly frequent use of tender offers as a method of acquiring substantial blocks of stock, and to the recent committee hearings on S. 510, a bill introduced by Senator Harrison A. Williams, Jr., to deal with some of the problems in this area. Although this bill has received widespread and general support from the financial community, some of the publicity, as well as some of the testimony at the hearings on the bill, has unfortunately been characterized by what I consider to be some serious misconceptions about the nature of the problem and what the bill is intended to accomplish.

Before I attempt to deal with these misconceptions, however, I believe it would be appropriate for me to outline briefly what S. 510 provides.

The bill is not designed either to encourage or to discourage tender offers or other types of take-over bids. It is simply intended to provide protection for public investors in connection with acquisitions of large blocks of stock in three specific contexts: first, the acquisition by

means of a cash tender offer of more than 10% of any class of stock of a publicly-held company, that is, a company registered under Section 12 of the Securities Exchange Act of 1934; second, any other acquisition by any person or group of more then 10% of any class of stock of a publicly-held company; and third, the repurchase by a corporation of its own outstanding shares. I plan to limit my remarks this evening principally to the problem of take-over bids by means of tender offers.

With respect to tender offers, the bill is designed to accomplish two purposes. The first is to assure that public shareholders will be given information adequate for an informed decision when a tender offer is made for the shares of their company. The bill requires a person or company making a tender offer to file with the Commission a statement disclosing his identify and background, the source of the funds being used to purchase the securities (except that when the funds are borrowed from a U.S. bank in the ordinary course of business the name of the bank need not be disclosed), his plans for major changes in the company's business and corporate structure if his bid for control is

successful, and any arrangements he may have with any persons regarding the company's securities. This statement would have to be filed with the Commission on a confidential basis at least five days before the commencement of the offer. The five-day period is important since it would give the Commission an opportunity to review the statement and point out any inaccuracies or inadequacies before any soliciting material was given to shareholders. It would also avoid embarrassment resulting from the need to send out material to correct improper or inadequate statements, whether or not advertent.

Advertisements for tenders would have to contain such information as the Commission may prescribe by rules and regulations. In addition, any recommendation to shareholders by management or others to accept or reject a tender offer would have to be made in accordance with rules prescribed by the Commission as necessary or appropriate in the public interest or for the protection of investors.

The second purpose of the bill is to eliminate practices in connection with tender offers which may result in unfair discrimination among persons tendering their shares, or which

may unreasonably restrict shareholders' freedom of action with respect to deposited shares. This aspect of the bill will be covered in Mr. Loomis' remarks.

Perhaps the most basic misconception, and the one to which I should like to address myself first, is the idea that tender offers for the securities of publicly-held companies are not of sufficient importance to concern the Congress or the Commission. This is rather curious, since all segments of the financial press have been showing a keen interest in tender offers. Furthermore, statistics recently published show that the aggregate of cash tender offers has grown from less than $200 million in 1960 to almost $1 billion in 1965, surpassing stock-for-stock tender offers, which aggregated about half a billion dollars in each of those years. This is a significant total, whatever standard one may apply.

Almost every day brings word of a new take-over bid for a publicly-owned company, with drastic effects on the

price of the company's securities and far-reaching potential effects on the company's operations. In many cases, public investors know little or nothing about the person or company making the offer, what the exact conditions of the offer are, or what it means for the future of their company or their investment. In these circumstances trading is characterized by rumor, by speculation and by fear, characteristics which are hardly conducive to public confidence in the securities markets. Over the past thirty-odd years we have all worked hard to foster that confidence, partly by requiring public disclosure of important events that affect a company and its securities. An attempt to acquire a substantial or controlling interest in a company is such an event, whether it is made by means of a stock-for-stock exchange offer, or a cash tender offer, or a private or open-market purchase. Unless public investors have the feeling that they "know what is going on" in one of these situations, they will suspect the worst, and they will lose confidence in the fairness and honesty of the securities markets. I know this is so, since we have received many letters from investors in the past few months, asking us to investigate this or that tender offer because they are

sure something improper is being done. Sometimes there is a basis for their suspicion. Sometimes there is not. But the important thing is that with appropriate disclosure requirements, we can replace suspicion with information, reduce the likelihood of hasty or ill-considered decisions, and lend greater stability to the markets.

I note with some chagrin that, despite our general world leadership in the development of securities law, this is an area in which other countries have led the way in recognizing and dealing with the problems. Great Britain, Canada, Australia, France, Germany, Italy and the Netherlands have all adopted rules regulating take-over bids in one way or another. Ontario recently considered the problem in detail in connection with the new securities legislation it adopted last year. We looked very closely at the Ontario legislation, and at the report of the Kimber Committee which preceded it, in formulating our comments and suggestions on S. 510 and its predecessor bill, and found them very useful in developing procedures which would maintain an appropriate balance among the various interests involved in any take-over attempt.

