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Mr. David Martin
Secretary, Advisory Committee
on Tender Offers
Room 3024
Securities and Exchange Commission
Washington, D. C. 20549

File # 265-15

Dear Mr. Martin:

This letter, which contains the comments of this law firm to the Advisory Committee on Tender Offers of the Securities and Exchange Commission, is written in response to the Advisory Committee's request for comments made earlier this year.

We have provided advice and actively engaged in litigation concerning tender offers since 1969, when the Ohio Takeover Act (§1707.041 of the Ohio Revised Code) was enacted. The firm has often represented offerors. For example, we represented Imetal in its takeover of Copperweld, Occidental in the Occidental-Mead fight and Mobil in Mobil Corp. v. Marathon Oil Co., 669 F.2d 336 (6th Cir. 1981), in which the anti-manipulation provisions of §14(e) of the Securities Exchange Act of 1934 were given a broad remedial reading.

The firm has also been active in representing targets and potential targets. Members of this firm were active in the drafting of the Ohio Takeover Act, §1707.041 of the Revised Code, and in drafting the Ohio Control Share Acquisition legislation, which was enacted in November, 1982 to amend Ohio's General Corporation Law, Ch. 1701 of the Ohio Revised Code, to provide for affirmative shareholder votes as a pre-condition to certain control share acquisitions. We represented Babcock & Wilcox against United Technologies' effort to acquire it. The firm also represented the target in AMCA International v. Krouse, 482 F. Supp. 929 (S.D. Ohio, 1979), in which the Ohio Takeover Act was held constitutional as a reasonable state regulation that often produced desirable competitive bidding. In addition, the firm's continuing representation of numerous public companies necessarily involves us in advising potential targets and potential offerors.

The Interests Involved

The Advisory Committee has wisely asked for comments concerning the interests at stake. How one answers this question will determine the remainder of one's answers.

Shareholders of the target constitute one group of interested parties. If, for example, shareholders of the target are pushed--by a short proration period or the short length of the offer--to tender fast, there is pressure for an uninformed decision or perhaps an inability to tender in time. This problem flows from the very nature of a tender offer, especially a hostile one. When companies are amalgamated by statutory merger or sale of assets, the requirements for approval by the board of directors of the target and by its shareholders at a meeting preceded by a proxy statement ensure adequate time for dissemination of all material information and for calm reflection. When a tender offer is used, however, in most states, the shareholders as a body have no say. This fact led to the enactment of state statutes such as the Ohio Takeover Act and Ohio's Control Share Acquisition legislation, for the very short minimum periods (7 and 10 days) in the Williams Act proved woefully inadequate, as tacitly admitted by the Securities and Exchange Commission in 1979, when the SEC's §14(e) powers were used to lengthen the minimum period to 20 business days. In late 1982, the SEC again tacitly recognized a related point when it used those same §14(e) powers to make the proration period run the length of the entire offer. These actions by the SEC obviously ameliorated the situation; however, it is our position, as explained below, that the longer 50 and 60-day periods under carefully drafted state legislation are clearly more appropriate.

Why are such longer periods more appropriate? That leads us to a second interest of shareholders of the target--an interest in competitive bidding for their shares once the tender offer technique is invoked by one bidder. If the more usual means of amalgamation--statutory merger or sale of assets-- are bypassed, shareholders of the target should be free to entertain competing bids. Such competing bids may have a larger economic consideration or may involve a bid by interests that would pay more consideration to local concerns such as location of plants and offices.

Employees, suppliers, customers and the communities in which plants and offices are located also have a deep legitimate interest in tender offer regulation. Shifts in control can cause massive dislocations for all of the above. Longer minimum time periods for tender offers would benefit these groups. For example, employee shareholders would have more time to consider whether and to whom to tender their stock (the employees' shareholder interest may be considerable if the target has a stock purchase plan). One or more of the above groups might be able to find more locally-oriented potential bidders.

The interests of employees, suppliers, customers and local communities are not necessarily antithetical to those of the shareholders of a potential target. The operation of a business is largely a positive-sum game in which, over the long run, all interested factors of production win by consideration of everyone's interests. Modern boards of directors recognize that fact. Goon squads are no longer used in labor disputes. Labor unions negotiate givebacks. Corporations cannot ignore their environmental impact upon communities or customers. Safety is also important. The schools, cultural environment and physical environment of a city go a long way in determining whether executives and employees can be recruited by a corporation, and employers today are enjoined by management experts to seek employee involvement and not to treat employees as interchangeable parts. All of these steps are taken for long-range profit maximization. In economics and finance courses, it is intellectually interesting to speak of plants, divisions and companies as "investment portfolios", to worship the impersonal nature of markets and to seek to feed the Invisible Hand; but the real world in which companies and their directors operate is more personal, complex and interdependent.