There are two conflicting misconceptions about the nature and purpose of cash tender offers. The first is that corporate takeovers by acquisitions of large blocks of stock are a good thing, because they provide a method, perhaps the most effective presently available, of dislodging entrenched but incompetent management, and thus improve the efficiency with which resources are allocated and businesses are managed. The other is that such takeovers are a bad thing, because they represent attempts by disreputable people to obtain control of established companies for the purpose of liquidating them at a profit.

No doubt there have been, and will continue to be, take-over bids which fall clearly into one or the other of these categories. The indications are, however, that many, if not most, take-over bids are not made for either of these reasons, but rather are made simply because the acquiring company wants to grow -- or diversify. In this respect cash take-over bids, like mergers and stock-for-stock acquisitions, are merely one aspect of the so-called "merger movement." Whether or not this is desirable, in social or economic terms, is a debatable point, and one which the Commission is not called upon to decide. The present bill

has been drawn so as neither to encourage nor to discourage cash takeovers, but simply to protect shareholders.

When Senator Williams introduced S. 510, he specifically stated that the legislation had been drafted with care to avoid tipping the scales either in favor of persons making tender offers or in favor of persons who may oppose them. We support the bill because we believe it provides a suitable framework for giving investors adequate material information without unduly hindering tender offers which may be beneficial to them.

There seems to be concern in some quarters that the disclosures required by the bill would inhibit the making of tender offers. This is the same theme that was advanced when the legislation which became the Securities Act of 1933 was being considered. At that time various witnesses made dire predictions to the Congress to the effect that if corporations distributing securities to the public were required to make full disclosure, grass would grow in Wall Street and financing of American industry would grind to a halt. Of course, nothing of the sort occurred. On the contrary, full disclosure has improved public confidence

and contributed to the tremendous expansion in corporate financing which has since occurred and which is a principal concern of many of you gathered here this evening. There is no reason to believe that full disclosure in tender offers will not have a similarly beneficial effect.

Just as the Securities Act of 1933 is designed to discourage high-pressure tactics in the sale of securities, the pending bill is designed to discourage the use of high-pressure tactics to stampede shareholders into acceptance of a tender offer without giving them an opportunity to consider the offer on its merits. On the other hand, the bill would also enable the Commission to control solicitations by management or others in opposition to a tender offer, which would make it more difficult to frighten shareholders into refusing a tender offer on the basis of unsubstantiated or irrelevant arguments. Thus the effect of the bill would not be to favor either side in a particular case, but rather to favor the presentation of reasoned proposals and arguments instead of hard-sell tactics and unsubstantiated claims.

I should also like to emphasize that the disclosures required by S. 510 are really very simple, especially when

compared to the disclosures required under the Securities Act of 1933 for a registered stock-for-stock tender offer. Assuming that a tender offer is honest and straightforward, the required disclosures should not constitute any great burden. The offeror would be required to disclose his name and his source of funds. The latter requirement could be complied with very simply by stating, for example, that part of the money is the offeror's own and that the rest represents bank borrowings. He would also be required to disclose any plans he has to liquidate the business, sell the assets, merge the company or make similar major changes, which questions in most instances could be answered "none," if no such purpose exists. He would further be required to describe any contracts or arrangements with other persons relating to the securities of the issuer, which in many straightforward cases could again be answered "none." And he would be required to state his existing holdings in the company. These requirements could, as I said, be met with a simple negative in many cases. But in the cases where disclosures were required, they would be just the sort of disclosures that would be most meaningful and important to the shareholders. It has been my experience that the financing arrangements and the side deals regarding the securities are usually the places where the skeletons are buried.

I do not believe that this uncomplicated disclosure pattern would inhibit the acceptance of legitimate tender offers. On the contrary, as pointed out in the Commission's testimony on the bill, it might reassure shareholders that they were being offered a legitimate proposition, and, if the price were right, might overcome doubts they might otherwise have about accepting the tender offer.

Until now, I have been talking principally about the interests of the parties making or opposing a tender offer. Perhaps the most serious misconception about this entire subject is that the interests of those parties are the principal -- or sole -- criteria to be used in judging the merits of the bill. Persons who have expressed apprehension that the bill's provisions for disclosure and regulation of both sides of contested tender offers will frustrate legitimate take-over efforts have laid almost exclusive stress on these criteria. The difficulty with this analysis is that the public shareholders become the forgotten men. They are treated as pawns in an elaborate game between the offeror and the management, or perhaps other competing interests. The Commission's principal concern -- and I am sure it is a concern shared by all of you -- is with these public shareholders.