Investment bankers, commercial bankers, institutional investors, stock brokers, information agents, arbitragers, stock exchanges and lawyers who do tender offer work also are interested parties. Many of them profit handsomely from tender offers, especially contested ones, but these persons also provide services that are useful and necessary. The tender offer mechanism is a legitimate and sometimes useful means of amalgamation. The possibility of a hostile tender offer provides shareholders with a useful check on management. It is also a useful means to force management to consider friendly amalgamation as a way of maximizing the benefits of all interested parties, including the company's shareholders. The legal and securities markets professionals are necessary elements of this system of checks and balances. However, their interests are probably less important than those of the shareholders, employees and suppliers and customers of targets and of the communities in which their offices and plants are located. In any event, the interests of all affected persons must be balanced.

Finally, it should be noted that the public at large, has a very real interest in being assured that the federal antitrust statutes are not violated and that there is not an undue concentration of assets, property and power in a few hands. The Hart-Scott-Rodino pre-filing requirements are of course, designed to protect the public interest. While it is our assumption, from the SEC's charge to the Advisory Committee, that the SEC considers the substantive and procedural federal antitrust statutes to be outside the SEC's jurisdiction, a careful analysis of tender offers necessarily involves antitrust considerations.

The Role of the States; Minimum Length of Tender Offers

Santa Fe Industries v. Green, 430 U.S. 462 (1977), determined that the primary law in the United States governing corporate transactions is state law. This is appropriate, of course, since the federal government charters almost no corporations aside from certain financial institutions. Proposals for federal chartering have never gained much support, the theory being that, in our federal system of checks and balances, the most crucial decisions on business structure and operation are best left to the states to work out by experiment and experience. The federal securities statutes, though crucial, are designed only to set a limited number of minimum standards which must be met by everyone. Even the Investment Company Act does not require federal incorporation. This arrangement does not leave the SEC with solely a formal role. Ensuring proper disclosure and preventing fraud and manipulation are pivotal assignments. The ultimate setting of generally accepted accounting principles for all public companies is itself a mammoth responsibility. The Exchange Act periodic reporting requirements are an invaluable shareholder protection and public interest innovation. Setting minimum requirements for proxy statements, prospectuses in public offerings, and disclosure in tender offers is a great responsibility and power. For example, it was through these powers that the SEC responded to Santa Fe v. Green -- rules of disclosure in going private transactions were supplied. The going private rules, however, illustrate our very point: The SEC properly limited itself to disclosure and prevention of fraud and manipulation, and left to state statutes and common law the delicate, complex questions of business purpose and substantive fairness in these transactions.

The limited, though crucial, role of the SEC has been recognized by Congress and the Executive Branch in sharply limiting the money appropriated to the SEC for its operations. The current membership of the SEC (aside from its Chairman) has opposed the current Administration's parsimony, but such fiscal tightness with the SEC is a matter of record. This fiscal action recognizes that the SEC is not to be all things to all people. It doesn't have, and will not have, the money to take over sole regulation of tender offers; even if it would be sound policy (and it wouldn't be) for the SEC to assume primary or total control, the money isn't there and won't be there. There should, and must, be continued reliance upon state statutory and common law.

Point V-B of Edgar v. MITE, 102 S.Ct. 2629 (1982), the only portion of that opinion gaining 5 votes, held the Illinois takeover statute invalid as an unreasonable indirect burden on commerce. The Illinois statute was found objectionable on several grounds: there was a state governmental hearing on which there was no time limit; the state official had almost unlimited jurisdiction to veto on substantive fairness grounds that were quite broadly defined; there was no even-handedness between hostile and friendly tender offers; and the statute could be applied to foreign corporations. Many state statutes, including the Ohio Takeover Act (§1707.041 of the Ohio Revised Code), were much more carefully drafted, but lower court cases subsequent to MITE have shown that any state takeover statute involving a state hearing probably meets the same fate as the Illinois Act.

Subsequent to MITE, Ohio amended its General Corporation Law, Ch. 1701 of the Ohio Revised Code, to provide that as a pre-condition to control share acquisitions of shares of an Ohio public corporation, there must be approval by a voting majority of the shareholders. It is believed that this statute meets the MITE tests. The shareholders vote must come within 50 days. There are no governmental hearings. Jurisdiction is limited to Ohio corporations having a significant Ohio nexus. Hostile and friendly control share acquisitions are treated the same. And, moreover, the statute allows the shareholder, by a charter amendment, to elect out of the statute. There, however, have been no court decisions on the constitutionality of this statute. In any event, the question of the role of the states is ultimately one for the Congress to decide.

We think that the Securities Exchange Act should be amended to provide expressly that the states have jurisdiction to regulate tender offers and control share acquisitions so long as such regulation does not make it impossible to comply with the federal regulation. At the same time, we think that a strict time limit--60 days--should be placed upon any state governmental hearing or shareholders vote. Sixty days is the period in the Ohio Takeover Act and was a common limit before MITE, although as earlier indicated the Illinois statute before the Court in MITE had no time limit. Such statute should also specify which single state can take jurisdiction over a tender offer, a power Congress has under the full faith and credit clause, and other clauses, of the constitution.

Authority for such a statutory grant of power to the states comes from the commerce clause itself, as Congress can exercise its power under that clause to authorize state regulation that otherwise would be forbidden by the commerce clause or forbidden by the supremacy clause under the preemption doctrine. See, e.g., Western and Southern Life Insurance Co. v. Bd. of Equalization, 451 U.S. 648 (1981); Prudential Insurance Co. v. Benjamin, 328 U.S. 408 (1946). Nothing in MITE undercuts this longstanding principle developed by the McCarran-Ferguson Act. We do want to make it clear that, unlike McCarran-Ferguson, our proposal would not oust the SEC or any other federal agency from any jurisdiction and that state regulation would in no event be valid to the extent that it were to make it impossible to comply with federal regulation. Since federal law sets no maximum length for tender offers, a state hearing or shareholder approval-by-vote provision as a pre-condition of closing and taking down the shares would be valid, if the 60-day test were met. However, since federal law requires a tender offer to commence upon certain information being made public, offers would commence as they do now, subject to a condition that closing and taking down of shares would be subject to the state requirements; this is the way that tender offers subject to the approval of a federal regulatory commission are now handled.

If the statutory amendment suggested in the next preceding paragraph were adopted, the questions of minimum length of tender offers would be settled--the 20 business day period now specified in the SEC's rules would govern unless a relevant state provision requiring a shareholder vote or a governmental hearing were applicable, but such latter requirement could not exceed 60 days, meaning 60 calendar days. It is our belief that the process worked much more smoothly when the state statutes prescribing 60 days were routinely given effect, as there was sufficient time for the competing offers to be developed and for all offers to be understood. Under current SEC practice, laypersons often cannot fully understand the pro's and con's of the various offers. Arbitragers and other securities professionals may have no problems, but the average shareholders should have time for that information to trickle down to them. Both groups deserve protection. And, again, it should be emphasized that it takes time to draw out the best competing offers, particularly for companies which are not closely followed by the analysts and, therefore, are not well-known. This process of competitive bidding should be encouraged. There may be some discouragement of tender offers by the possibility of competing tender offers, but that possibility would seem clearly outweighed by the very real probability, once a hostile tender offer develops, that either a better offer can be obtained from a third party or the initial offeror can be forced to increase its offer. Commenting on the Allied/Bendix/Martin-Marietta fiasco, Martin-Marietta's Chief Executive Officer, Thomas G. Pownall, said: "The chances are fifty-fifty, that if this were to have taken three months instead of one it might have turned out differently. Agee did not pay any attention to us. If he had, he would have sensed how indignant we were right off. He never came to see me. His letter announcing a tender offer was a gun at my head."

Regulation of Defensive Measures

The SEC and the Advisory Committee have asked several questions about regulation of defensive measures such as Pac-Man (the target making a counter tender offer for the shares of a hostile offeror); high vote, staggered board, and fair price charter provisions; sale of "crown jewel" assets and grant of lock-up options to competiting offerors; and "golden parachutes" (employment contracts compensating key officers and employees who quit because of a hostile change in control or a diminution in duties). At present, the primary regulation is under state law, although the SEC's various disclosure rules (e.g., the proxy provisions) clearly apply, and the antifraud and anti-manipulation provisions of § 14(e) of the Exchange Act also clearly apply. Two questions which have been asked are -- whether the business judgment rule applied under state law offers sufficient protection and whether federal law should govern both offensive and defensive tactics of tender offers.

Our position on these questions--at the general, conceptual level--is clear: state law should continue to govern so long as it does not make impossible the compliance with the federal standards now set by the Exchange Act and the SEC's rules thereunder. In our discussion of the minimum time period, we have indicated why state regulation, within a 60-day limit, should be expressly sanctioned by amending the Exchange Act. The same reasoning applies here. State law is the primary source of authority for all types of business decisions, including amalgamation, and tender offers should be treated no differently. Furthermore, the defensive measures mentioned usually favor competitive bidding, which should be encouraged once a hostile tender offer is commenced. Such defensive measures should be adopted and employed with proper disclosure and without fraud or manipulation; the Exchange Act presently contains a number of provisions [e.g., the proxy rules, periodic reporting, and the disclosure and antifraud and anti-manipulation provisions of §§ 13(d), 14(d), and 14(e)] that either assure disclosure and absence of fraud and manipulation or provide the basis for further rules producing that result.