The first misconception about the position of the public shareholder faced with a tender offer is that because he is being offered cash rather than a security, he does not need the protection of any disclosure. There are two answers to this. In the first place, the shareholder is not being offered cash, but the possibility that he may get a certain amount of cash for all or some undetermined portion of his tendered shares at some undetermined time, if certain events do or do not happen. Thus he needs full disclosure of the exact terms and conditions of the offer, in addition to the substantive protections provided by the bill, which Mr. Loomis will discuss with you shortly.

In the second place, the shareholder cannot make an intelligent decision whether or not to tender his shares solely on the basis of the price which is offered. How can he evaluate the adequacy of the price if he cannot assess the possible impact of a change in control? Certainly without information which would allow him to make such an assessment, he cannot judge the adequacy of the offer by the current or recent market price of his stock. That price presumably reflects the assumption that the company's present business, control and management will continue. If that assumption

is changed, is it not likely that the market price might change? An example will show why. Assume that a company's stock sells for $5 per share -- its going concern value as assessed by investors. Its earnings are poor; its prospects dim; its management uninspired. Is a cash tender offer of $6 per share adequate? Or does the shareholder need more information? Suppose a person believes that with control he can liquidate the company and realize $15 per share, or maybe more. Certainly the company's shareholders would want to know about liquidation plans. Indeed, it is the plan to liquidate which makes the bidder willing to pay more than $5 per share. Whether or not the company's liquidation value is generally known is not important, for without someone to carry out the liquidation, this value is unobtainable. If the company's shareholders, at the time of the tender offer, know of the plan to liquidate, would they consider $6 per share adequate?

The provisions of the bill that I have described are tailored to the investor's need for the information necessary to make a decision -- an investment decision -- whether to retain his investment in the company and perhaps cast his lot with a new management, or to attempt to liquidate his investment and put his funds to other use.

A further misconception is that, if a shareholder decides to tender his stock, what happens to the company is of no further concern to him, since he no longer has a financial interest in it. This assumption would be true only if the person making the offer were to take up all the stock tendered, which is by no means always the case. Persons making tender offers normally commit themselves to accept only a specified number of shares, which may be the amount they consider necessary to obtain "working control" of the company. If more than the specified number of shares are tendered they are under no obligation to accept the excess, and, under existing practices, the shares they do accept may be taken up on a first-come, first-served basis, or pro rata. If the shares are taken up on a first-come, first-served basis, some persons who tendered their shares would have none of them taken up. On the other hand, if the shares are taken up pro rata, the shareholder who tenders will have only a portion of his shares taken up. In either event, if the offer is successful, he remains a shareholder of the old company, under a new management.

The parallel between this situation and a proxy contest is obvious. In each case a new person or group is

asking the shareholders to turn over control of the company to him, either by giving him their votes or part of their stock. In cases where a tender offer is contested, or there are competing tender offers, moreover, there arise many of the same practical problems of providing shareholders with a balanced presentation of competing arguments as are found in a proxy contest for control of a corporation. The bill is designed to permit the Commission to exercise the same sort of control of solicitations and advertising that we have found so effective in dealing with proxy contests.

Indeed, the need for protection may be greater in the case of a tender offer. After a proxy contest, the public shareholders retain the ability to vote out the management at a later date if its promises are not fulfilled. If a tender offer is successful, however, the offeror may obtain a majority or near-majority of the stock of the corporation, and thus eliminate whatever influence the public shareholders may previously have had in choosing the management of their company. Furthermore, the fact that a substantial number of shares have been removed from the public trading market as a result of the tender offer may cause a lessening of trading interest in the stock. If the

shareholder has not had all his shares taken up, but does not wish to remain with the company, he may find it more difficult to dispose of his remaining shares.

There is one other point that should be mentioned. The protections of disclosure, particularly those relating to the background and financial arrangements of the persons seeking control of the corporation, are not designed solely for the protection of those shareholders who consider tendering their shares, but also for those who wish to retain their stake in the company. Recent judicial decisions under Rule 10b-5 indicate that a shareholder has a right not to have his interests adversely affected by actions of his fellow shareholders which were induced by fraudulent misrepresentations or omissions. He has a similar concern with actions induced by high-pressure tactics or inadequate disclosures.

This concern for the non-selling shareholder is also recognized in the provisions of the bill which would require disclosures from those who acquire 10% of the stock of a company by open market or private purchases similar to the disclosures required in the case of tender offers. We have also suggested adding another provision to the bill which

would require appropriate disclosure when a majority of the board of directors is to be changed in connection with a stock acquisition. These provisions, like Section 14(c) of the 1934 Act, reflect the belief that disclosure can serve as an effective check on the actions of those who control, or seek to control, publicly-held corporations, in addition to its function of assisting investors in making informed decisions.