The American Law Institute's Tentative Draft No. 1 on Principles of Corporate Governance and Structure: Restatement and Recommendations (April 1, 1982), which is widely and properly regarded as an indirect play for a federal corporations statute, has proposed, *inter alia*, a sharp curtailment of the business judgment rule. The replies by groups such as the Business Roundtable and the Litigation Section of the American Bar Association have properly been overwhelmingly critical. The critics have pointed out the usefulness of the flexible, evolutionary, experience-oriented business judgment standard under state law as corporations adapt to new challenges. The almost overwhelmingly negative response to the ALI Draft Restatement is instructive and fully applicable to tender offers. Flexibility of response rather than rigid government-set fiat is to be desired, with the role of the SEC and the federal government to be limited to the highly important, but interstitial management of disclosure and preventing of fraud and manipulation.

The SEC's present interstitial powers are considerable. The disclosure role of the present proxy rules has played a major part in the current drama in which many managements of potential targets are having difficulty in selling high-vote and staggered-board provisions to shareholders. More disclosure might be required of golden parachute agreements, which are complex, relatively new and, as of the present, not fully understood. Golden parachutes do seem to make management able to evaluate acquisition proposals, including tender offers, with objectivity and in the interests of shareholders, because management has some protection against the adverse effects of sudden change. The question is whether they are worth what they cost, a question best dealt with under state law after SEC rules require more complete disclosure in, say, periodic public reports to the SEC or in proxy statements.

Other hard-hitting defensive measures such as Pac-Man, sale of crown jewel assets, and granting of lock-up options do seem to have increased in use since the shorter 20 business day minimum period of the SEC rules has been substituted for the longer periods specified under state law. It would, we submit, be useful to have a longer 50 or 60 day minimum period to see if more straightforward competitive bidding or negotiation of standstill agreements would result. In any event, it would seem open to the SEC to use its § 14(e) power (a power to adopt rules reasonably designed to prevent manipulation) to curb devices that in fact do not promote competitive bidding once a hostile tender offer erupts. Cf., Mobil Corp. v. Marathon Oil Co., 669 F.2d 336 (6th Cir., 1981).

Two-tier tender offers have become common. The consideration offered for the initial control block is greater in amount and/or better in kind (cash as opposed to securities) than that offered in the clean-up merger. The question has been asked whether these types of tender offers should be curbed. Again, our answer is that given proper disclosure and a longer time period for everyone to better understand the complexities of these offers, the underlying substantive law should remain state law, and primary reliance should be placed upon a lengthened minimum time period more likely to yield competing offers. The SEC has, wisely we think, just amended its proration rule to require pro-rata treatment for the length of the offer. With this innovation and given a 60-day minimum period which we suggest, offerors engaging in two-tier offers would be subject to the possibility of having to compete against simpler and better offers from competing offerors. That is the best protection against the possible harms from any complex offer, including a two-tier offer.

Amendment the 10% Rule of § 16 To Correlate With the 5% Rule of the Williams Act

When the Williams Act was first enacted, the threshold test of §§ 13(d) and 14(d) was 10% ownership, the same as that employed by § 16. Soon thereafter, the Williams Act was amended to employ a 5% test. We suggest that § 16 of the Exchange Act be correlated with the Williams Act by amending the percentage test in § 16 to 5%. The Williams Act has established that 5% is significant, and § 16(b) should apply to a greater number of persons who buy with the expectation of selling soon, perhaps by attempting to pressure the issuer to repurchase the shares. With 5% ownership, one must file under § 13(d), and 5% owners are likely to have inside information from discussions with the management of the issuer. The prophylactic rules of § 16 should be extended to 5% owners. We also believe that consideration should be given to increasing the six-month period for recapture of profits to twelve months. This would correlate with the twelve-month period for long-term capital gains and would tend to discourage those who might otherwise make a significant investment for the purpose of short-term profit at the expense of the corporation and its other shareholders.

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We appreciate having this opportunity to submit our views to the Advisory Committee and to the SEC. Though hostile tender offers are often conceived of as a brutal, arcane type of high finance of interest only to securities professionals, such tender offers (and the possibility of them) affect large portions of the American public in all sections of the country. The proper regulation of tender offers involves the broadest possible questions of the general public interest.

We should be pleased to furnish the Advisory Committee, or any member of the Commitee, with further analyses and data regarding our views. Please feel free to write or telephone, collect, either of the undersigned.

Respectfully submitted,

VORYS, SATER, SEYMOUR AND PEASE

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